

# The ABCs and XYZs For The Dentist

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Prior to practicing law in the representation of dentists and dental practices, Bill worked as a dental dealer in the dental equipment and supply industry, primarily with Saslow and Meer Dental Companies, for 16½ years as a territory salesman, equipment specialist and General Manager of Saslow Dental — Northern Ohio.

**Author**

Bill is the author of: **Business, Legal, And Tax Planning for the Dental Practice, First Edition, 1994, Second Edition, 2001, and Third Edition, to be released in 2009; The Practice Acquisition Handbook**, Randall K. Berning and Affiliates, 1997, currently being rewritten; **The Limited Liability Company and Other Entities for Dentistry**, Randall K. Berning and Affiliates, 1996; **Joining And Leaving the Dental Practice**, released January, 2008.

Bill is also the author of **Quarterly Supplement to Business, Legal, And Tax Planning for the Dental Practice**. The purpose of the **Quarterly Supplement** is to continually update the material contained in such book.

**Member**

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**Appointments**

Chair, Subcommittee for Doctors, Lawyers and Other Professionals, 2003-2005 Term; Vice-Chair, Professional Services, 2003-2005 Term; Chair, Closely Held Businesses Committee, American Bar Association, Section of Taxation, 2007-2009 Term; Editorial Board, The Practical Tax Lawyer, American Law Institute/American Bar Association.

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This Program is not intended to provide the participant with specific legal or accounting advice. For solutions to legal and accounting questions, consult your attorney and/or certified public accountant.

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# **Joining And Leaving The Dental Practice**

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## **I. STEPS TO RETIREMENT — 10 POINT PLAN!**

- A. Prepare your personal financial plan; assess the necessity of additional or increased retirement plan funding to make contributions.
- B. Adjust the financial plan to reflect the changes in your life created by retirement, as well as for anticipated inflation and return on any investment(s).
- C. Determine whether your retirement is complete or partial and to what extent you need or choose to continue to work in the future; work out post closing independent contractor or employment relationship; consider what will you do with your time?
- D. Analyze the condition of your, your spouse's and any other dependents' health and the associated costs of health care; make arrangements for continued health coverage.
- E. Review and update your and your spouse's estate plans.
- F. Authorize preparation of the practice valuation.
- G. Maximize system efficiency and practice profitability.
- H. Maintain the practice, but do not overspend on new equipment.
- I. Prepare and complete your succession plan; your advisor(s) should assess your practice options, make decisions and summarize, in writing, the terms and conditions of the anticipated sale of your practice or practice interest, e.g., sale of assets or stock, extent of seller assisted financing, terms, security and any other relevant factor(s); locate your successor!
- J. Complete the due diligence on your successor; review resume, interview, obtain release, check references and credit history; complete unpaid working trial; assess clinical and practice management skills; assess — Can I recommend this dentist/specialist to my patients/referral sources?; Will this dentist/specialist develop a long term relationship with my former patients or will this dentist attempt to complete all diagnosed work immediately?; Will this dentist/specialist continue to employ my former employees?

### **Notes**

## **II. ASSESSING SUCCESSION OPTIONS**

- A. Complete Sale — What's to Structure, Unless You Have a C-Corporation?
  - 1. Structuring the Sale
  - 2. Asset Sale
  - 3. Stock Sale — Not With a Complete Sale! Well, Not Usually.
  - 4. Letter of Intent — Should I Request a Deposit?
  - 5. Financing the Purchase Price — Specialty Lending is Changing.
  - 6. Your Continued Employment — To What Extent?
  - 7. Sale and Acquisition Documents — Is this a "Cookie Cutter" Process?
- B. Hire Associate With Later Sale — And This Does What?
- C. Solo Group Arrangements — Yes, They Really Do Work In General Practices!
- D. Partnerships — They Are Complex, But Workable.
  - 1. The Buy-In
  - 2. Operations
  - 3. The Buy-Out
- E. The Fifth Option — It's the Simplest, but Least Rewarding.

### **Notes**

### **III. ASSESSING PRACTICE ENTRY OPTIONS**

- A. Associating Leading to Full Ownership, Solo Group Arrangement or Partnership
- B. Acquiring a Practice
- C. Establishing a Practice
- D. Solo Group Arrangement
- E. Acquiring a Portion of a Practice — Partnership
- F. Practice Option Report
  - 1. Qualitative Considerations
  - 2. Quantitative Considerations

Figure 3-1

Figure 3-2

#### **Notes**

**Figure 3-1**  
**PRACTICE OPTION REPORT**  
**PRACTICE OBJECTIVES/QUALITATIVE SEGMENT**

**In narrative form, list your goals and career objectives in terms of the categories below:**

- I. Patient Demographics;
- II. Method of Payment for Your Services;
- III. Procedural Mix;
- IV. Practice Location;
- V. Location of Residence;
- VI. Practice Form;
- VII. Mission Statement;
- VIII. Continuing Education Statement;
- IX. Statement of Commitment to Learning the Business of Dentistry/Specialty;
- X. Practice Characteristics;
- XI. Statement of Community Involvement;
- XII. Statement of Personal and Family Goals; and
- XIII. Other Categories Which You Deem Relevant.

Figure 3-2

<b>PRACTICE OPTION REPORT PRACTICE OPTION MATRIX/QUANTITATIVE SEGMENT</b>					
Annual Projected Budget	Associate	Acquire Practice	Acquire Portion of Practice/Partnership	Solo Group Arrangement	Establish Practice
1. Revenues/Collections					
2. Total Operational Costs/List by Individual Expense Category					
3. Equipment Replacement/Remodeling Costs After Acquisition					
4. Retirement Plan Contribution					
5. Associate/Owner Compensation					
6. Provision for Income Taxes					
7. Associate/Owner Net Compensation					
8. Total Practice Debt Repayment					
9. Total Personal Debt Repayment					
10. Total Personal Expenses					
11. Cash Reserve					
12. Net First Year					
13. Net Through Second Year					
14. Net Through Specified Number of Years					

#### **IV. THE IMPORTANCE OF THE PRACTICE VALUATION**

- A. Seller's Perspective
- B. Incoming Doctor's Perspective
- C. Increasing versus Decreasing Practice Values?
- D. Verification Analysis — The Four Components of Any Appraisal
- E. Importance of Practice Profitability
- F. The Impact of Reduced Fee and Managed Care Plans
- G. Capitalization Rates — Do They Equate to the Repayment Period?
- H. Relocation of Expansion — Does This Increase the Repayment Period or Reduce the Purchase Price to the Purchaser?
- I. Post Retirement Services by Seller
- J. Accounts Receivable — To Purchase or Not to Purchase? / Clean and Collectable Amounts
- K. The Procedures You Don't Do! Orthodontics, Implants, Cosmetic Cases — What's Left?
- L. Co-Ownership Values
- M. Required Valuation Data
- N. High Revenue Practices
- O. Satellite Offices and Multiple Locations
- P. Seller Beware!
  - 1. Complete Sale
  - 2. Partial Sale

#### **Notes**

**Figure 4-1**

**REQUESTED INFORMATION FOR VALUATION PURPOSES**

**A. Compatibility of Purchaser and Seller**

1. Contrast seller'(s) practice mission and philosophy to yours;
2. Contrast seller'(s) personal values and work ethic to yours; and
3. Assess seller'(s) reason for departure from active practice.

**B. Financial Information**

1. Federal income tax returns of the practice for the lesser of the last five fiscal years or the number of years in practice;
2. Financial statements and balance sheets (assuming that they are prepared for the practice) for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date; and
3. An aged trial balance of all practice accounts receivable and the historical practice collection records for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date.

**C. Practice Facility**

1. A floor plan of the practice facility;
2. An itemized list and the fair market value of all dental equipment being acquired by treatment room, plus darkroom, utility room, sterilization area, x-ray area and laboratory;
3. An itemized list and the fair market value of all office equipment and furniture being acquired;
4. An itemized list and the fair market value of all tangible assets, personal and other items located in the practice facility not being acquired;
5. An itemized list and the fair market value of all tangible assets (dental equipment, office equipment, and furniture) leased by the practice or located in the practice facility to which the practice does not hold clear title; and
6. Maintenance records for all dental and office equipment from the date of purchase through the current date.

## Figure 4-1

### **D. Lease and Real Estate**

1. A copy of the current lease, any renewal amendments and any document evidencing recording of the lease; and
2. Copies of any deed, documents and/or agreements relating to the practice owner's (or family members') ownership of the practice real estate.

### **E. Operations**

1. The number of active patients (patients treated in the past twenty-four consecutive months), as well as inactive patients (those patients not having any dental services rendered within the last twenty-four consecutive months);
2. A summary of the number of new patients in each consecutive month for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;
3. A summary of the current number of patients (and percentage of the practice) in recall, if applicable;
4. A current fee schedule and a summary of fee increases for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;
5. A specific list of those procedures performed by the practice and those referred to specialists, if applicable; and
6. Provide your written evaluation of the area demand and potential for economic growth for a dentist/specialist in the geographical area where you intend to practice.

### **F. Employment Relations and Benefits**

1. Census of all employees of the practice, the hours worked, compensation levels, positions, responsibilities and dates of hire (including former employees) for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date; and
2. Provide copies of any employee handbooks, job descriptions and/or other publications distributed to employees of the practice.

## V. CALCULATING PRACTICE VALUE IN A REAL STRANGE MARKET

### A. Summation of Assets

1. Dental Equipment and Cabinetry
2. Office Equipment/Technology
3. Dental Supplies
4. Office Supplies
5. Accounts Receivable
6. Paid in Full Cases in Orthodontic Practices—Matching Payments with Work Completed/Retention and Retreatment
7. Lease
8. Leasehold Improvements
9. Intangible Assets — Corporate versus Personal Goodwill

### B. Capitalization of Earnings

### C. Excess and Discounted Future Earnings

### D. Multiple of Gross Revenues

### E. Similar Practices

### F. Verification Analysis

Figure 5-1

Figure 5-2

Figure 5-3

Figure 5-4

Figure 5-5

Figure 5-6

Figure 5-7

### Notes

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Figure 5-1

**SUMMATION OF PRACTICE ASSETS**

<b>I.</b>	<b><u>Estimated Fair Market Value ("FMV") of Tangible Assets of the Practice</u></b>	
A.	FMV of Dental Equipment, Office Equipment, Furniture and Technology	
1.	Balance Sheet Approach — Book Value, Plus 1/3 Accumulated Depreciation	
2.	Tangible Asset Appraisal by Dental Equipment Supply Company, but must include office equipment, technology and furniture	
3.	15 years straight line depreciation	
4.	12 years straight line depreciation with de minimis salvage value	
5.	Estimated FMV of Dental Equipment, Office Equipment, Furniture and Technology .....	\$ 130,000
B.	Leasehold Improvements — Not Owned by Seller	
C.	Dental Supplies	
1.	Dental Supplies @ 6% of \$1,000,000 .....	\$ 60,000
2.	Divided by 12 Months .....	÷ 12
3.	Monthly Cost of Dental Supplies .....	\$ 5,000
4.	Three Month Multiple .....	x 3
5.	Estimated FMV of Dental Supplies .....	\$ 15,000
D.	Dental Instruments @ 1/2% of \$1,000,000 .....	\$ 5,000
1.	Estimated FMV of Dental Instruments .....	\$ 5,000
E.	Recap of Tangible Asset Categories	
1.	Dental Equipment, Office Equipment, Furniture and Technology .....	\$ 130,000
2.	Leasehold Improvements .....	N/A
3.	Dental Supplies .....	\$ 15,000
4.	Dental Instruments .....	\$ 5,000
5.	Estimated FMV of Tangible Assets of the Practice .....	\$ 150,000
<b>II.</b>	<b>Agreed Intangible Asset Value of the Practice and/or Personal Goodwill of Selling Owner at 50% of Practice Gross Revenues of \$1,000,000.....</b>	<b>\$ 500,000</b>
<b>III.</b>	<b>Estimated FMV of the Practice and/or Personal Goodwill of Selling Owner.....</b>	<b>\$ 650,000</b>

**Figure 5-2**

**PRACTICE PROFILE FACTORS FOR  
SELECTION OF CAPITALIZATION AND GOODWILL RATES**

1. Annual owner compensation in all forms
2. Annual gross revenues of the practice
3. Operating expenses as a percentage of gross revenues
4. Ability of the seller(s) to transfer the patients and/or referral sources of the practice
5. Number of active patients/referral sources in the practice
6. Number of new patients per month and degree of patient turnover/The number of referral sources in the practice
7. Stability of the practice and surrounding community
8. Competition
9. Fee structure
10. Practice location
11. Demographic characteristics of patients, location, age and income
12. Likelihood that staff, including any associate doctor(s), will remain with the practice after it is sold
13. Availability of seller assisted financing
14. Facility design and square footage
15. Number of treatment rooms, age and condition of dental equipment (right or left handed)
16. Overall appearance, aesthetics and condition of practice facility
17. Reputation of the practice
18. The number of hours and days worked per year
19. The percentage of patients covered by insurance/managed care/medicaid/other
20. Assignability and term of lease/availability of practice facility, land and building, for purchase

## Figure 5-2

21. Ability to expand the practice facility
22. Patient and/or referral source demographics
23. Percentage of collections to gross revenues and age
24. Willingness of seller to assist the purchaser in practice transition
25. Parking and of public transportation availability
26. Effectiveness of recall system
27. Quality of patient records and clinical work performed
28. Quality and experience of staff and degree of turnover
29. Effectiveness of management systems
30. Entity form/completeness of accounting and legal records, as well as any owner agreements, e.g., buy-sell agreement

Figure 5-3

**VERIFICATION ANALYSIS**

	<b><u>No Revenue Decrease</u></b>	<b><u>Revenue Decrease of 10%</u></b>
1. Practice Gross Revenue:	\$1,000,000	\$900,000
2. Proposed Selling Price of the Practice at 65% of Gross Revenues: (Practice Assets, \$150,000; Goodwill, \$500,000 or 50% of One Year's Gross Revenue):	\$650,000	\$650,000
3. Less: Payment of Debt Service for Practice (Yearly Payment of Selling Price Over Seven Years @ 9%):	<\$125,495>	<\$125,495>
4. Less: Working Capital — Assumes Account Receivables Not Purchased (Yearly Payment of \$60,000, Payable Over Seven Years @ 9%):	<\$11,584>	<\$11,584>
5. Less: Remodeling and Equipment Replacement Costs (Yearly Payment of \$50,000, Payable Over Seven Years @ 9%):	<\$9,654>	<\$9,654>
6. Practice Operating Expenses @ 60% of Gross Revenues/10% Lab; 6% Supplies:	\$600,000	\$584,000
7. Adjusted Yearly Owner Compensation @ 40% of Gross Revenues/Reduced Revenues:	\$400,000	\$316,000
(Owner's net profit from Federal income tax return, plus: (a) automobile expense; (b) existing equipment lease paid off by the selling doctor; (c) retirement plan contribution for the doctor(s); (d) continuing education; (e) travel expense; (f) entertainment expense, less: (a) rental increase after acquisition; (b) wages, part-time employee)		
8. Less: Total of Items 3, 4 & 5:	<\$146,733>	<\$146,733>
9. Yearly Available Compensation for Purchaser:	\$253,267	\$169,267
10. Ratio of Compensation for Purchaser to Average Gross Revenues where Initial Remodeling, Equipment Costs and Working Capital are Considered ( $\$253,267/\$169,267 \div \$1,000,000/\$900,000 = 25.33\%/18.81\%$ ):	25.33%	18.81%

**Figure 5-3**

11.	Ratio of Compensation for Purchaser to Average Gross Revenues where Initial Remodeling, Equipment, and Working Capital Are Not Considered (\$400,000/\$316,000, Less: Yearly Payment of the Selling Price of \$125,495 = \$274,505/\$190,505) (\$274,505/\$190,505 ÷ \$1,000,000/\$900,000 = 27.45%/21.17%)	27.45%	21.17%
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**Considerations**

1. Can you maintain yearly revenues of \$1,000,000/\$900,000?
2. To what extent will the seller work post-closing and how will this affect your cash flow?
3. Is this an associate buy-in and how is this different from a complete purchase and sale?
4. What is the effect of an increased repayment term to 10 or 15 years?
5. Is the anticipated compensation packaged fair, while paying for the practice or practice interest in light of what you can earn as an associate non-owner?
6. Should you acquire another practice in light of your available choices?
7. Should you start your own practice in light of your available choices and given area demographics?
8. Revenue increases — are you selling or acquiring potential?
9. What if revenues, patients and/or referral sources decrease — how does this analysis change?
10. What is the tax and business structure of this complete sale or associate buy-in and what are the implications to you?
11. Is this a fee for service practice? To what extent does the practice participate in reduced fee plans?
12. What procedures are performed in this practice and what procedures are referred to specialists? — What unique services does this practice provide that you do not do, e.g., orthodontics, TMJ, cosmetic services, endodontics, etc.?
13. How much of the goodwill of the practice is corporate and how much is personal to the selling owner?
14. The \$500,000 question: How much of the goodwill is transferable?

Figure 5-4

**CAPITALIZATION OF EARNINGS AND VERIFICATION ANALYSIS —**  
**ANOTHER WAY OF LOOKING AT THIS!**

	<b><u>No Revenue Decrease</u></b>	<b><u>Revenue Decrease of 10%</u></b>
1. Gross Revenues:.....	\$1,000,000	\$900,000
2. Operating Expenses:.....	<\$ 600,000>	<\$584,000>
3. Less Working Capital Needs (Yearly Payment of \$60,000, Payable Over Seven Years @ 9%:.....	<\$ 11,584>	<\$11,584>
4. Less: Remodeling and Equipment Replacement Costs (Yearly Payment of \$50,000, Payable Over Seven Years at 9%)	<\$ 9,654>	<\$9,654>
5. Subtotal: Operating Expenses, Remodeling and Equipment Replacement Costs and Working Capital Needs:.....	<\$ 621,238>	<\$ 605,238>
6. Yearly Available Owner Compensation in All Forms: .....	\$ 378,762	\$ 294,762
7. Less, Compensation Requirements for Purchaser @ approximately 30% of Practice Gross Revenue*: .....	<\$ 300,000>	<\$ 270,000>
8. Yearly Available Sum to Pay Purchaser Price Exclusive of Interest:.....	\$ 78,762	\$ 24,762
9. Above Sum, Multiplied by Seven Years, Exclusive of Interest**: .....	\$ 551,334	\$ 173,334
10. Purchase Price as a Percentage of Practice Gross Revenue:.....	\$ 551,334 \$1,000,000	\$ 173,334 \$ 900,000

\* Should compensation be a percentage of revenues or the associate's current yearly compensation, e.g., \$120,000? Answer — A percentage because it takes an additional dentist or specialist to produce at this level!

\*\* Should interest be included or excluded as the time value of money? If interest is excluded, to what extent will the repayment period be increased?

**Figure 5-5**  
**MULTIPLE OF GROSS REVENUE**

1.	Gross Revenue.....	\$ 1,000,000
2.	Gross Revenue Multiplier.....	<u>62%</u>
3.	Practice Value.....	\$ 620,000

**Figure 5-6**

**RECAP OF PRACTICE VALUES**

1.	Summation of Assets .....	\$ 650,000
2.	Capitalization of Earnings .....	\$ 551,334
3.	Multiple Gross Revenue.....	\$ <u>620,000</u>
4.	Subtotal.....	\$ 1,821,334
5.	Averaged .....	<u>        </u> ÷ 3
6.	Estimated FMV of the Practice .....	\$ 607,111

**Figure 5-7**

**PAYING RELOCATION OR EXPANSION COSTS**

<u>CATEGORY</u>	<u>AMOUNT</u>	<u>PERCENTAGE</u>
A. Collections:	\$ 1,000,000	100%
Operating Expenses:	< \$ 600,000 >	60%
Owner and Associate Compensation:	\$ 400,000	40%
Yearly Relocation/Expansion Costs; 2,200 sq. feet at \$125 per sq. ft. = \$275,000, plus \$125,000 equipment costs = \$400,000 @ 9% interest, payable over 10 years (7 years) = \$77,228:	\$ 60,804	
 B. Collections:	 \$ 1,000,000	 100%
Operating Expenses:	< \$ 600,000 >	
Additional Costs:	< \$ 60,804 >	
Total Expenses:	< \$ 660,804 >	66.1%
 Revised Owner & Associate Compensation:	 \$ 339,136	 33.9%
 C. Maintain 40% Profit		
Additional Costs:	\$ 60,804	
Additional Required Collections, Inclusive of 40%	÷ .6	
Owner & Associate Profit:	\$ 101,340	
Prior Collections:	\$ 1,000,000	
 Revised Collections/40% Profit:	 \$ 1,101,340	
 Revised Collections:	 \$ 1,101,340	 100%
Total Expenses:	< \$ 660,804 >	60%
 Owner & Associate Compensation/40% Profit:	 \$ 440,536	 40%
 D. Cover Costs — No Additional Profit		
Prior Collections:	\$ 1,000,000	
Additional Collections Covering Costs:	\$ 60,804	
Revised Collections/No Additional Profit:	\$ 1,060,804	
 Revised Collections:	 \$ 1,060,804	
Total Expenses:	< \$ 606,804 >	
Owner & Associate Compensation/ No Additional Profit:	\$ 400,000	

**To What Extent Will Revenues Increase if I Relocate or Expand?**

## **VI. NEGOTIATING THE WIN-WIN PRACTICE SALE & ACQUISITION**

- A. Asset Sale
  - 1. Reporting Requirements — What's This Form 8594?
  - 2. Contingent Liabilities
  - 3. Like-Kind Exchanges — How Often Is This Done?
  - 4. Goodwill — Corporate?
  - 5. Personal Goodwill — Well, it Really Is!
  - 6. Contingent Sales
- B. Stock Sale
- C. Transfer of Ownership to Family Members
- D. Representations and Warranties
- E. Mutual Indemnification/Mutual Due Diligence
- F. Retreatment and Unique Procedures — Orthodontics, Implants, Cosmetic Cases.
- G. The Letter of Intent
- H. Obtaining Financing — How Long Does This Take?
- I. Seller Assisted Financing — It's Okay If You Get Paid! Are You Second In Line?
- J. Contingent Transactions
- K. Practice Mergers
- L. Covenants Not To Compete
- M. Post Closing Considerations
  - 1. Continued Employment or Engagement of Seller
    - a. Employment versus Independent Contractor Relationships
    - b. Locum Tenans
    - c. Ability of Purchaser to Terminate Relationship

- d. Compensation/Fees
- e. Benefits and Insurances
- 2. Employment of Staff
  - a. Compensation and Benefit Levels
  - b. Retirement Plan Benefits
  - c. Accrued Vacation and Time-Off
- 3. Retirement Plan Design
- 4. Fringe Benefit Programs
- 5. Legislative Issues

Figure 6-1

Figure 6-2

Figure 6-3

**Notes**

## Figure 6-1

### **REPRESENTATIONS AND WARRANTIES**

1. **Representations and Warranties of Seller.** Seller hereby represents and warrants to Purchaser as follows:

1.1 **Organization.** The Practice is a professional corporation duly organized, validly existing and in good standing under the laws of the State of \_\_\_\_\_, has full corporate power and authority to own all of its property and assets and to carry on its dental practice as it is now being conducted.

1.2 **Authorized Agreement.** All corporate action by the Practice necessary for the authorization and consummation of the transactions contemplated hereby has been taken.

1.3 **Valid and Binding Agreement.** This Agreement has been validly executed and delivered by and constitutes a valid and binding obligation of Seller enforceable in accordance with its terms.

1.4 **Ownership of the Practice.** Seller owns beneficially and of record one hundred percent (100%) of the shares of the Practice's issued and outstanding capital stock, free and clear of all liens, claims, encumbrances or restrictions of any kind, which constitutes the "Shares". Each of the Shares has been duly authorized and validly issued and is fully paid and nonassessable. The Practice has outstanding no other equity securities, or any securities options, warranties or rights of any kind convertible into equity securities of the Practice.

1.5 **Financial Statements.** Seller has delivered to Purchaser copies of the Practice's financial statements for the fiscal year ended \_\_\_\_\_ (herein called the "Financial Statement Date"), and for the fiscal year ended on \_\_\_\_\_, of each of the years \_\_\_\_\_ and \_\_\_\_\_ and notes thereto and the Practice's "Interim Financial Statements" for the period \_\_\_\_\_ through and including \_\_\_\_\_ (all of which statements are herein collectively called the "Financial Statements"). The Financial Statements have been prepared on a compilation basis and are true, complete and correct, have been prepared, from the books and records of the Practice on a comprehensive basis of accounting, consistently applied for the periods indicated, and which present fairly the financial position and results of operations of the Practice as of the dates thereof and for the periods covered thereby. There are no facts known to Seller which would materially alter the information contained in the Financial Statements.

1.6 **Inventory.** The Practice's dental supply inventory and dental instruments are merchantable, suitable and usable in the ordinary course of the Practice's business and operations. The Practice's assets include a sufficient (but not an excessive) quantity of each type of such dental supplies and instruments in order to meet the normal requirements of the Practice's business and operations.

1.7 **Accounts Receivable.** All accounts receivable of the Practice are valid and enforceable. To the best of Seller's knowledge, the accounts receivable are fully collectible.

## Figure 6-1

**1.8 Liabilities.** Except as disclosed in the Financial Statements or on Schedule 1.8 (attached hereto and incorporated herein by reference), the Practice has no debts, liabilities or obligations of any nature whatsoever, whether accrued, absolute, contingent, or otherwise. All deposits, accounts and notes payable, and other liabilities of the Practice are current and not in default.

**1.9 Tax Matters.** The Practice has timely and duly filed with the appropriate governmental agencies all tax reports and returns required to be filed by it. All of such reports and returns are true, correct and complete for the periods covered thereby. The Practice has timely and duly paid all taxes required to be paid by it in respect of the periods covered by such returns. All deposits required by law to be made by the Practice with respect to employees' withholding taxes have been duly and timely made. True and complete copies of all federal income tax returns on Form 1120 for the tax years ending \_\_\_\_\_; \_\_\_\_\_; and \_\_\_\_\_ as filed with the Internal Revenue Service have been delivered to Purchaser, together with all supporting schedules thereto. There are no federal, state or local tax liens upon any property or assets of the Practice. The Practice has not requested any extension of time within which to file any tax returns which have not since been filed, and no deficiencies for any tax, assessment or governmental charge have been claimed, proposed or assessed by any taxing authority and there is no basis for any such deficiency or claim. As used herein, the term "tax" includes (but is not limited to) all federal, state, and local income, sales, employees' income withholding, social security, franchise, property, and all other governmental taxes, fees and charges.

**1.10 Title to and Condition of Property.** The Practice has good and marketable title to and rightful possession of all assets it owns, except assets sold or otherwise disposed of in the ordinary course of the Practice's business and operations, free and clear of all liens, security interest, encumbrances, and restrictions, except: (i) liens for current taxes not yet due and payable; and (ii) liens or encumbrances described in Schedule 1.10 (attached hereto and incorporated herein by reference). Purchaser acknowledges that Seller is making no representation or warranty with regard to the condition or use of the assets of the Practice, except as expressly set forth in this Agreement.

**1.11 Compliance with Law.** The Practice has been and is being conducted in compliance with all applicable federal, state and/or local laws, rules, regulations and orders, non-compliance with which would have a material and adverse affect on the Practice, its business and operations, or its assets.

**1.12 Insurance.** Schedule 1.12 (attached hereto and incorporated herein by reference) lists all insurance policies maintained by the Practice, showing the types of coverage, policy expiration dates, policy numbers and policy limits as to each such policy. All such policies pursuant to which coverage exists are in full force and effect and have been issued under valid policies for the benefit of the Practice by insurance carriers licensed to do business in \_\_\_\_\_. The consummation of the transactions contemplated hereunder shall not cause the termination or cancellation of any such insurance policy.

## Figure 6-1

**1.13 Contracts and Leases.** Except as disclosed on Schedule 1.13 (attached hereto and incorporated herein by reference), the Practice is not a party to any written or oral contract, lease or commitment. All agreements listed in Schedule 1.13, to the extent that the same grants rights to the Practice, are enforceable by the Practice and the Practice has not received notice of any claim to the contrary. Each agreement listed in Schedule 1.13 is in full force and effect, constitutes a legal, valid and binding obligation of the respective parties thereto, enforceable in accordance with its terms, except as indicated in Schedule 1.13. Complete and correct copies of all written items listed in Schedule 1.13 have been made available to Purchaser prior to the execution of this Agreement.

**1.14 Defaults.** Except as listed in Schedule 1.14 (attached hereto and incorporated herein by reference), all parties obligated under the agreements listed on Schedule 1.13 are in compliance in all material respects with the terms thereof and there has been no notice of default or termination.

**1.15 Transactions with Seller.** Except as disclosed on Schedule 1.15 (attached hereto and incorporated herein by reference), the Practice does not owe any amount to, or have any contract with or commitment to, Seller (other than compensation for current services not yet due and payable and reimbursement of expenses arising in the ordinary course of business), and Seller does not owe any amount to the Practice.

**1.16 Employee Benefit Plans.** Except as disclosed on Schedule 1.16 (attached hereto and incorporated herein by reference), the Practice has not and does not sponsor, maintain or contribute to any employee pension benefit plans within the meaning of Section 3(2) of the Employee Retirement Income Security Act of 1974 ("ERISA") or any other program or arrangement under which the Practice has any obligations in respect of, or which otherwise cover, any of the current or former employees of the Practice, or their beneficiaries. Each terminated qualified retirement plan (within the meaning of Section 401(a) of the Internal Revenue Code), herein called the "Terminated Plan," (a) has received a favorable determination letter from the Internal Revenue Service with respect to its termination; and (b) was terminated in accordance with all applicable federal, state and local laws, rules and regulations. In addition to and no in limitation of the indemnification provisions contained in Section \_\_\_\_\_ hereof, Seller hereby agrees to indemnify and forever hold harmless Purchaser, individually and jointly, from and against any and all actions, causes of action, liabilities, damages, penalties, costs and expenses (including, but not limited to, attorneys' fees) directly or indirectly arising from or related to the Terminated Plan.

**1.17 Other Employee Matters.** Except as disclosed in Schedule 1.17 (attached hereto and incorporated herein by reference), the Practice has no plans and/or policies with respect to vacation pay, holiday and/or sick pay, pension and profit-sharing contributions, health, medical or any other type of employee welfare benefit plan within the meaning of Section 3(1) or ERISA to which the Practice presently contributes or is required to contribute, nor is the Practice indebted to any employee other than for wages and benefits earned during the current payroll period which are not yet due and payable. Except as set forth on Schedule 1.17, there are no controversies pending between the Practice and any of its employees, which controversies have affected or may affect materially and adversely the business, operations, assets, prospects or condition (financial or otherwise) of the Practice.

## Figure 6-1

**1.18 Absence of Certain Changes.** Except as set forth in Schedule 1.18 (attached hereto and incorporated herein by reference), during the period from the Financial Statement Date to the Closing Date, the Practice has not and will not have:

- (a) Experienced any change in its business, financial condition or operations which may have any material adverse effect on the Practice, its financial condition, its operational results or patients; or
- (b) Incurred any obligation or liability, except current (liabilities incurred in the ordinary course of business and consistent with its prior practice;
- (c) Failed to replenish its inventory of dental supplies and instruments in a normal and customary manner consistent with its prior practice;
- (d) Created or suffered to exist any lien, claim or encumbrance with respect to its assets;
- (e) Sold, transferred or otherwise disposed of any assets or properties of the Practice other than in the ordinary course of its business;
- (f) Forgiven or cancelled any debts or claims, or waived any contractual or other rights; or
- (g) Otherwise conducted its business or entered into any transaction, except in the usual and ordinary manner and in the ordinary course of its business.

**1.19 Litigation.** No litigation or other judicial, administrative or investigative proceeding is pending or threatened against or affect the Seller, the Practice or its assets.

**1.20 Consents.** To the best of Seller's knowledge, no consents or approvals of any third party are required or will be required in order to permit the consummation of the transactions contemplated by this Agreement.

**1.21 Permits and Licenses.** Schedule 1.21 (attached hereto and incorporated herein by reference) sets forth all licenses and permits issued by applicable governmental authorities presently held by the Practice with respect to the operation of its business. Seller has not received notice of any violations with respect to any of such license or permits.

**1.22 Bank Accounts.** Set forth in Schedule 1.22 (attached hereto and incorporated herein by reference) is an accurate and complete list, disclosing the name and address of each bank in which the Practice has an account or safe deposit box, the number of any such account or any such box and the names of all persons authorized to draw thereon or to have access thereto.

## Figure 6-1

**1.23 No Guaranties.** None of the obligations or liabilities of the Practice are guaranteed by any other person or entity, nor has the Practice guaranteed the obligations or liabilities of any other person or entity.

**1.24 Title to the Shares.** Seller has valid and unencumbered title to the Shares, free and clear of all restrictions, liens and encumbrances, and has full legal right, power and authority to enter into this Agreement, to sell, assign, transfer, and deliver the Shares hereunder, and to perform his other obligations under this Agreement. Upon delivery of and payment for the Shares, Purchaser shall acquire title thereto, free and clear of all liens, restrictions or encumbrances.

**1.25 Correctness of Representations and Warranties.** The representations and warranties made by Seller herein or in any certificate to be furnished to Purchaser or Purchaser's counsel pursuant hereto, or in connection with the transactions contemplated hereby, do not contain and, at the Closing, shall not contain any untrue statement of a material fact and do not omit and shall not omit to state all material facts necessary to make the statement or facts contained therein not misleading. All statements made and data presented by Seller in this Agreement and in any certificate or schedule provided to Purchaser by Seller pursuant hereto shall be deemed to be representations and warranties under this Agreement to Purchaser by Seller.

**Figure 6-2**

**LETTER OF INTENT**

**ACQUISITION OF STOCK OR ASSETS?**

Joseph G. Jones, D.D.S., Inc.  
[Insert Address]

[Insert Date]

Dr. Thomas R. Roberts  
[Insert Address]

Dear Tom:

The purpose of this correspondence is to summarize certain of the key terms of your proposed acquisition of my dental practice, as follows:

1. Dr. Thomas R. Roberts ("Purchaser") shall acquire all of the assets (the "Assets") of Joseph G. Jones, D.D.S., Inc.

**What about personal goodwill?**

2. The purchase price ("Purchase Price") for the Assets shall be \$[Insert Amount].
3. The closing of the above-described purchase and sale of the Assets shall occur on [Insert Date] (the "Closing Date").
4. At closing on the Closing Date, Purchaser shall pay Seller an amount equal to the Purchase Price, less the earnest money described in paragraph 5.
5. Seller hereby acknowledges receipt of \$[Insert Amount] as an earnest money deposit ("Earnest Money"), which shall be retained by Seller as liquidated damages (and not as a penalty) in the event that Purchaser does not purchase the Assets by the Closing Date for any reason, except as set forth in Sections 8 or 9 herein. The Earnest Money shall be applied against the Purchase Price. In consideration of Purchaser's payment of Earnest Money, Seller hereby grants to Purchaser the exclusive right and option to purchase the Assets (subject to the terms of any definitive agreements between Seller and Purchaser) from the date of this letter through the Closing Date. In the event that Purchaser does not purchase the Assets on the Closing date for any reason set forth in Sections 8 or 9 herein, Seller shall promptly return the Earnest Money to Purchaser upon Purchaser's written request (either hand delivered or by ordinary U.S. mail) stating such reason.

## Figure 6-2

Dr. Thomas R. Roberts

[Insert Date]

Page 2

6. Seller (at Purchaser's option) may remain employed by Purchaser for a period of three months immediately following the Closing Date at a rate of compensation equal to \$[Insert Amount] of gross collections attributable to Seller's rendering of professional dental services to Purchaser's patients.
7. During negotiations regarding Purchaser's proposed acquisition of the Assets, Purchaser will have access to and will be requesting certain of the following information regarding Seller and its patients (all of which information is herein collectively called the "Confidential Information"): patient lists, records and other information regarding Seller's patients (whether or not evidenced in writing); patient fee schedules and fee policies; financial plans, records, ledgers and information; employment records, data and policies; business and practice methods and operations; business and practice forms, correspondence, memorandums and other records; and any other Confidential Information which Purchaser encounters during Purchaser's review of the transactions contemplated by this letter. In consideration of the release by the Seller of the Confidential Information to Purchaser, Purchaser agrees that: (a) the Confidential Information shall (at all times) be and remain the exclusive property of Seller; and (b) Purchaser shall hold the Confidential Information as a trustee and fiduciary for the Seller; and (c) Purchaser shall not directly or indirectly use for any purpose, copy, retain or disclose or convey to any third party, except Purchaser's advisors, any Confidential Information without the prior written approval of Seller.
8. This Agreement is expressly contingent upon Purchaser obtaining financing for the purchase of the Assets, suitable to Purchaser in Purchaser's sole discretion.
9. This Agreement is expressly contingent upon Purchaser obtaining a lease for the premises of Seller, suitable to Purchaser in Purchaser's sole discretion.
10. Purchaser and Seller acknowledge and agree that except for the matters outlined in Sections 5 and 7 herein, this letter of intent does not create or impose any legally binding obligations on the part of either Purchaser or Seller. Purchaser and Seller further acknowledge and agree that the consummation of the transactions outlined above, other than those described in Sections 5 and 7 herein, are expressly conditioned upon and subject to the execution of definitive legal documents, which legal documents shall be in form and substance satisfactory to Purchaser, Seller and their respective legal counsel.

**Figure 6-2**

Dr. Thomas R. Roberts  
[Insert Date]  
Page 3

If the terms outlined are acceptable, please sign and date where indicated below, and return a signed and dated copy to me.

Sincerely yours,

JOSEPH G. JONES, D.D.S., INC.

By: \_\_\_\_\_  
Dr. Joseph G. Jones, President

I hereby accept the terms contained in this letter.

Date: \_\_\_\_\_

\_\_\_\_\_  
Dr. Thomas R. Roberts

Figure 6-3

**PRACTICE DOCUMENT MATRIX**

Establish Practice	Sell/Acquire Practice	Sell/Acquire Portion of Practice/Practice Merger	Associateship	Solo Group Arrangement
<ol style="list-style-type: none"> <li>1. Lease for Practice Facility</li> <li>2. Choose Operating Format (Corporate or Non-Corporate Form)</li> </ol>	<ol style="list-style-type: none"> <li>1. Non-Binding/Binding Letter Of Intent</li> <li>2. Asset or Stock Purchase Agreement</li> <li>3. Assignment or Sale of Personal Goodwill Agreement</li> <li>4. Promissory Note</li> <li>5. Pledge and Security Agreement</li> <li>6. Bill of Sale</li> <li>7. Restrictive Covenant Agreement</li> <li>8. Employment Agreement for Former Owner, if Applicable</li> <li>9. Consulting Services Agreement for Former Owner, if Applicable</li> <li>10. Deferred Compensation Agreement-Already in Effect</li> <li>11. Lease Agreement</li> <li>12. Memorandum of Lease/ For Recording Purposes</li> </ol>	<ol style="list-style-type: none"> <li>1. Share or Asset Purchase Agreement</li> <li>2. Owner Employment Agreements</li> <li>3. Buy-Sell Agreement</li> <li>4. Deferred Compensation Agreements, if Applicable</li> <li>5. Close Corporation or Shareholder or Operating Agreement</li> <li>6. Owner Employment Agreements</li> <li>7. Merger Documents, if Applicable</li> </ol>	<ol style="list-style-type: none"> <li>1. Associate Employment Agreement</li> <li>2. Non-Binding Letter Agreement Outlining Key Terms of Potential Practice Ownership vs.</li> <li>3. Share Option Agreement and Co-Ownership Agreements as Schedules</li> </ol>	<ol style="list-style-type: none"> <li>1. Associate Employment Agreement</li> <li>2. Asset Purchase Agreement</li> <li>3. Operating Agreement/Facility Sharing Agreement</li> <li>4. Buy-Sell Agreement</li> <li>5. Lease Agreement, if Applicable</li> <li>6. Choose Operating Format (Corporate or Non-Corporate Form)</li> </ol>

## **VII. ACQUIRING YOUR PRACTICE — THE IMPORTANCE OF PURCHASER DUE DILIGENCE**

- A. Comparison of Practice Options
- B. Preparation or Confirmation of the Practice Valuation
- C. Confirmation of Value
  - 1. Compatibility of Purchaser and Seller
  - 2. Financial Information
  - 3. Practice Facility
  - 4. Lease and Real Estate Matters
  - 5. Operational Matters
  - 6. Employment Relations and Benefits
  - 7. Litigation, Pending/Threatened
  - 8. Organizational Matters

Figure 7-1

### **Notes**

**Figure 7-1**  
**DUE DILIGENCE CHECKLIST<sup>1</sup>**

**\* Designates that the due diligence information should have been requested, reviewed and used as part of the preparation or confirmation of the practice valuation.**

Completed      Not Completed      Inapplicable

**A.      Compatibility of Purchaser and Seller**

- |       |       |       |   |
|-------|-------|-------|---|
| _____ | _____ | _____ | *1. Contrast seller'(s) practice mission and philosophy to yours;   |
| _____ | _____ | _____ | *2. Contrast seller'(s) personal values and work ethic to yours;  |
| _____ | _____ | _____ | *3. Assess seller'(s) reason for departure from active practice;  |
| _____ | _____ | _____ | 4. Assess reputation of the practice and practice owner(s) within the community and among colleagues; and |
| _____ | _____ | _____ | 5. Assess willingness of seller(s) to transfer ownership of the practice.                                 |

**B.      Financial Information**

- |       |       |       |  |
|-------|-------|-------|--|
| _____ | _____ | _____ | *1. Obtain federal income tax returns of the practice for the lesser of the last five fiscal years or the number of years in practice;   |
| _____ | _____ | _____ | *2. Obtain financial statements and balance sheets (assuming that they are prepared for the practice) for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date; |

---

<sup>1</sup> William P. Prescott, M.B.A., J.D., The Practice Acquisition Handbook, Randall K. Berning and Affiliates, Naples, Florida, 1997, Appendix I.

**Figure 7-1**

<u>Completed</u>	<u>Not Completed</u>	<u>Inapplicable</u>	
_____	_____	_____	*3. Obtain an aged trial balance of all practice accounts receivable and the historical practice collection records for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;
_____	_____	_____	4. Obtain appropriate certificates of payment from state authorities evidencing proper payment of or provision for sales taxes, workers' compensation premiums and unemployment compensation premiums;
_____	_____	_____	5. Obtain list of bank accounts and lenders for the practice;
_____	_____	_____	6. Obtain copies of any equipment lease and/or loan agreements or line of credit agreements with lenders for the practice and a list of those individuals guaranteeing said agreements;
_____	_____	_____	7. Obtain specific amounts of gross production and collections by individual doctor and hygienist(s) for the lesser of the last five fiscal years or the number of years in practice and the current year to date;
_____	_____	_____	8. Obtain listing of all accounts receivable written off and/or sent to any collection agency or attorney in each of the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date; and
_____	_____	_____	9. Obtain itemized list of all leasehold improvement costs made in the current practice facility and the date(s) said leasehold improvements were made.
_____	_____	_____	10. Your accountant should prepare your financial budget for the practice being acquired.
_____	_____	_____	11. Your accountant should assist you in the preparation of your personal financial statement to assess your current financial situation and ability to obtain financing for the purchase price of the practice.

**Figure 7-1**

Completed      Not Completed      Inapplicable

**C. Practice Facility**

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

- \*1. Obtain floor plan of the practice facility;
- \*2. Obtain an itemized list and the fair market value of all dental equipment being acquired by treatment room, plus darkroom, utility room, sterilization area, X-ray area and laboratory;
- \*3. Obtain an itemized list and the fair market value of all office equipment and furniture being acquired;
- \*4. Obtain an itemized list and the fair market value of all tangible assets, personal and other items located in the practice facility not being acquired;
- \*5. Obtain an itemized list and the fair market value of all tangible assets (dental equipment, office equipment and furniture) leased by the practice or located in the practice facility to which the practice does not hold clear title;
- \*6. Obtain maintenance records for all dental and office equipment from the date of purchase through the current date;
- 7. Assess overall appearance, aesthetics and condition of practice facility;
- 8. Determine whether dental equipment is right or left handed in light of your ability to practice comfortably and efficiently;
- 9. Review your ability to expand the current practice facility; and
- 10. Assess current parking availability.

**Figure 7-1**

Completed      Not Completed      Inapplicable

**D.      Lease and Real Estate Matters**

- |       |       |       |   |
|-------|-------|-------|---|
| _____ | _____ | _____ | *1. Obtain copy of any current lease, any renewal amendments and any document evidencing recording of the lease;  |
| _____ | _____ | _____ | *2. Obtain copies of any deed, documents and/or agreements relating to the practice owner's (or family members') ownership of the practice real estate;   |
| _____ | _____ | _____ | 3. Obtain copies of any surveys, plans, blueprints, specifications and other technical documents relating to the practice real estate, improvements, sewerage, etc.;  |
| _____ | _____ | _____ | 4. Obtain copies of any environmental or other regulatory permits, proceedings, abatement proceedings or any other regulatory matter affecting the practice real estate;  |
| _____ | _____ | _____ | 5. Obtain copies of any title insurance policies and environmental audits relative to the practice real estate;   |
| _____ | _____ | _____ | 6. Obtain copies of any contracts to sell, purchase or lease the practice real estate;  |
| _____ | _____ | _____ | 7. Obtain copies and/or list of any insurance policies for the practice real estate;  |
| _____ | _____ | _____ | 8. Obtain list of any zoning, public health, building code or other violations for the practice real estate for the lesser of the last five calendar years or the number of years the seller owned the practice real estate and the current year to date; and |
| _____ | _____ | _____ | 9. Obtain list of any material easements, licenses or other rights-of-way granted relative to the practice real estate.   |

**Figure 7-1**

Completed      Not Completed      Inapplicable

**E. Operational Matters**

\_\_\_\_\_

\*1. Obtain number of active patients (patients treated in the past twenty-four consecutive months), as well as the number of inactive patients (those patients not having any dental services rendered within the last twenty-four consecutive months);

\_\_\_\_\_

\*2. Obtain a summary of the number of new patients in each consecutive month for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;

\_\_\_\_\_

\*3. Obtain the number of the current patients (and percentage of the practice) in recall, if applicable;

\_\_\_\_\_

\*4. Obtain a current fee schedule and a summary of fee increases for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;

\_\_\_\_\_

\*5. Obtain a specific list of those procedures performed by the practice and those referred to specialists, if applicable;

\_\_\_\_\_

\*6. Provide your written evaluation of the area demand and potential for economic growth for a dentist/specialist in the geographical area where you intend to practice;

\_\_\_\_\_

7. Obtain reports demonstrating practice compliance with OSHA and State Dental Board Regulations;

\_\_\_\_\_

8. Assess stability of the practice and surrounding community;

\_\_\_\_\_

9. Assess competition in the geographical location of the practice;

\_\_\_\_\_

10. Assess practice location;

\_\_\_\_\_

11. Review demographic characteristics of patients (location, age and income);

**Figure 7-1**

<u>Completed</u>	<u>Not Completed</u>	<u>Inapplicable</u>	
_____	_____	_____	12. Determine availability of seller assisted financing;
_____	_____	_____	13. Determine the number of hours and days worked per month by the dentist(s)/hygienist(s);
_____	_____	_____	14. Determine the amount of time taken off by the practice owner yearly;
_____	_____	_____	15. Determine the number and percentage of patients in the practice covered by insurance/managed care/medicaid/other;
_____	_____	_____	16. Assess availability of public transportation;
_____	_____	_____	17. Review all current patients' charts, manner of payments, patient demographics, etc.;
_____	_____	_____	18. Review quality of the manner in which patient records and charts are retained in the practice;
_____	_____	_____	19. Review effectiveness of management systems;
_____	_____	_____	20. Review entity type/completeness of legal and accounting records;
_____	_____	_____	21. Obtain list of all contracts or other agreements to which the practice is a party;
_____	_____	_____	22. Obtain copies of all insurance policies for the practice;
_____	_____	_____	23. Obtain copies of any current third-party payment contracts;
_____	_____	_____	24. Copies of all licenses, permits, registrations, certificates, consents, accreditations and approvals needed to conduct the operation of the practice;
_____	_____	_____	25. Obtain list of all names, trade names, d/b/a, etc. used in the practice for the lesser of the last five fiscal years or the number of years in practice;

**Figure 7-1**

<u>Completed</u>	<u>Not Completed</u>	<u>Inapplicable</u>	
_____	_____	_____	26. Obtain copy of any broker, finder or other contract requiring the payment of a fee in connection with the sale of the practice;
_____	_____	_____	27. Calculate the current percentage of case acceptance rate as a percentage of all cases presented for treatment in the practice; and
_____	_____	_____	28. Obtain copies of any shareholder or member operational agreements (e.g. buy/sell agreements, deferred compensation agreements, employment agreements or close corporation agreements, etc.);

**F. Employment Relations and Benefits**

_____	_____	_____	*1. Obtain a census of all employees of the practice, the hours worked, compensation levels, positions, responsibilities and dates of hire (including former employees) for the lesser of the last five fiscal years or the number of years in practice and the current fiscal year to date;
_____	_____	_____	*2. Obtain copies of all employee handbooks, job descriptions and/or other publications distributed to employees of the practice;
_____	_____	_____	3. Obtain copies of all employee benefit plans (and summary plan descriptions) for the practice, including defined benefit, defined contribution, medical, severance, sick pay, vacation, retirement or any other plan, whether or not included in a formal plan;
_____	_____	_____	4. Obtain copies of all IRS determination letters and similar governmental approvals and filings for any employee benefit plans;
_____	_____	_____	5. Obtain all recent actuarial reports relating to employee benefits, if applicable;
_____	_____	_____	6. Obtain list of all insurance plans relating to employees of the practice;

**Figure 7-1**

<u>Completed</u>	<u>Not Completed</u>	<u>Inapplicable</u>
------------------	--------------------------	---------------------

_____	_____	_____
-------	-------	-------

7. Obtain list of all employment discrimination claims of the practice and/or any other employee claims or disputes against the practice for the lesser of the last five fiscal years or the number of years in practice and current fiscal year to date;

_____	_____	_____
-------	-------	-------

8. Obtain specific details relating to any doctor(s) formerly working in the practice since its inception; and

_____	_____	_____
-------	-------	-------

9. Assess feasibility and likelihood of each staff member remaining with the practice after the ownership change.

**G. Litigation — Pending/Threatened**

_____	_____	_____
-------	-------	-------

1. Obtain copies of pleadings for any pending litigation, arbitrations, grievances, other judicial or administrative proceedings;

_____	_____	_____
-------	-------	-------

2. Obtain list of any pending and threatened litigation since the inception of the practice relating to litigation, claims and assessments;

_____	_____	_____
-------	-------	-------

3. Obtain description of all outstanding judgments, assessments, penalties or fines;

_____	_____	_____
-------	-------	-------

4. Obtain list and copies of all demand letters, notices or claims received within the lesser of the last five years or the number of years in practice; and

_____	_____	_____
-------	-------	-------

5. Obtain copies of any audits performed or other governmental filings relative to the practice, including, but not limited to, ERISA and employee benefits/Department of Labor, State Dental Board, OSHA, Internal Revenue Service or State Department of Taxation since the inception of the practice.

**Figure 7-1**

Completed      Not Completed      Inapplicable

**H. Organizational Matters**

_____	_____	_____	1. Obtain charter and all amendments certified by the State;
_____	_____	_____	2. Obtain articles of incorporation or organization certified by corporate officer or member, if applicable;
_____	_____	_____	3. Obtain list of current directors and officers (or members and managers);
_____	_____	_____	4. Obtain list of shareholders/members and shares/units owned;
_____	_____	_____	5. Obtain current stock or membership transfer records, certificates and shares or units owned;
_____	_____	_____	6. Obtain record of directors' and shareholders' (or members') actions since the inception of the practice (e.g., corporate record book); and
_____	_____	_____	7. Obtain all professional annual reports for the lesser of the last five fiscal years or the number of years in practice.

**VIII. SELLING TO OR WORKING FOR A DENTAL SERVICE MANAGEMENT ORGANIZATION — THEY'RE BACK!**

- A. The Economics
- B. Getting Paid
- C. Unwinding the Transaction

**Notes**

## **IX. HIRING & BECOMING THE ASSOCIATE**

- A. Personality Profiling — Does This Really Work?
- B. The Spouse in the Practice — How are Patients Assigned?
- C. Length of Association Based Upon Pre-determined Performance Standards
- D. Timing the Hiring Process — The Effect of Relocation or Expansion
- E. Associate Compensation
- F. Proposal For Employment
- G. Key Employment Agreement Provisions — Did We Forget Anything?
  - 1. At-Will Employment; No Prior Agreement Prohibiting Employment
  - 2. Employment Term — Specific Period or Open-Ended?
  - 3. Employee Compensation — Bonus or No Bonus? Base Compensation or Draw?
  - 4. Employee's Duties And Responsibilities
  - 5. Employee's Non-Disclosure Promises
  - 6. Employee's Non-Competition Promises — When Does This Start? Can I Buy It?
  - 7. Vacation and Time-Off — Paid or Unpaid?
  - 8. Retirement Plan, Fringe Benefits and Expenses — This Can Add Up! Can Compensation be Reduced by the Cost of the Benefits?
  - 9. Prohibition Against Transfer
  - 10. Termination of Employment — When Does the Money Stop?
  - 11. Indemnification and Contribution — Is this Mutual?
  - 12. Miscellaneous — Where and When Do We Do Battle?
  - 13. Equity Purchase Provision — In the Employment Agreement?
  - 14. Additional Benefits — Like What?
- H. Anticipating Ownership — Well When?

- I. Independent Contractor Status — With This Fly?
- J. Buy-Sell Agreements — What If?
- K. Except for Limitation Situations, Do Not Maintain a Satellite Location
- L. Associate To Owner

Figure 9-1A

Figure 9-1B

Figure 9-1C

Figure 9-1D

Figure 9-2

Figure 9-3

Figure 9-4

Figure 9-5

Figure 9-6

Figure 9-7

Figure 9-8

## **Notes**

**Figure 9-1**

**EFFECT OF DENTAL LABORATORY COSTS  
ON ASSOCIATE COMPENSATION**

**Figure 9-1A**

**Production, Less Percentage Lab, Times Percentage**

1.	Monthly Associate Production: .....	\$30,000
2.	Less, 1/3 Dental Laboratory Costs Attributable To Associate (10% x .33 = \$3,000 x .33 = \$1,000): .....	<\$ 990>
3.	Subtotal: .....	\$29,010
4.	Compensation Percentage: .....	x 33%
5.	Monthly Associate Compensation: .....	\$ 9,573

**Figure 9-1B**

**Production, Times Percentage, Less Percentage Lab**

1.	Monthly Associate Production: .....	\$30,000
2.	Compensation Percentage	x 33%
3.	Subtotal: .....	\$ 9,900
4.	Less, 1/3 Dental Laboratory Costs: .....	<\$ 990>
5.	Monthly Associate Compensation: .....	\$ 8,910

**Figure 9-1C**

**Production, Times Percentage**

1.	Monthly Associate Production: .....	\$30,000
2.	Compensation Percentage	x 30%
3.	Subtotal: .....	\$ 9,900

**Figure 9-1D**

**Production, Less 1/2 Lab, Times Higher Percentage**

1.	Monthly Associate Production: .....	\$30,000
2.	Less, 1/2 Dental Laboratory Costs: .....	<\$ 1,500>
3.	Subtotal: .....	\$28,500
4.	Compensation Percentage: .....	x 35%
5.	Monthly Associate Compensation: .....	\$ 9,975

**Figure 9-2**

**ASSOCIATE COMPENSATION**

For each consecutive month of the Employment Term, Corporation shall pay Employee a basic salary (the "Basic Salary") equal to the greater of: (a) \_\_\_\_\_ Dollars (\$\_\_\_\_\_); or (b) thirty percent (30%) of Adjusted Production (as herein defined) attributable to professional dental services rendered to Corporation's Patients (as herein defined) inclusive of hygiene examination fees and excluding hygiene services performed by Corporation's hygienist(s). The Basic Salary shall be paid in at least monthly installments during Corporation's usual and customary pay periods and shall be prorated (on a daily basis) if the Employment Term terminates prior to the completion of any monthly period. For purposes of this Agreement, Adjusted Production means Employee's rendering of professional dental services hereunder, less dental laboratory remakes, refunds, uncollectible accounts, write-offs, discounts and reduced fee plans of any nature. Notwithstanding the foregoing, Employee's Basic Salary and any Bonuses (as herein defined) shall be reduced and off-set by the full cost of any benefits and business expenses under Section \_\_\_\_ and any retirement plan contributions made by Corporation on Employee's behalf under Section \_\_\_\_\_.

**Figure 9-3**  
**BONUS(ES)**  
**(OPTIONAL)**

In its sole discretion, Corporation may, but should not be obligated to, pay Employee a bonus(es) (collectively the "Bonus"). Any Bonus hereunder shall be based upon Employee's overall contribution to Corporation's dental practice, including, but not limited to, Employee's attitude, effort, quality of clinical care, relationships with Patients and staff, productivity and punctuality, and shall further be based upon Corporation's general cash and financial position.

**Figure 9-4**

**PROPOSAL FOR EMPLOYMENT AND FUTURE OWNERSHIP**

**DRS. SMITH & JONES, INC.**  
[Insert Address]

August 1, \_\_\_\_\_

Dr. Thomas R. Roberts  
[Insert Address]

RE: Proposal for Employment

Dear Tom:

Dr. Smith and I would be very pleased to have you join Drs. Smith & Jones, Inc. (the "Corporation") as a full-time periodontist on or approximately January 1, \_\_\_\_\_, pursuant to the proposal described herein.

I. Term of Employment. Your employment as an associate periodontist with the Corporation would be for a term, not to exceed three (3) years and based upon your production that must exceed \$575,000.00 over a twelve (12) consecutive month period, the "Agreement Term". During such time, the Corporation, its shareholders and you would have the opportunity to mutually evaluate our working relationship and the prospect of working together as shareholders of the Corporation over the long term.

II. Ownership Interest. After completion of the Agreement Term, you would be provided the opportunity to purchase a number of shares of the Corporation's issued and outstanding common stock equal to that of any other shareholder, presumably one-third (1/3) of the issued and outstanding shares. The purchase of your shares in the Corporation would be subject to the preparation of documents mutually acceptable to you and the Corporation.

III. Compensation as an Employee/Periodontist. You would be paid compensation as follows:

- (a) For the first year of the Agreement Term, you would be paid a salary of \$150,000.00; and
- (b) For the second year of the Agreement Term, you would be paid a salary of \$175,000.00.

Additionally, you would be eligible for a discretionary bonus payable prior to the end of each calendar year of the Agreement Term, which would be based upon your total contribution to the Corporation's periodontal practice and further based upon the Corporation's cash and financial position.

IV. Benefits Paid on your Behalf. In addition to your salary, the Corporation would pay the reasonable cost of benefits on your behalf, which would be substantially similar to those of its current periodontist/employees, dependent upon economic and market conditions. Such benefits presently include the payment of:

## Figure 9-4

- (a) Liability insurance premiums;
- (b) Family hospitalization insurance premiums;
- (c) Disability insurance premiums;
- (d) Continuing education costs and associated travel expenses, approved in advance by the Corporation;
- (e) Entertainment expenses;
- (f) Dues and membership fees; and
- (g) Retirement plan contributions (in accordance with the eligibility provisions of the Corporation's profit-sharing plan).

V. Time Off. You would receive three (3) weeks of vacation for each year of the Agreement Term. Additionally, you would receive holidays off and receive certain days off for attendance at continuing education courses.

VI. Expenditure of Time. The position which the Corporation is offering to you requires your full-time efforts. You would be expected to work on a full-time basis in accordance with the Corporation's usual scheduling policies. However, there would be times which you would be expected (during the day, evenings and weekends) to develop referring relationships with general dentists through various non-clinical marketing activities.

VII. Employment Agreement. Provided that you accept the terms of the proposed employment with the Corporation as outlined herein, you would be asked to sign an employment agreement. The employment agreement would be presented to you in the near future for your and your legal counsel's review. The employment agreement would contain provisions relating to your compensation, fringe benefits, non-competition/non-disclosure, termination and responsibilities.

VIII. Termination of Employment. It is the intention of the Corporation's current shareholders that you become a shareholder within three (3) years. However, in the event that the working relationship between you and the Corporation would ever become unacceptable, either to you or the Corporation for any reason, a provision contained in your employment agreement would provide for termination by either party, upon the expiration of thirty (30) days written notice.

IX. Purchase Price. The purchase price for the shares in the Corporation which you would purchase would equal the fair market value of such shares as a percentage of all of the issued and outstanding common shares of the Corporation. Our recent appraisal indicates that the fair market value of the Corporation is \$900,000.00 and has been reduced to reflect that you are purchasing stock in after-tax dollars. Therefore, the purchase price for one-third (1/3) of the issued and outstanding shares would equal \$300,000.00 as of the date you become an owner of the Corporation (the "Buy-In").

**Figure 9-4**

X. Payment of the Purchase Price. The purchase price for the Buy-In would be paid as follows: (a) twenty-five percent (25%) of the purchase price would be paid pursuant to a cash down payment; and (b) the remaining seventy-five percent (75%) of the purchase price would be financed by the Corporation and paid over seven (7) years, at two percent (2%) less than the prime rate of interest then charged by the Corporation's bank.

XI. Operational Control. As an owner of the Corporation, you would share a voice in its operation and control equal to that of any other shareholder.

XII. Non-Binding Proposal. This proposal is not intended to create or impose any legally binding obligations on the part of you, the Corporation or its shareholders. The consummation of the proposal contained herein is expressly conditioned upon and subject to the execution of definitive legal documents, which legal documents must be in form and substance satisfactory to you, the Corporation and our respective legal counsel.

Please carefully review the foregoing with your legal counsel and call me with any questions which you may have relative to this matter. Thereafter, if the terms and conditions described herein meet with your and your legal counsel's approvals, please sign and date below where indicated and return a signed copy of this letter to me in the pre-addressed, stamped envelope on or before August 15, \_\_\_\_\_. Upon my receipt of the signed copy of this letter, I will request that the Corporation's legal counsel commence preparation of your employment agreement in "draft" version.

Dr. Smith and I look forward to your joining the Corporation as an periodontist in the near future.

Sincerely yours,

DRS. SMITH & JONES, INC.

By: Dr. Joseph G. Jones, President

I have read this letter carefully and accept the terms and conditions stated herein.

\_\_\_\_\_  
Date

\_\_\_\_\_  
Dr. Thomas R. Roberts

**Figure 9-5**  
**ASSOCIATE INTERVIEW QUESTIONS**

**1. Mission and Philosophy**

What is the mission, philosophy and clinical quality standards of the practice?

**2. Goals**

Do we share similar goals for clinical excellence, leadership, practice growth and learning the business of dentistry?

**3. Facility Design**

How is the practice facility designed and what are the spacial limitations, if any? —Is the facility clean? —How many treatment rooms are there and how many hygienist(s) work in the practice? Who will work where as compared to current scheduling practices?

**4. Compatibility**

What type of person do I want to associate with and will patients and/or referral sources, as well as staff accept me? How do I give my patients away? Will we be compatible on both the professional and personal levels?

**5. Personality Profiling**

Will we use personality profiling testing to assess our compatibility? —If not, how will we evaluate each other? —At what point in the interview process will the non-doctor spouses meet?

**6. Practice Systems**

How are the systems of the practice managed? A partial list of the systems that should be managed are described in Attachment 8.

**7. Professional Services Performed/Collections**

What procedures and services does the practice owner perform and what procedures are referred? What procedures and services will the incoming doctor perform? —How are the services performed paid for and what is the collection policy and rate of the practice?

## Figure 9-5

### **8. Work Schedule/Patient Assignment**

What is the work schedule for the practice owner (days and hours)? What is the anticipated work schedule for the associate (days and hours) and how will patient assignments be made? —What kind of patients will be treated by the associate? —Inspect and discuss the appointment book! —Is the practice overbooked and do patients wait?

### **9. Internal and External Marketing**

What is the internal and external marketing policy of the practice? What are the internal and external marketing expectations for the incoming doctor?

### **10. Coverage/On-Call**

What are the office coverage "on-call" expectations for the incoming doctor and practice owner? How many emergencies occur on a monthly basis?

### **11. Mentoring**

How will the clinical and administrative mentoring process take place?

### **12. Productivity**

What are the productivity and revenue expectations for the incoming doctor?

### **13. Compensation**

How will the incoming doctor compensation package be structured?

### **14. Benefits and Expenses**

What benefits and expenses will be paid through the practice versus the incoming doctor?

### **15. Staff Interview**

What point in the interview process will the staff be introduced to the incoming doctor?

### **16. Roll of Non-Doctor Spouse and Other Family Members**

What is the role of the non-doctor spouse and other family members in the practice?

## Figure 9-5

### 17. Restrictive Covenants/Termination of Employment

What are the restrictive covenants and termination of employment provisions in the event that the working arrangement fails?

### 18. Associate Employment Agreement

At what point of the interview process will the incoming doctor be presented with an associate employment agreement and what are the terms? —Note, the incoming doctor is probably not an independent contractor.

### 19. Associate and Future Relationship

What is the length of the associate relationship and what are the specific objectives for the future working relationship?

### 20. Purchaser Due Diligence-Succession Planning Documents or Proposal for Ownership

After signing a confidentiality letter, how will the incoming doctor evaluate the specific objectives for the future working relationship in light of cash flow and debt of the practice, practice valuation and succession plan documents. See the Due Diligence Checklist is described in Attachment 6. Certain of the items in Attachment 6 should be requested to be reviewed or used as part of the preparation or confirmation of the practice valuation.

## Figure 9-6

### **JOB APPLICATION RELEASE PROVISION**

I certify that the information presented in this Application is true and complete. I understand that, if hired, my continued employment is expressly conditioned upon the accuracy and completeness of the information I have provided. If I am offered, and I accept, employment, I agree to abide by all rules, regulations and policies which the company may institute from time to time, in its discretion.

I understand that this Application, copies of rules, regulations and policies, and any other company documents, are not contracts of employment, and that either I or the company may terminate my employment at any time, for any reason, or no reason. No representative of the company has made any oral or written statements to the contrary and I have not relied on any oral or written statements by a company representative regarding any employment hereunder.

I authorize the company to contact any of the schools, colleges, employers, and references which I have listed on this Application, as well as any other persons or institutions, and to inquire about my suitability and qualifications for employment with the company. In consideration for the opportunity to submit this application, I agree to indemnify and save harmless the company, all the aforementioned schools, colleges, employers and references, and any other person or institution contacted by the company with respect to this Application, from and against all liabilities, costs, expenses (including attorney fees), charges, claims, fines, actions, causes of action directly or indirectly related to this Application and the company's acceptance or the rejection of the Application. A copy of this authorization and release shall be considered the same as the original.

**Figure 9-7**  
**CONFIDENTIALITY LETTER**

[INSERT DATE]

**PERSONAL AND CONFIDENTIAL**

[Insert Name]  
[Insert Address]

RE: Confidentiality Letter

Dear [Insert Name]:

You have expressed an interest in acquiring my dental practice (herein called the "Practice"). As such, you will request and I will disclose to you and your advisors certain financial, tax and operational information regarding the Practice, as well as certain of my personal financial information (herein collectively called the "Confidential Information").

In consideration of my release of the Confidential Information, you agree that: (i) the Confidential Information shall (at all times) be and remain my exclusive property; and (ii) you shall hold the Confidential Information as a trustee and fiduciary for me; and (iii) you shall use the Confidential Information solely and exclusively for the purpose of evaluating the potential acquisition of the Practice. Notwithstanding the foregoing, you are permitted to share the Confidential Information with your advisors.

If negotiations between you and I terminate (for any reason) without the consummation of your acquisition of the Practice, you shall promptly return all Confidential Information to me.

If the terms and conditions of this letter are acceptable, please so indicate by signing and dating the enclosed copy of this letter where indicated on page 2, and return the signed copy to me in the self-addressed, stamped envelope. Thereafter, my advisors will provide you and your advisors with any and all reasonable requests for information, including recent financial statements and Federal Income Tax Returns for the Practice.

I look forward to working with you.

Sincerely yours,

[Insert Name]

**Figure 9-7**

I have read this letter carefully concerning the terms and conditions of the Confidential Information, and accept the same as stated herein above.

Date: \_\_\_\_\_

\_\_\_\_\_  
[Insert Name]

**Figure 9-8**  
Revenue Ruling 87-41

1. Instructions;
2. Training;
3. Integration;
4. Services Rendered Personally;
5. Hiring, Supervising and Paying Assistants;
6. Continuing Relationship;
7. Set Hours of Work;
8. Full Time Required;
9. Doing Work on Employer's Premises;
10. Order or Sequence Set;
11. Oral or Written Reports;
12. Payment by Hour, Week or Month;
13. Payment of Business and/or Traveling Expenses;
14. Furnishing Tools and Materials;
15. Significant Investment;
16. Realization of Profit or Loss;
17. Working for More than One Firm at a Time;
18. Making Services Available to General Public;
19. Right to Discharge; and
20. Right to Terminate.

**X. USING RESTRICTIVE COVENANTS FOR THE ASSOCIATE AND DEPARTING OWNER**

- A. Enforcement
- B. Associate Employment Relationships
  - 1. When Does the Provision Take Effect?
  - 2. Realistic Buy-Out of Restrictive Covenant
- C. Sale and Acquisition
- D. Associate Buy-Ins and Owner Buy-Outs
- E. Non-Competition
  - 1. Time — Employment versus Ownership
  - 2. Radius — Attach a Map?
  - 3. Non-Solicitation
    - a. Patients
    - b. Referral Sources
    - c. Employees
- F. Non-Disclosure of Confidential Information/Trade Secrets
- G. Liquidated Damages versus Injunctive Relief
- H. Will a Restrictive Covenant be Enforceable for an Independent Contractor?

**Notes**

## **XI. PLANNING ASSOCIATE BUY-INS & OWNER BUY-OUTS**

- A. Can Partnerships Work?
  - 1. Criteria for Successful Partnerships
  - 2. Reasons Partnerships Failed in the 1970s are the Same Reasons Partnerships Fail Today
- B. Review Your Succession and Entry Options
  - 1. The New Partner is Not Necessarily the Partner Who Will Buy-Out the Senior Partner — Is Mandatory Buy-Out Required?
  - 2. Exception for Owners Approximately the Same Age
    - a. Maintain Separate Patients in a General Practice
    - b. Consider a Solo Group in a General Practice
  - 3. Would Like a Minimum of Five Years to Plan Exit Strategy
  - 4. Continued Post-Retirement Work of Retired Doctor
    - a. Employment or Engagement Within Control of Remaining Owner(s)
    - b. Worker Classification
- C. Joining the Practice
  - 1. Associate Employment
    - a. Succession Plan Should Be In Place
    - b. Valuation Completed
    - c. Confidentiality Letter
    - d. Interview Process
    - e. Employment Proposal and Employment Agreement
    - f. For Incoming Dentist or Specialist, Have Advisory Team Assembled and Be Ready to Sign Confidentiality Letter
    - g. Associate Bonuses Should Be Discretionary Based Upon Associate's Total Contribution to the Practice and Further Based Upon Its Cash and Financial Position
    - h. The Practice Must Earn an Administrative Profit on the Associate of 10% - 15%

- i. Necessity of Practice Management for Systems Development and Learning Leadership Skills
- j. No Associate Picks Up a Handpiece Until the Employment Agreement is Signed
  - (i) When Do Restrictive Covenants Become Effective?
  - (ii) Discretionary Termination of Employment Agreement for Some Period of Time by the Practice
  - (iii) Employee's Patients, If Any, Excluded by Schedule?
  - (iv) Can Restrictive Covenant Be Bought Out?
  - (v) Associate Compensation
- 2. Valuation of a Partial Practice Interest
  - a. Importance of Yearly Revenue, Profitability and Pent-Up Demand
  - b. Effect of Expansion and Relocation on Profitability
  - c. Ownership Based Upon Performance Standards, Not Time
  - d. New Owner Will Not Agree to a Reduction of Compensation
  - e. "Difference" Between Associate Compensation and Benefits and Hygiene Profit Attributable to the New Owner Pays for the Interest Acquired
- 3. Stock in After-Tax Dollars
- 4. Stock or Interest at Lowest Reasonable Value, Coupled With Compensation Shift
- 5. Three Entity Approach
- 6. Buy-In Will Almost Always Be Internally Financed, As Distinguished From an Owner's Buy-Out
- D. Operational Considerations
  - 1. Retirement Plan Funding
  - 2. Allocation of Compensation
    - a. Collections of One Owner as a Percentage of the Collections of All Owners, With General Operating Expenses Allocated On a Pro rata Basis
    - b. Ownership Percentage
    - c. Administrative and Management Responsibilities

- d. Number of Days, Half-Days or Time Worked
  - e. Allocation of Direct Business Expenses
  - f. Combination of Methods
3. Decision Making Control
- a. Equal
  - b. 51% / 49%
  - c. Close Corporation Statutes
  - d. Buy-In Internally Financed, Should Decisions Be Equal?
  - e. Maybe Certain Decisions Require Unanimous Consent?
  - f. Can New Owner's Employment and Ownership Be Terminated By Senior Owner?
  - g. The New Owner Can Quit?
  - h. How Does This Affect the Buy-Out?
  - i. Under What Circumstances May the New Owner Leave and Practice Within the Restricted Area?
4. Dispute Resolution
5. Employment of Family Members
- a. Non-Doctor Staff
  - b. Dentists / Specialists
  - c. Admitting Third Party Dentists / Specialists in a Family Practice
- E. Leaving the Practice
- 1. Stock In After-Tax Dollars
  - 2. Stock At Lowest Reasonable Value, Coupled With Corporation's or Entity's Purchase of Personal Goodwill or Payment of Deferred Compensation
  - 3. Three Entity Approach
  - 4. Purchase Price
    - a. Agreed Value
    - b. Formula
    - c. Appraisal

5. Buy-Out Obligation — Problem or Opportunity?
6. Timing the Associate Buy-In
7. Availability of Acquisition Candidates
8. Can Partnerships Work?

Figure 11-1

Figure 11-2

Figure 11-3

Figure 11-4

Figure 11-5

Figure 11-6

Figure 11-7

Figure 11-8

Figure 11-9

Figure 11-10

Figure 11-11

Figure 11-12

Figure 11-13

Figure 11-14

Figure 11-15

## **Notes**

### **Figure 11-1**

#### **CRITERIA FOR SUCCESSFUL CO-OWNERSHIP**

1. The younger dentist(s) or specialist(s) agrees to a mandatory buy-out of the senior owner(s) upon retirement in accordance with a predetermined and agreed upon formula to account for future practice growth; incentives and disincentives in place to ensure that the parties live up to their obligations;
2. Practice valuation and transition memorandum are prepared as early as possible;
3. There is a "way out" or exit that is available for any doctor;
4. Patient base remains separate for each doctor in general practices;
5. The practice is economically healthy;
6. There are sufficient new patients and growth;
7. The existing owner(s) cannot incur a drop in compensation, unless time in practice is reduced;
8. The owners are compatible with each other;
9. The economics of the associate buy-in are "fair" to both or all parties;
10. Compensation and benefits are allocated fairly;
11. Decision making control of the practice is agreed upon by both or all parties, with dispute resolution devices in place;
12. Spousal involvement in the practice is agreed upon by both or all parties in advance.

**Figure 11-2**

**COMMON REASONS WHY CO-OWNERSHIP RELATIONSHIPS FAIL**

1. The economics of the associate buy-in(s) and owner buy-out(s) are incorrect and unrealistic;
2. Insufficient patients and/or referral sources;
3. Disproportionate quality of clinical treatment;
4. Disproportionate productivity;
5. Disproportionate effort;
6. Varying long-range or strategic goals;
7. Failure to discuss practice business through regularly scheduled board or owner meetings;
8. Practicing in the wrong location;
9. Inefficient facility design;
10. Inability to compromise;
11. Personality conflicts and other personality issues;
12. Ineffective management and/or delegation of management duties and responsibilities, including staff training;
13. Ineffective leadership; and/or
14. Inadequate, unrealistic, outdated or the absence of buy-in, operational and buy-out documents.

**Figure 11-3**  
**EFFECT OF COMPENSATION SHIFT**

**Assumptions**

Capital Gains – 20%  
Ordinary Income – 40%

**Per \$500,000 Buy-In**

<b><u>Pre-Tax</u></b>	<b><u>Purchaser</u></b>	<b><u>Seller</u></b>	<b><u>Total</u></b>
Purchase Price	\$500,000	\$500,000	\$500,000
Tax Rate	N/A	40%	40%
Taxes Paid	N/A	\$200,000	\$200,000

<b><u>Post-Tax</u></b>	<b><u>Purchaser</u></b>	<b><u>Seller</u></b>	<b><u>Total</u></b>
Purchase Price	\$500,000	\$500,000	\$500,000
Tax Rate	40%	20%	60%
Taxes Paid	\$200,000	\$100,000	\$300,000

**Per \$100,000**

<b><u>Pre-Tax</u></b>	<b><u>Purchaser</u></b>	<b><u>Seller</u></b>	<b><u>Total</u></b>
Purchase Price	\$100,000	\$100,000	\$100,000
Tax Rate	N/A	40%	40%
Taxes Paid	N/A	\$40,000	\$40,000

<b><u>Post-Tax</u></b>	<b><u>Purchaser</u></b>	<b><u>Seller</u></b>	<b><u>Total</u></b>
Purchase Price	\$100,000	\$100,000	\$100,000
Tax Rate	40%	20%	60%
Taxes Paid	\$40,000	\$20,000	\$60,000

Given capital gains of 20%, inclusive of State Tax and AMT, and ordinary income rates of 40%, it costs one-third more to purchase stock in after-tax dollars than it does to reallocate compensation. This assumes that the senior doctor actually performs administrative and management services in exchange for the fees paid. **Potential Risk!**

**Figure 11-4**

**COMPENSATION SHIFT AND ALLOCATION**

**3. Employee's Compensation.**

3.1 Basic Salary. For each consecutive month of the Employment Term, Corporation shall pay Employee a basic salary (herein called the "Basic Salary") equal to any other Officer/professional employee of Corporation. The Basic Salary shall be payable in at least monthly installments and prorated (on a daily basis) if the Employment Term terminates prior to the completion of any monthly period.

3.2 Year-End Bonus. In consideration of Employee's productivity and overall contribution to the benefit of the Corporation, Corporation shall also pay Employee a bonus (herein called the "Year-End Bonus") before the end of each Corporate fiscal year as follows:

- (a) The sum of the available bonus pool, as determined by Corporation's Board of Directors;
- (b) Add all Basic Salary and advance bonus payments paid to Employee and Dr. \_\_\_\_\_ for such Corporate fiscal year;
- (c) Add all "unique" expenses (as herein defined) paid by Corporation on behalf of Employee and Dr. \_\_\_\_\_ for such Corporate fiscal year;
- (d) Multiply the sum of (a), (b) and (c), above, times a fraction, the numerator of which is Corporation's collections attributable to Employee's rendering of professional dental services for such Corporate fiscal year, and the denominator of which is Corporation's collections attributable to Employee's and Dr. \_\_\_\_\_'s rendering of professional dental services for such Corporate fiscal year;
- (e) Subtract all Basic Salary and advance bonus payments paid to Employee for such Corporate fiscal year; xx[and]xx
- (f) Subtract direct business expenses attributable to Employee's employment with Corporation, which direct business expenses include; (i) dental laboratory; (ii) automobile; (iii) travel; (iv) entertainment; (v) continuing education; (vi) retirement plan contributions; and (vii) any other expenses, as determined by the Corporation's Board of Directorsxx[.]xx xx[; and]xx

#### Figure 11-4

xx[(g) Subtract the Management Fees payable to Dr. \_\_\_\_\_ under a certain Practice Management Agreement, dated \_\_\_\_\_, 20\_\_.]xx

The Corporation's Board of Directors may make partial advance payments of bonus from time to time during a Corporate fiscal year based upon Corporation's general cash and financial position. xx[it is determined by Corporation's Board of Directors that the Year-End Bonus is a negative amount, then such negative amount shall be treated as a cash advance by Corporation to Employee which shall be repaid through an offset against Employee's future Basic Salary; provided, however, that upon termination of this Agreement and the Agreement Term, Employee shall immediately repay the cumulative total of any outstanding cash advances. Corporation's Board of Directors may require said advances to be evidenced by a promissory note (in form and substance satisfactory to Corporation).]xx Any Year-End Bonus shall be prorated (on a monthly basis) if the Agreement Term terminated prior to the completion of any Corporate fiscal year.

**Figure 11-5  
BUY-IN APPROACHES**

<u>Method</u>	<u>Advantages</u>	<u>Disadvantages</u>
1. Stock in after-tax dollars	<ul style="list-style-type: none"> <li>• No tax risk</li> <li>• Simple and straightforward</li> <li>• Capital gains to seller</li> <li>• Basis to purchaser</li> <li>• Security for payment</li> <li>• Second doctor unaffected by sale of senior owner's stock to a third doctor</li> </ul>	<ul style="list-style-type: none"> <li>• Expensive</li> <li>• After-tax dollars to purchaser</li> <li>• Contingent and unknown liabilities</li> </ul>
2. Stock at lowest reasonable value, coupled with compensation shift	<ul style="list-style-type: none"> <li>• Inexpensive and affordable for the new owner</li> </ul>	<ul style="list-style-type: none"> <li>• Potential tax risk</li> <li>• Contingent and unknown liabilities</li> <li>• Ordinary income to seller</li> <li>• Minimal security for payment</li> <li>• Second owner affected by senior owner's sale of stock to a third doctor</li> </ul>
3. Three entity approach	<ul style="list-style-type: none"> <li>• Goodwill amortizable, if practice formed post-1993, except for family members</li> <li>• Owner flexibility in business expense allocation</li> <li>• Second doctor unaffected by senior owner's sale of interest to a third doctor</li> </ul>	<ul style="list-style-type: none"> <li>• Goodwill arguably non-amortizable, if practice formed pre-1993</li> <li>• Three tax returns</li> <li>• All employees are covered in retirement plan</li> </ul>

### Figure 11-6

#### **POTENTIAL ISSUES IN FUNDING RETIREMENT PLAN CONTRIBUTIONS WITH ASSOCIATE PROFITS AND COMPENSATION BASED BUY-INS.**

1. This mechanism assumes that associate buy-ins can be made on a pretax basis.
2. The economics of the associate buy-ins are based upon future projections of growth that may or may not occur. The associate/new owner may leave the practice if the future projections of growth are incorrect.
3. What is the facility relocation cost to accommodate the new doctor? Will the existing facility allow for significant increases in revenues and profits?
4. If the retirement plan adopted is a defined benefit plan, significant contributions are mandatory, not optional.
5. Any defined benefit plan will need to be in effect for minimally three years, usually five years. What happens if contributions cannot be made?
6. Human behavior and theoretical outcomes greatly differ. Behavioral change is mandatory to change economic outcomes.
7. Profitability will affect income allocation.
8. Practice owners are being told that they can fund their retirement plan from the efforts of the associate/new owner. The associate/new owner and this individual's advisors may not share the same view.
9. Tax-qualified retirement plans are not for everyone. What about real estate and other investments outside of the retirement plan? This assumes that the doctor has the discipline to save outside of the tax-qualified retirement plan.
10. Practice management is crucial to the success of this mechanism to increase revenues and profitability on a consistent basis. Given the quality, quantity and economic cost of management training, will the doctor(s) change the practice for the better?

**Figure 11-7**

**SHAREHOLDER COMPENSATION**

**Senior Owner**

**3. Employee's Compensation.** During the Employment Term, Corporation shall allocate Employee's compensation and any bonuses (collectively the "Basic Salary") as periodically determined by Corporation's Board of Directors and as described in the "Compensation Allocation" in Schedule A, attached herein and incorporated herein by reference.

Corporation's Board of Directors may make partial advance payments of the Basic Salary from time to time during a Corporate fiscal year based upon Corporation's general cash and financial position. If it is determined by Corporation's Board of Directors that the Basic Salary is a negative amount, then such negative amount shall be treated as a cash advance by Corporation to Employee which shall be repaid through an offset against Employee's future Basic Salary; provided, however, that upon termination of this Agreement and the Agreement Term, Employee shall immediately repay the cumulative total of any outstanding cash advances. Corporation's Board of Directors may require said advances to be evidenced by a promissory note (in form and substance satisfactory to Corporation). Any Basic Salary shall be prorated (on a monthly basis) if the Agreement Term terminated prior to the completion of any Corporate fiscal year.

**New Owner**

**3. Employee's Compensation.** During the Employment Term, Corporation shall allocate Employee's compensation and any bonuses (collectively, the "Basic Salary") as periodically determined by Corporation's Board of Directors and as described in the "Compensation Allocation" in Schedule A, attached hereto and incorporated herein by reference. Notwithstanding the foregoing, Employee's Basic Salary shall be reduced and offset by the Management Fees payable to Dr. \_\_\_\_\_ under a certain Practice Management Agreement of even date, between Corporation and Dr. \_\_\_\_\_.

Corporation's Board of Directors may make partial advance payments of the Basic Salary from time to time during a Corporate fiscal year based upon Corporation's general cash and financial position. If it is determined by Corporation's Board of Directors that the Basic Salary is a negative amount, then such negative amount shall be treated as a cash advance by Corporation to Employee which shall be repaid through an offset against Employee's future Basic Salary; provided, however, that upon termination of this Agreement and the Agreement Term, Employee shall immediately repay the cumulative total of any outstanding cash advances. Corporation's Board of Directors may require said advances to be evidenced by a promissory note (in form and substance satisfactory to Corporation). Any Basic Salary shall be prorated (on a monthly basis) if the Agreement Term terminated prior to the completion of any Corporate fiscal year.

**Figure 11-7**

**SCHEDULE A**

**Compensation Allocation**

For each consecutive month of the Employment Term, Employee shall be entitled to Basic Salary equal to: (a) the monthly collected revenues attributable to professional dental services rendered to Corporation's Patients by Employee; (b) less fifty percent (50%) of Corporation's fixed overhead expenses (prorated on a monthly basis); (c) less fifty percent (50%) of Corporation's variable overhead expenses (prorated on a monthly basis); and (d) less all direct business expenses (prorated on a monthly basis) incurred by Corporation and attributable to Employee's aforementioned professional dental services on behalf of Corporation, which monthly collected revenues, fixed expenses, variable expenses, and direct business expenses shall be determined by Corporation's accountant and approved by Corporation's Board of Directors.

**Figure 11-8**  
**AN EXAMPLE OF PARTNERSHIP**

1. Associate relationship, including signed employment agreement.
2. Valuation — often reduced by the revenues of the new doctor, as an associate.
3. Stock at "lowest reasonable value", plus additional compensation in the form of management fees/guaranteed bonus, includes accounts receivable, to the founder — Tax Risk? Does this sum represent the personal goodwill of the founder at the time of the buy-in? Are the services rendered equal to the additional compensation paid?
4. 51%/49% ownership/decision making control during buy-in — some decisions require unanimous consent — use of close corporation agreements where permissible.
5. 50%/50% ownership/decision making control after buy-in fully paid.
6. Founder retains discretionary termination of employment provision for incoming owner.
7. Practice redeems stock of departing owner for pre-determined value per share.
8. Practice purchases the personal goodwill of founder upon retirement, death or permanent disability pursuant to a formula that measures future value as a function of value at the time of the buy-in and accounts for variances in the productivity of the owners at the time of the buy-out.
9. Entire buy-out is paid in cash, as second owner can use the practice as security to obtain financing.
10. Incoming owner may have deferred compensation agreement with the practice.
11. If new doctor leaves, new doctor receives 50% of the management fees/guaranteed bonus previously paid to the founder, over the same period of time that the founder was paid. 409A Issues?
12. If founder terminates employment of new owner, the departing owner receives 150% of management fees/guaranteed bonus previously paid to founder from the practice, payable in a lump-sum as severance pay. 409A Issues?
13. If new doctor leaves for any reason, new doctor can elect to treat his or her patients and no severance or deferred compensation is paid.

### Figure 11-8

14. This election must be made prior to receiving any deferred compensation or severance benefits. 409A Issues?
15. If management fees, accounts receivable or guaranteed bonuses have not fully been to the founder, the remaining balance must be paid by the departing new doctor as purchase of personal goodwill from founder, reduced by the tax detriment, in cash — then competition allowed for those patients previously treated by the new doctor.
16. Restrictions for soliciting patients and employees of the practice remain in effect.

**Note:** In states where restrictive covenants are not or are marginally allowable, should buy-outs be made through the payment of stock and/or deferred compensation over time, and payments cease if competition takes place?

**Figure 11-9**  
**BUY-OUT APPROACHES**

<u>Method</u>	<u>Advantages</u>	<u>Disadvantages</u>
1. Stock in after-tax dollars	<ul style="list-style-type: none"> <li>• No tax risk</li> <li>• Simple and straightforward</li> <li>• Capital gains to seller</li> <li>• Basis to purchaser</li> <li>• Buy-out made in cash</li> <li>• Second doctor unaffected by sale of senior owner's stock to a third doctor</li> <li>• In three or more owner practices, the other doctors should be unaffected by an owner's buy-out</li> </ul>	<ul style="list-style-type: none"> <li>• Expensive</li> <li>• After-tax dollars to purchaser</li> <li>• Contingent and unknown liabilities</li> </ul>
2. Stock at lowest reasonable value, coupled with corporation's purchase of personal goodwill or payment of deferred compensation	<ul style="list-style-type: none"> <li>• Arguably, capital gains to seller, relative to corporation's purchase of personal goodwill</li> <li>• Deferred compensation inexpensive and affordable to new owner, but not as beneficial to seller as corporation's payment of personal goodwill</li> <li>• Buy-out paid in cash, except for deferred compensation</li> </ul>	<ul style="list-style-type: none"> <li>• Potential tax risk — low stock value / purchase and sale of personal goodwill</li> <li>• Contingent and unknown liabilities</li> <li>• Restrictive covenant issues for corporation's purchase of personal goodwill</li> <li>• 409A issues for deferred compensation</li> <li>• Deferred compensation paid over time with minimal security for payment</li> </ul>
3. Three entity approach	<ul style="list-style-type: none"> <li>• Goodwill amortizable, except for family members</li> <li>• Owner flexibility for business expense allocation</li> <li>• Second doctor unaffected by senior owner's sale of interest to a third doctor</li> </ul>	<ul style="list-style-type: none"> <li>• Three tax returns</li> <li>• All employees are covered retirement plan</li> <li>• Goodwill amortization issues for family members</li> </ul>

**Figure 11-10**  
**BUY-SELL AGREEMENT MATRIX**

	Contract Terms						
	Purchase Price (a)	Payment Terms (b)	Purchase of Insurance (c)	Nature of Parties' Obligations			
				Practice/ Remaining Owner(s) Must Buy	Practice/ Remaining Owner(s) have Option to Buy	Departing Owner Must Sell	Departing Owner has Option to Sell
<b>T</b>							
<b>R</b>							
<b>I</b>							
<b>G</b>							
<b>E</b>							
<b>R</b>							
<b>I</b>							
<b>N</b>							
<b>G</b>							
<b>E</b>							
<b>V</b>							
<b>E</b>							
<b>N</b>							
<b>T</b>							
<b>S</b>							

**(a) Purchase Price Options:**

1. Stock In After-Tax Dollars
2. Stock At Lowest Reasonable Value, Coupled With Corporation's Payment of Personal Goodwill or Payment of Deferred Compensation.
3. Three Entity Approach

**(b) Payment Term Options:**

1. Cash
2. Promissory Note
3. Cash Down Payment and Promissory Note

**(c) Purchase of Insurance to Fund Obligation:**

1. Life Insurance
2. Disability Buy-Out Insurance

**Figure 11-11**  
**Schedules A, B, C, D, E**

**CORPORATE SHARE VALUE**

The value of each Corporate Share of a Deceased, Disabled, Electing, Terminated or Retiring-Shareholder shall equal \_\_\_\_\_ Dollars (\$\_\_\_\_\_).

Corporate Share Values May Vary According To The Triggering Event

\_\_\_\_\_  
xx[Dr. 1]xx

\_\_\_\_\_  
xx[Dr. 2]xx

\_\_\_\_\_  
xx[Dr. 3]xx

–Shareholders–

xx[PROFESSIONAL CORPORATION]xx

By: \_\_\_\_\_  
xx[Dr. 1]xx, President

And: \_\_\_\_\_  
xx[Dr. 2]xx, Vice-President

And: \_\_\_\_\_  
xx[Dr. 3]xx, Vice-President

–Corporation–

\_\_\_\_\_, 20\_\_

**Figure 11-12**  
**Schedules A, B, C, D**

**CORPORATE SHARE VALUE IN THE EVENT OF DEATH,  
PERMANENT DISABILITY,  
ELECTION TO TRANSFER,  
OR RETIREMENT**

The value of the Corporate Shares of a Deceased, Disabled, Electing or Retiring-Shareholder shall equal: (a) the sum of Corporation's billed and collected gross revenues for the fiscal year immediately preceding the fiscal year in which a Shareholder's Death, Disability, Election to Transfer, or Retirement occurs; (b) multiplied by \_\_\_\_\_%; and (c) multiplied by a percentage, the numerator of which is the percentage of the Corporate Shares owned by the Deceased-Shareholder, Disabled-Shareholder, Electing-Shareholder, or Retiring-Shareholder, and the denominator of which is the number of Corporate Shares owned by all Shareholders.

Separate Schedule for Termination of Employment

\_\_\_\_\_  
xx[Dr. 1]xx

\_\_\_\_\_  
xx[Dr. 2]xx

\_\_\_\_\_  
xx[Dr. 3]xx

–Shareholders–

xx[PROFESSIONAL CORPORATION]xx

By: \_\_\_\_\_  
xx[Dr. 1]xx, President

And: \_\_\_\_\_  
xx[Dr. 2]xx, Vice-President

And: \_\_\_\_\_  
xx[Dr. 3]xx, Vice-President

–Corporation–

\_\_\_\_\_, 20\_\_\_\_

**Figure 11-13**

**LIQUIDATION VALUE**

The Liquidation Value of the Company on the Valuation Date shall equal the most recent appraisal of Company's dental practice completed by \_\_\_\_\_ or any appraiser designated by the Members.

**Figure 11-14**

**Schedule E**

**CORPORATE SHARE VALUE IN THE EVENT OF  
TERMINATION OF EMPLOYMENT**

The value of the Corporate Shares of a Terminated-Shareholder shall equal: (a) the fair market value of Corporation's dental equipment, office equipment and furniture (herein called the "Tangible Assets") determined by (i) the net book value of the Tangible Assets as of the date of purchase, plus (ii) one-third (1/3) of the depreciation previously taken by Corporation on the Tangible Assets as of the Purchase Date; plus (b) the fair market value of Corporation's dental supplies determined by (i) the sum of the dental supplies purchased by Corporation for the most recent twelve (12) months immediately preceding the Purchase Date, and (ii) divided by twelve (12) months, and (iii) multiplied by three (3) months; plus (c) the fair market value of dental instruments determined by (i) the sum of Corporation's billed and collected revenues for the most recent twelve (12) months immediately preceding the Purchase Date, and (ii) multiplied by one-half percent (1/2%); plus (d) \_\_\_\_\_ percent (\_\_\_\_%) of Corporation's accounts receivable on the Purchase Date; less (e) Corporation's long-term debt on the Purchase Date; and (f) the sum of (a) through (e) multiplied by a percentage, the numerator of which is the percentage of the Corporate Shares owned by the Terminated-Shareholder, the denominator of which is the number of Corporate Shares owned by all Shareholders.

\_\_\_\_\_  
xx[Dr. 1]xx

\_\_\_\_\_  
xx[Dr. 2]xx

\_\_\_\_\_  
xx[Dr. 3]xx

–Shareholders–

xx[PROFESSIONAL CORPORATION]xx

By: \_\_\_\_\_  
xx[Dr. 1]xx, President

And: \_\_\_\_\_  
xx[Dr. 2]xx, Vice-President

And: \_\_\_\_\_  
xx[Dr. 3]xx, Vice-President

–Corporation–

\_\_\_\_\_, 20\_\_\_\_

## Figure 11-15

### TEN QUESTIONS ON PARTNERSHIPS

#### **Question 1.**

Is the associate who acquires a 49% or 50% practice interest, the candidate who will purchase the remaining 51% or 50%?

#### **Answer 1.**

Probably not, and the practice owner should not elevate the associate to ownership without the incoming doctor being obligated to buy-out such owner(s) upon retirement. Retirement should be a defined term in the buy-out agreements and may include a "no later than date", e.g., age 70. If the incoming doctor will not agree to buy-out the retiring doctor, it is difficult to sell the retiring doctor's interest to a third party who must work with the remaining doctor.

#### **Question 2.**

If the newly admitted owner is acquiring a 49% or 50% interest of the practice for fair market or appraised value, won't he or she want equal decision making control?

#### **Answer 2.**

First, if the incoming owner is acquiring his or her interest for fair market value, the new owner should want to purchase an interest in the practice equal to any other owner, e.g., 50% in a two-doctor practice. Otherwise, the parties are not truly "partners". And yes, the newly admitted dentist or specialist does desire to maintain equal decision making control in the practice. However, it is rare where associate buy-ins are paid in cash as the lender requires the practice as security. Where the practice owner guarantees the new doctor's loan, the practice owner is still financing the buy-in due to the guarantee. Therefore, until the incoming owner pays for his or her interest in the practice, I do not object to decision making control remaining with the existing owner(s) until such interest is fully paid, typically in five or seven years. However, certain decisions such as hiring a new dentist or specialist or relocating the practice would require the unanimous consent of both or all owners during this period. Thereafter, decision making control can be equal, provided that appropriate dispute resolution mechanisms are contained in the agreements. Roughly 16 states have close corporation statutes, whereby decision making control can be determined by contract. These statutes are useful tools as multiple owners can be admitted and the "founder" of the practice can maintain decision making control so long as such individual retains one share of stock in the professional corporation.

## Figure 11-15

### **Question 3.**

Will the incoming doctor be willing to pay the fair market value of the practice interest being purchased as of the date of the buy-in?

### **Answer 3.**

Probably not. The incoming doctor would prefer to have the practice value determined as of the date that the associate agreement is signed, as opposed to the completion of the associate period, e.g., after three years. Therefore, the practice owner should not interview any associate until his or her succession plan is prepared and the practice valued. Preparation of a succession plan includes delineating the tax and business structure of leaving the practice and may include admitting a new owner or selling the practice in its entirety at some point. I prefer to prepare all ownership agreements prior to the new doctor commencing employment so that significant issues are not raised at a later date. Minimally, I would want the practice valuation completed, the associate employment agreement prepared and a letter of intent outlining the future ownership. An exception to this would be where the associate relationship is permanent and will not lead to future ownership. The succession plan will be applicable irrespective of the identity of the associate/candidate. What seems to be a workable solution is to revalue the practice after predetermined performance and quality standards are consistently met by the associate being elevated to ownership. New patients brought to the practice by or collections attributable to the associate are measured and the goodwill is correspondingly reduced. This should be distinguished with the solo group arrangement, whereby the associate buys the goodwill attributable to his or her developing patient base. Not dealing with the future working relationship in advance usually leads to disagreements and misunderstandings at the time ownership is offered.

### **Question 4.**

What steps should the new doctor take prior to commencing employment if co-ownership is contemplated?

### **Answer 4.**

The new doctor should determine, both qualitatively and quantitatively, what he or she wants in a practice, rather than entering into an associateship just to have a job. Assuming that the vision and objectives of both parties are the same or substantially similar, the new doctor should sign a confidentiality letter and commence the due diligence or purchaser "homework" investigation prior to commencing employment. Unfortunately, this significant step is often overlooked by both parties as the practice owner should complete his or her due diligence investigation of the incoming doctor/candidate.

### **Question 5.**

What recourse does a practice owner have in the event that the new owner does not perform as expected or if the parties just cannot work with each other?

## Figure 11-15

### **Answer 5.**

Ownership in dental and dental specialty practices may be offered earlier than is appropriate, e.g., three years, rather than requiring the associate to attain predetermined quality and productivity standards. As a result, the parties can end up in a dispute where expectations differ. Thus, the newly admitted owner's employment agreement may include a "termination by notice" provision and the buy-out agreements would specify who stays and who leaves the premises in the event of a dispute. Obviously, if the existing practice owner terminates the ownership without cause, the newly admitted owner would be bought out for full fair market value, provided that the departing new owner complies with the restrictive covenant provisions contained in the buy-out agreements. As an alternative, the buy-out agreements may provide that the newly admitted owner can elect to be bought out for the pro rata value of the tangible assets of the practice only, less any amount(s) owed to the practice owner(s), and retain the charts of those patients customarily treated by such newly admitted owner. This assumes that the new owner has paid for the goodwill attributable to his or her patient base within the practice. And yes, each doctor's patients should remain separate. In this case, the departing doctor would be permitted to practice within the restricted area, but not solicit other patients of the practice or its employees, except perhaps for his or her assistant. While this issue is more complex in specialty practices because patients and referral sources will probably not be separate, it is solvable.

### **Question 6.**

What if the newly admitted owner does not honor his or her obligation to purchase the retiring owner's interest in the practice?

### **Answer 6.**

If the newly admitted owner does not honor his or her obligation to buy-out the retiring owner, there would be a breach of contract claim by the retiring doctor against the remaining doctor. Additionally, the owner and buy-out agreements would provide that the employment of this owner would terminate and such breaching owner would receive very little for his or her interest in the practice. The agreements would further provide that the restrictive covenants would remain in effect. Thereafter, the retiring dentist or specialist would search for a new candidate to purchase the practice in its entirety.

### **Question 7.**

Should family members and spouses be permitted to work in the practice?

### **Answer 7.**

Some of the best run practices employ non-doctor family members as administrators. These relationships should be identified and dealt with at the time that the co-ownership relationship is structured, hopefully prior to the associate picking up a "handpiece". From my

## Figure 11-15

experience, some of the most difficult spouses in the practice are males who function as office administrators. However, this is only a generalization. If the spouse works in the practice, the compensation should be the fair market value of such services, as opposed to a lower value, which is often the case. A very positive reason to employ the non-doctor spouse(s) is to obtain the favorable retirement plan contributions, e.g., a safe harbor 401(k) profit-sharing plan.

### **Question 8.**

How should the owners allocate compensation and benefits?

### **Answer 8.**

Compensation and benefits are typically allocated in one of four ways by: (1) the respective collections of one owner as a percentage of the collections of all owners; (2) ownership percentage; (3) the administrative and management duties performed by one owner and not the other(s); or (4) a combination of these methods. Where compensation is allocated by respective collections or production, certain expenses, e.g., occupancy costs, may be allocated equally and this should be defined in the respective employment agreements, the limited liability company operating agreement or partnership agreement. If one owner does not desire to participate in the retirement plan, a bad idea, such owner can be written out of the plan and admitted at a later date. Those expenses and benefits that are disproportionate among the owners can be fairly allocated under the compensation formula. An example of this may be an automobile expense, continuing education and travel or dental laboratory costs. It should be noted that compensation based upon respective collections or production is relatively uncommon for a specialist, especially orthodontists and pediatric dentists.

### **Question 9.**

Are owner buy-outs paid for over time and is there a risk of default?

### **Answer 9.**

Owner buy-outs used to be paid over time and sometimes still are. Yes, if the buy-out is paid over time, there is a risk of default, particularly if the retired dentist or specialist relocates. However, because of the Martin Ice Cream and Norwalk vs. Commissioner cases in 1998, it may, arguably, be possible for the professional corporation to redeem or purchase, the departing owner's stock in the professional corporation at its "lowest reasonable value" and acquire the "personal goodwill" of the retiring owner. The sale and purchase of the personal goodwill, arguably, results in favorable capital gains to the retiring doctor and is amortizable over 15 years by the professional corporation. While this structure results in cash buy-out because the remaining shareholder(s) owns 100% of the professional corporation's stock, it is not as tax favorable to the professional corporation as is the redemption of stock for the lowest reasonable value, coupled with the payment of deferred compensation to the departing owner. The deferred compensation is fully and immediately deductible to the professional corporation when paid and results in ordinary income to the retiring doctor. Thus, the economics of a buy-out through the

## Figure 11-15

payment for personal goodwill, versus the payment of deferred compensation, should be carefully calculated because the tax results affect affordability. Typically, the buy-out agreements contain a formula to determine the sum(s) that a departing owner receives, versus the time, cost and inconsistency of obtaining an appraisal when an owner departs. However, the formula(s) should be reviewed by the doctors and advisors each year as circumstances can change at any time. By using a formula, a retiring owner is paid the pro rata value for future practice growth. **Having said this, my favorite method of an owner buy-out is the purchase of stock in after-tax dollars, reduced by the tax detriment to the purchaser in doing so.**

### **Question 10.**

How are buy-outs handled when two or more owners are roughly the same age?

### **Answer 10.**

When two or more owners are roughly the same age, it is difficult, although this is a generalization, to continue co-ownership with two or more new doctors in place of the retiring doctors. What does work well, however, is to split the practice into two separate entities as a solo group and sell each practice separately. The respective purchasers obtain the benefit of sharing expenses in one facility, assuming they chose to do so.

## **XII. WHY SOLO GROUP PRACTICE MAKES SENSE**

- A. Associate Employment Arrangement
- B. Associate Acquisition
- C. Separate Practices
- D. Compensation, Expense Allocations
- E. Office Sharing Agreement Provisions
- F. Dissolution Provisions
- G. Lease and Real Estate Issues
- H. Option Versus Obligation to Buy-Out a Departing Practice Owner
- I. Sale of a Solo Group Practice to a Third Party Dentist
- J. Shared/Leases Employees — Consistent Compensation and Benefits
- K. Health Insurance
- L. Retirement Plan Contributions

Figure 12-1

### **Notes**

## Figure 12-1

### SOLO GROUP ARRANGEMENTS

#### OFFICE SHARING AGREEMENT PROVISIONS

1. Management of the facility, decision making procedures, and dispute resolution provisions.
2. Work schedules and use of the facility.
3. Joint and individual checking accounts.
4. Division of expenses either shared equally or based upon respective practice productivity.
5. Facility maintenance.
6. Equipment repair.
7. Sharing of certain staff members as well as payment of staff compensation, fringe benefits and retirement plan contributions.
8. Confidentiality of patient records and/or referral sources.
9. Use of telephone lines.
10. Mutual indemnification or hold harmless provisions.
11. Maintenance of current license to practice the doctor's profession.
12. Responsibility for repair of the premises other than equipment.
13. Capital and cash contributions.
14. Requirements to sublet or assign space, as well as the process to hire or engage an associate doctor.
15. Termination provisions.
16. Miscellaneous provisions, e.g., an integration clause whereby the document contains the entire agreement relative to the subject matter, possible arbitration in the event of a dispute, jurisdiction and venue provisions, changes to the agreement must be in writing.
17. Maintenance of malpractice/liability insurance with specific coverage limits.
18. Any individual or entity who or which acquires the practice of a retiring or departing practice owner may be required to become a party to the Office Sharing Agreement as a condition to the practice sale.
19. The dates, time and place of respective practice owner meetings to discuss common agenda items and business.
20. Real Estate and Lease commitments — who stays and who leaves in the event of a dispute.

# **Practice Operations And Personal Planning**

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### **XIII. DISPUTE RESOLUTION — FINDING MIDDLE GROUND**

- A. Litigation
- B. Monthly Board Meetings
- C. Annual Meetings
- D. Close Corporation, Shareholder or Operating Agreements
- E. Independent Third Party
- F. Split Off
- G. Dissolution
- H. Buy-Sell Agreements

#### **Notes**

#### **XIV. NEGOTIATING YOUR FACILITY LEASE**

- A. Purchaser Due Diligence
- B. Bargaining Position
- C. Measure the Facility
- D. Leasehold Improvement Costs
- E. Lease Considerations
  - 1. Lease Term — When Does the Rent Start?
  - 2. Payment Terms
  - 3. Security Deposits
  - 4. Recording the Lease
  - 5. Landlord Responsibilities
  - 6. Repair Costs
  - 7. Improvements or Alterations
  - 8. Use and Occupancy — Only a Dental Practice?
  - 9. Adequate Parking
  - 10. Subletting or Assignment
  - 11. Default Provisions and Cure Period
  - 12. Options to Renew
    - a. Renewal Term
    - b. Renewal Rental
    - c. No Default Condition
    - d. Manner of Giving Notice of Renewal
    - e. Option to Cancel, e.g., Death or Permanent Disability
  - 13. Obligations to Repair if Premises Unusable
  - 14. Death or Permanent Disability
  - 15. Cost Segregation Studies

#### **Notes**

## **XV. OWNING, ACQUIRING & SELLING YOUR BUILDING**

- A. Options/Rights of First Refusal
- B. Appraisals
  - 1. Appraiser Selection
  - 2. Appraisal Method
- C. Environmental Considerations
  - 1. Superfund Act
  - 2. Environmental Assessments and Audits
- D. Negotiating the Purchase of Real Estate
  - 1. Description of Premises
  - 2. Purchase Price
  - 3. Depreciation Deductions / Cost Segregation Studies
  - 4. Down payment and Escrow
  - 5. Title and Title Insurance
  - 6. Building and Zoning Regulations
  - 7. Licenses, Permits and Certificates of Occupancy
  - 8. Condition of Premises/Violations
  - 9. Fixtures and Personal Property
  - 10. Possession of Premises
  - 11. Representations and Warranties
  - 12. Brokerage Commissions
  - 13. Recording the Contract
  - 14. Real Estate Closing
  - 15. Tax-Free Exchanges of Real Estate

- E. Miscellaneous Ownership Issues
- F. Financing the Acquisition of Real Estate

**Notes**

**XVI. SELECTING YOUR PRACTICE ENTITY — S OR C CORPORATION, LLC OR SOLE PROPRIETOR**

- A. Sole Proprietorship
- B. Limited Liability Company
- C. C Corporation
- D. S Corporation
- E. General and Limited Partnerships
- F. Tax Considerations
- G. Non-Tax Considerations

Figure 16-3

Figure 16-4

Figure 16-5

**Notes**

**Figure 16-3**

JOHN SMITH, D.D.S., P.A.

---

ACTION BY SHAREHOLDER  
IN WRITING  
WITHOUT A MEETING

The undersigned, being the sole Shareholder of JOHN SMITH, D.D.S., P.A. (herein called the "Corporation"), does hereby take and adopt the following actions, in writing and without a meeting, pursuant to the authority of Section 607.0704 of the Florida Business Corporation Act:

RESOLVED that these Minutes are hereby deemed to constitute the Annual Meeting of the Shareholder for the year 20\_\_.

RESOLVED, FURTHER, that the following persons are hereby elected as Directors of Corporation to serve until their successors are elected at the next Annual Shareholder's Meeting, or until their earlier resignation, disqualification, removal from office or death:

John Smith, D.D.S.  
Susan A. Smith

RESOLVED, FURTHER, that the Shareholder hereby approves Corporation's Financial Statements from and since the last Annual Shareholder's Meeting, which Financial Statements satisfy the requirements of Section 607.1620 of the Florida Business Corporation Act.

RESOLVED, FURTHER, that all acts, transactions and business of the Directors and Officers from and since the last Annual Shareholder's Meeting hereby are fully ratified, approved and confirmed.

---

John Smith, D.D.S.

December 8, 20\_\_

**Figure 16-4**

JOHN SMITH, D.D.S., P.A.

---

ACTION BY DIRECTORS  
IN WRITING  
WITHOUT A MEETING

The undersigned, being all of the Directors of JOHN SMITH, D.D.S., P.A. (herein called the "Corporation"), do hereby take and adopt the following actions, unanimously in writing and without a meeting, pursuant to the authority of Section 607.0821 of the Florida Business Corporation Act:

RESOLVED that these Minutes are hereby deemed to constitute the Annual Meeting of the Directors for the year 20\_\_.

RESOLVED, FURTHER, that the following persons are hereby elected as Officers of Corporation to serve until the next Annual Directors' Meeting immediately following the Annual Shareholder's Meeting and until their successors are elected thereat, or until their earlier resignation, disqualification, removal from office or death:

President/Treasurer - John Smith, D.D.S.

Secretary - Susan A. Smith

RESOLVED, FURTHER, that the Directors hereby approve Corporation's Financial Statements from and since the last Annual Directors' Meeting, which Financial Statements satisfy the requirements of Section 607.1620 of the Florida Business Corporation Act.

RESOLVED, FURTHER, that all acts, transactions and business of the Directors and Officers from and since the last Annual Directors' Meeting hereby are fully ratified, approved and confirmed.

\_\_\_\_\_  
John Smith, D.D.S.

\_\_\_\_\_  
Susan A. Smith

December 8, 20\_\_

**Figure 16-5**

**FOR-PROFIT YEAR-END MATTER INFORMATION SHEET**

NAME OF CORPORATION John Smith, D.D.S., Inc. FISCAL YEAR ENDING December 31, 20

CLIENT NO. 9999.001

\_\_\_\_ (A) **DIVIDENDS:** Date Declared: \_\_\_\_\_ Amount Per Share: \$ \_\_\_\_\_

Date Paid: \_\_\_\_\_ Total Amount Paid: \$ \_\_\_\_\_

\_\_\_\_ (B) **PROFIT-SHARING:** Total Amount (or percentage) contributed to Plan: \$ \_\_\_\_\_ % \_\_\_\_\_

\_\_\_\_ (C) **TOTAL COMPENSATION** (Basic Salary PLUS all bonuses) paid to **key, management employees** (Shareholders, Directors, Officers) during the fiscal year:

<u>Name of Employee</u>	<u>Basic Salary (According to Employment Agreement)</u>	<u>TOTAL Bonuses Paid*</u>	<u>If Accrual Basis Taxpayer, TOTAL Bonuses Accrued</u>	<u>TOTAL COMPENSATION</u>
_____	\$ _____	\$ _____	\$ _____	\$ _____
_____	\$ _____	\$ _____	\$ _____	\$ _____
_____	\$ _____	\$ _____	\$ _____	\$ _____
_____	\$ _____	\$ _____	\$ _____	\$ _____
_____	\$ _____	\$ _____	\$ _____	\$ _____

\*Please also list bonuses in Item (D), below:

\_\_\_\_ (D) **BONUSES:** All other employees. (Please attach additional sheets, if necessary)

<u>Name of Employee</u>	<u>Bonus Paid</u>	<u>Date Paid</u>	<u>Bonus Accrued</u>	<u>Date Accrued</u>	<u>Was this a Holiday Season Bonus?</u>
_____	\$ _____	_____	_____	_____	No ___ Yes ___
_____	\$ _____	_____	_____	_____	No ___ Yes ___
_____	\$ _____	_____	_____	_____	No ___ Yes ___
_____	\$ _____	_____	_____	_____	No ___ Yes ___
_____	\$ _____	_____	_____	_____	No ___ Yes ___

\_\_\_\_ (E) **SALARY INCREASES:**

<u>Name of Employee</u>	<u>Effective Date</u>	<u>Old Salary</u>	<u>New Salary</u>
_____	_____	\$ _____	\$ _____
_____	_____	\$ _____	\$ _____
_____	_____	\$ _____	\$ _____
_____	_____	\$ _____	\$ _____
_____	_____	\$ _____	\$ _____

**Figure 16-5**

**\_\_\_\_ (F) MAJOR CORPORATE CAPITAL EXPENDITURES: (Over \$5,000.00):\*\***

<u>Item</u>	<u>Date Purchased</u>	<u>Cost</u>
_____	_____	\$ _____
_____	_____	\$ _____
_____	_____	\$ _____
_____	_____	\$ _____

\*\* (Note — If item purchased/sold was an automobile, list whether it was (a) purchased, or (b) sold, total purchase/sale price, date purchased/sold, year and make of car, indicate if car is for Corporate use only (or the particular person that will be using car) and give details (if applicable) for financing, (e.g., financing institution, amount borrowed, date borrowed, interest rate and payment schedule).

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**\_\_\_\_ (G) SEMINARS AND CONVENTIONS ATTENDED:**

<u>Date Attended</u>	<u>Date Expenses PAID</u>	<u>Place</u>	<u>Subject</u>	<u>Attendees</u>
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____
_____	_____	_____	_____	_____

**\_\_\_\_ (H) MISCELLANEOUS TRANSACTIONS** (e.g., institution of benefit plans (e.g. Medical, Group-Term Life, Disability, Employee Expense Reimbursement Accountability), real estate or equipment leases, amendments to the Articles of Incorporation or Regulations, fiscal year changes, statutory agent changes, change of business address, charitable contributions, directors' fees, membership dues, reimbursement of expenses, etc.) Please give important details (e.g. date, amounts, etc.).

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**\_\_\_\_ (I) No change in Officers and/or Directors (check if applicable).**

**\_\_\_\_ (J) If (I), above, not checked, then please list Officers and/or Directors.**

President: \_\_\_\_\_ Secretary: \_\_\_\_\_  
 Vice-President: \_\_\_\_\_ Treasurer: \_\_\_\_\_  
 Vice-President: \_\_\_\_\_ Other (if any): \_\_\_\_\_  
 Directors: \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

## **XVII. FINDING & RETAINING QUALITY EMPLOYEES**

### **A. Hiring**

1. Soliciting Applicants
2. Employment Applications/Interviews
3. Releases
4. Applicant Testing

### **B. Employment Policies**

1. Wage and Hour Considerations / Overtime
2. Written Policies
3. Workplace Harassment
4. Employee Handbook Provisions
5. Performance Appraisals
6. Record Keeping—OSHA, Personnel Files, Employee Medical Records and Forms I-9.

### **C. Termination of Employment**

1. Contract Issues
2. Promissory Estoppel
3. Unlawful Practices
4. Just Cause Discharge
5. The Termination Interview

### **Notes**

## **XVIII. DESIGNING THE "RIGHT" RETIREMENT PLAN FOR YOUR PRACTICE**

- A. Deadline For Updating Plans
- B. Protection Of Retirement Plan Assets From Creditors
- C. Entity Considerations
- D. Social Security Integration
- E. Distribution Rules
- F. Compensation Limits
- G. Eligibility and Vesting
- H. Types of Qualified Plans
  - 1. Defined Contribution Plans
  - 2. Profit-Sharing Plans
  - 3. Cross Tested Profit-Sharing Plans
  - 4. 401(k) Plans
  - 5. 401(k) Plan Integrated with Social Security at Social Security Taxable Wage Base.
  - 6. Money Purchase and Target Benefit Pension Plans — The Old Days!
  - 7. Defined Benefit Pension Plans
  - 8. Cash Balance Plans
- I. Employee Census
- J. A Final Thought on Retirement Plans

### **Notes**

## **XIX. REVIEW OF FRINGE BENEFITS & BUSINESS DEDUCTIONS**

- A. Fringe Benefits
  - 1. Accident and Health Plans
    - a. Traditional Plans
      - (i) Benefits
      - (ii) Costs
    - b. Medical Reimbursement Plans
    - c. HSAs
  - 2. Long-Term Care Plans
  - 3. Disability Income Plans
  - 4. Group Term-Life Insurance
  - 5. Dependent Care Assistance Plans
  - 6. Achievement Award Plans
  - 7. Education Assistance Plans
  - 8. Cafeteria Plans
  - 9. Summary Plan Descriptions
- B. Business Deductions
  - 1. Entertainment and Meal Expenses
  - 2. Expense Reimbursement Plans
  - 3. Record Keeping Requirements
  - 4. Automobile Expenses
  - 5. Purchasing an Automobile
  - 6. Leasing an Automobile
  - 7. Deductible Travel Expenses

Figure 19-1

Figure 19-2

### **Notes**

**Figure 19-1**  
**COMPARISON OF TAX-QUALIFIED**  
**FRINGE BENEFIT PLANS**

PLAN ELEMENTS	GROUP TERM LIFE INSURANCE IRC §79	DEPENDENT CARE ASSISTANCE IRC §129	EDUCATIONAL ASSISTANCE IRC §127	HEALTH INSURANCE IRC §§105 & 106	HEALTH BENEFITS SELF-INSURED IRC §105(h)
1. Excludable Employees:					
(a) Service Less Than —	3 Years	1 Year	None	Any	3 Years
(b) Union Coverage	Yes	Yes	Yes	Yes	Yes
(c) Part-Time or Seasonal	Yes	No	No	Yes	Yes
	(20 hours per week/ five months per year)				(25-35 hours per week/ 9 months per year)
(d) Under Age —	None	21 Years	None	Any	25 Years
2. Discrimination Testing:	(i) 70% of all employees; or	Average benefits to non-highly compensated employees are at least 55% of highly compensated employee benefits and no more than 25% of total benefits go to 5% owners, their spouses and dependents.	No more than 5% of the total benefits paid to 5% owners, their spouse and dependents.	N/A	(i) 70% or more of all employees receive benefits; or
	(ii) 85% of participants are not <u>key employees</u> .  plus special rules for employees with less than 10 employees.				(ii) 80% of <u>eligible employees receive benefits if 70% of all employees are eligible</u> .

**Figure 19-2**

<b>PLAN ELEMENTS</b>	<b>GROUP TERM LIFE INSURANCE IRC §79</b>	<b>DEPENDENT CARE ASSISTANCE IRC §129</b>	<b>EDUCATIONAL ASSISTANCE IRC §127</b>	<b>HEALTH INSURANCE IRC §§105 &amp; 106</b>	<b>HEALTH BENEFITS SELF-INSURED IRC §105(h)</b>
<p>3. Penalty for Discrimination as to:</p> <p>(a) Benefits</p> <p>(b) Coverage</p>	<p>Key employees receive no exclusion; key employees include in income the higher of actual premium or table amount in regulations.</p> <p>Key employees receive no exclusion; key employees include in income the higher of actual premium or table amount in regulations.</p>	<p>Highly compensated employee takes entire benefit into income.</p>	<p>Highly compensated employee takes benefits into income.</p>	<p>N/A</p> <p>N/A</p>	<p>Highly compensated employees take into income the excess reimbursements they receive over the non-highly compensated employees benefits.</p> <p>Highly compensated employees take into income a portion of their reimbursement multiplied by a ratio in which all highly compensated employee reimbursements bears to total benefits paid under the plan.</p>
<p>4. Maximum Tax Free Benefit if Plan Non-Discriminatory:</p>	<p>\$50,000.00 term life insurance policy</p>	<p>\$5,000.00</p>	<p>\$5,250.00</p>	<p>N/A</p>	<p>N/A</p>

## Figure 19-2

### **EXPENSE REIMBURSEMENT POLICY EXAMPLES**

#### EXAMPLE I.

- A. Facts: Specialist entertains referring doctor and has a specific business discussion regarding a particular patient.
- B. Result:
1. Practice: The expense is tax-deductible under IRC Section 162 and Section 274. Accountable plan rules apply under Reg. 1.62-2(c)(2).
  2. Specialist: The expense is not includable in income and not reportable as wages on Form W-2. Reg. 1.62-2(c)(4).

#### EXAMPLE II.

- A. Facts: Specialist takes referring doctor to dinner, sporting event or entertainment without significant business discussion, before or after, for marketing purposes or for purposes of goodwill, e.g., appreciation of past business.
- B. Result:
1. Practice: The expense is not tax-deductible under IRC Section 162 or Section 274. Expense deductible as compensation if expense is considered compensation to specialist. If expense is not compensation to specialist, at practice's option, expense not deductible as compensation to practice. IRC Section 274(e)(3).
  2. Specialist: The expense is or is not compensation to specialist at option of practice. IRC Section 274(e)(3).

#### EXAMPLE III.

- A. Facts: Specialist gives certain tickets to sporting or entertainment event to referring doctor.
- B. Result:
1. Practice: The expense is not tax-deductible under IRC Section 162 or Section 274. Expense is deductible up to \$25.00 as a business gift. Reg. 1.274-2(b)(1)(iii)(b)(2) and 1.274-3(a).

## Figure 19-2

2. Specialist: The expense is or is not compensation to specialist at option of practice. IRC Section 274(e)(3).

### EXAMPLE IV.

A. Facts: The expense otherwise deductible under IRC Section 162 and Section 274 not authorized for payment by the practice. Specialist pays expense personally.

B. Result:

1. Practice: Not applicable.

2. Specialist: Specialist can deduct expense personally, two percent over adjusted gross income. IRC Section 67(a).

### EXAMPLE V.

A. Facts: Practice provides sports tickets to specialist for family use and specialist uses sports tickets for personal purposes.

B. Result:

1. Practice: The expense is not tax-deductible to practice and would be considered as a dividend if more than the de minimis under IRC Section 132-6(c)(1) and (2). De minimis means not more than occasional.

2. Specialist: The expense is includable as income to practice owner/specialist under Reg. 1.61-9, unless de minimis.

## **XX. DESIGNING, RELOCATING OR ESTABLISHING THE PRACTICE FACILITY**

### **A. Relocating the Practice**

1. Facility is Too Small
2. Facility was Improperly Designed
3. Facility and/or Building is Aged and Worn Out
4. Community and/or Patient Demographics has Changed
5. Practice Facility is being Downsized
6. Rental Increases
7. Flood, Fire or other Catastrophes
8. Facility is Too Expensive as a Percentage of Practice Revenues
9. You had Planned to Relocate the Practice at a Future Date
10. You Initially Established a Low Cost Practice Facility to Start Your Practice in Order to Keep Overhead Low.

### **B. The Practice Facility**

### **C. Dental Equipment**

### **D. Dental Supplies**

### **E. Facility Design**

### **F. Contracts**

### **G. Lease Versus Purchase**

Figure 20-1

Figure 20-8

Figure 20-9

Figure 20-10

Figure 20-11

Figure 20-12

## **Notes**

**Figure 20-1**

**CONSIDERATIONS FOR DESIGNING, RELOCATING  
OR ESTABLISHING THE PRACTICE FACILITY**

1. \_\_\_\_\_ Develop a practice/business plan.
2. \_\_\_\_\_ Select the community where you will practice.
3. \_\_\_\_\_ Select advisory team.
4. \_\_\_\_\_ Select your dental dealer and determine the feasibility of available suites.
5. \_\_\_\_\_ Select location and building.
6. \_\_\_\_\_ Sketch rough plan of the layout of your suite.
7. \_\_\_\_\_ Determine traffic flow for practice facility.
8. \_\_\_\_\_ Determine operating concept (rear, side or over the patient delivery).
9. \_\_\_\_\_ Design preliminary floor plan.
10. \_\_\_\_\_ Review and negotiate lease/real estate.
11. \_\_\_\_\_ Furnish exact specifications of dental equipment to contractor or architect.
12. \_\_\_\_\_ Complete final facility design (plumbing, electrical, carpentry, reflected ceiling grid and cabinetry).
13. \_\_\_\_\_ Obtain costs from contractors and tradespersons.
14. \_\_\_\_\_ Arrange for financing and establish relationship with lender(s).
15. \_\_\_\_\_ Select entity in which to practice (e.g., C corporation, S corporation, sole proprietorship, etc.).
16. \_\_\_\_\_ Sign lease/acquire real estate.
17. \_\_\_\_\_ Purchase dental equipment.
18. \_\_\_\_\_ Have practice telephone number listed.
19. \_\_\_\_\_ Obtain permits and licenses.
20. \_\_\_\_\_ Select your interior decorator and decorating concept.
21. \_\_\_\_\_ Select and purchase furnishings.

**Figure 20-1**

- 22. \_\_\_\_\_ Purchase dental supplies and instruments.
- 23. \_\_\_\_\_ Order supplies other than dental.
- 24. \_\_\_\_\_ Select and purchase practice recordkeeping system.
- 25. \_\_\_\_\_ Order stationery.
- 26. \_\_\_\_\_ Develop employee handbook.
- 27. \_\_\_\_\_ Run ad for staff—interview, select and train.
- 28. \_\_\_\_\_ Adopt and/or review fee schedule.
- 29. \_\_\_\_\_ Determine your insurance plans.
- 30. \_\_\_\_\_ Adopt collection and payment plans.
- 31. \_\_\_\_\_ Select laboratory.
- 32. \_\_\_\_\_ Determine opening date and make specific arrangements for complete installation of dental equipment and furnishings.
- 33. \_\_\_\_\_ Make arrangements for utilities and installation of telephone systems.
- 34. \_\_\_\_\_ Establish relationship with pharmacies, area hospitals and physicians.
- 35. \_\_\_\_\_ Begin publication subscriptions to your practice address.
- 36. \_\_\_\_\_ Make arrangements for maintenance service and disposal of hazardous wastes.
- 37. \_\_\_\_\_ Make arrangements for uniform and linen service.
- 38. \_\_\_\_\_ Meet leading civic, school and religious leaders.
- 39. \_\_\_\_\_ Meet colleagues in the area.

**OTHER CONSIDERATIONS.**

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Figure 20-8

**COORDINATION OF EFFORTS FOR RELOCATION  
OR ESTABLISHMENT OF PRACTICE FACILITY**



**Figure 20-9**

**ESTABLISHING OR RELOCATING THE DENTAL PRACTICE**

- I. Prepare Personal Budget and Financial Statement Which Will Delineate Income Requirements — Monthly/Yearly**
- II. Establishing the Practice Costs**
  - A. Dental Equipment, Office Equipment, Furniture and Technology
  - B. Dental Supplies, Instruments and Office Supplies
  - C. Leasehold Improvements/Remodeling Charges
    - 1. Plumbing
    - 2. Electrical
    - 3. Carpentry
    - 4. Decorating
    - 5. Painting, Wall Covering, Floor Covering, Ceilings
    - 6. Cabinetry — Non-Dental Equipment
    - \* Cost Segregation Study
  - D. Lease Versus Building Ownership — New Versus Existing Building — Single Tenant Versus Multiple Tenants — Lease Terms and Provisions
  - E. Total Costs
- III. Complete Demographic Analysis**
  - A. Income Study
  - B. Industry Study
  - C. Number of Dentists to Population
  - D. Access to Specialties
  - E. Short, Medium and Long Range Demographic Determination
- IV. Revenue Projection — Patients and Patient Charges**
  - A. Realistically Assess the Number of New Patients Per Month/Year to Your Practice

## Figure 20-9

- B. Determine How Many New Patients Per Month/Year That Are Necessary To Cover Your Costs
  - C. Assess Monthly/Yearly Fees Per Patient — New Patient Exam Fees
  - D. Determine Procedures Performed Versus Referred
  - E. Assess How the Practice Will Be Paid — Fee For Service, Insurance, Reduced Fees
  - F. Assess Collection Percentage and When the Practice Will Be Paid
- V. Determine Lending Requirements / Availability**
- A. Dental Lending Versus Commercial Bank
  - B. Interest
  - C. Loan Structure
  - D. Term of Loan
  - E. Governmental Loans — SBA, etc.
  - F. Determine Working Capital Requirements (e.g., the First Four Months — Line of Credit)
- VI. Determine Entity Selection for Practice and Real Estate, If Applicable**
- A. Sole Proprietorship
  - B. C-Corporation
  - C. S-Corporation
  - D. Limited Liability Company
  - E. Partnership
- VII. Prepare Strategic Plan — Prepare 5-Year Budget — First 2 Years By Month; Then 10, 15, 20 Years. This Shows Necessity for Mission and Vision Statements**
- VIII. Determine Additional Income Requirements**
- IX. Project Analysis and Completion Dates — Sign Lease / Form Entity / Obtain Financing. What Else Do I Need To Do? Hire Staff?**
- X. Opening — Systems In Place!**

**Figure 20-10**  
**COST EXAMPLE**

<u>Cost Categories</u>	<u>Costs</u>
1. Dental Equipment, Office Equipment, Furniture and Technology.....	\$ 100,000
2. Dental Supplies, Instruments and Office Supplies .....	\$ 20,000
3. Leasehold Improvements / Remodeling Charges — 1,200 Square Feet @ \$100 Per Square Foot.....	\$ 120,000
4. Working Capital Needs for First Four Months.....	<u>\$ 60,000</u>
5. Total:.....	\$ 300,000
6. 9% Approximate Monthly Loan Payment @ 7 Years.....	\$ 4,827/month \$57,921/year
9% Approximate Monthly Loan Payment @ 10 Years.....	\$ 3,800/month \$45,603/year

**Figure 20-11**  
**REVENUE PROJECTION**

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
1. New Patients/Month .....	10	20	25	30	35
2. Annualized.....	<u>x 12</u>	<u>x 12</u>	<u>x 12</u>	<u>x 12</u>	<u>x 12</u>
3. Yearly Patients.....	120	240	300	360	420
4. Less Reduction of Patients at 15% Per Year .....		<u>102</u>	<u>291</u>	<u>502</u>	<u>733</u>
5. Total Patients.....	120	342	591	862	1,153
6. Average Patient Value .....	<u>x \$ 500</u>	<u>x \$ 525</u>	<u>x \$ 550</u>	<u>x \$ 580</u>	<u>x \$ 610</u>
7. Yearly Production.....	\$ 60,000	\$179,550	\$325,050	\$499,960	\$703,330
8. Estimated Collection Percentage Each Year.....	<u>x 97%</u>	<u>x 97%</u>	<u>x 97%</u>	<u>x 97%</u>	<u>x 97%</u>
9. Estimated Collections	\$ 58,200	\$174,164	\$315,299	\$484,961	\$682,230

Assumptions:

1. I will need another job.
2. Fees increase at approximately 5%/year.
3. I need sufficient new patients to complete this project.

**Figure 20-12**  
**FIRST YEAR BUDGET**

	<b>Month (Budget Each Month Separately)</b>	<b>Year</b>
1. Revenue .....	\$4,850	\$58,200
2. First Year Expenses:		
a. Rent And Occupancy Costs .....	\$2,000	\$24,000
b. Supplies (Dental And Office) .....	1,940	23,280
c. Salaries and Responsibly Related Employee Expenses .....	3,000	36,000
d. Laboratory Expense .....	1,940	23,280
e. Marketing .....	500	6,000
f. Insurances .....	300	3,600
g. Telephone / MIS .....	200	2,400
h. Other Miscellaneous Expense Categories .....	<u>500</u>	<u>6,000</u>
i. Subtotal: .....	\$10,380	\$124,560
j. Owner Profit .....		<\$ 66,360>
k. Retirement Plan Contributions .....		< ? >
l. Subtotal: .....		<\$ 66,360>
m. Loan Payment .....		<\$ <u>57,921</u> >
3. Net Income / Loss .....		<\$ 124,281>

## **XXI. IMPLEMENTING AND UPDATING YOUR STRATEGIC PRACTICE PLAN**

- A. Mission or Continuing Purpose Statement
- B. Goals and Objectives to Correspond to Mission Statement and Your Personal Goals
- C. The Three Financial Tools
  - 1. Balance Sheet
  - 2. Cash Budget
  - 3. Financial Statement
- D. Environmental Analysis
  - 1. External Factors(s)
    - a. The Economy
    - b. Environmental Factors such as OSHA Regulations, State Dental Board Regulations, etc.
    - c. The Profitability of Other Practices Throughout the Country as Compared to Yours.
    - d. The State of Technology of Dentistry or Your Specialty Versus Your Practice
    - e. Competition
    - f. Market Demand for Dental or Specialty Services
  - 2. Internal Factors
    - a. Patient Mix
    - b. Procedures Performed
    - c. Financial Systems
    - d. Hygiene
    - e. Current Location Assessment and Necessity of Future Relocation
    - f. Scheduling
    - g. Marketing
    - h. Operating Expense Level

- i. Potential of Practice
- j. Collections
- k. Personnel
- l. Productivity
- m. Appearance of Practice Facility
- n. Insurance Claims Processing
- o. Ability to Diagnose
- p. Records Maintenance and Charting
- q. Days and Hours Worked
- r. Management Efficiency
- s. Cash Flow Position
- t. Desired Owner Compensation

E. Advisory Team — No Particular Order

- 1. Accountant
- 2. Attorney
- 3. Practice Management Advisor
- 4. Dental Dealer
- 5. Banker
- 6. Laboratory Technician
- 7. Broker
- 8. Financial Planner
- 9. Investment Advisor
- 10. Insurance Advisors

F. Borrowing

- 1. Introduction and Request for Funds
- 2. Resume' of Experience and Background

3. Business History
  4. Strategic Practice Plan, inclusive of Yearly Balance Sheets, Cash Budgets and Income Statements.
  5. Previous Yearly Balance Sheets, Cash Budgets and Financial Statements for Past Five Calendar or Fiscal Years and Year to Date.
  6. Federal Income Tax Returns for the Past Five Years, Practice and Personal.
  7. Personal Financial Statement
  8. List of Collateral
  9. List of References
  10. Brochures, Specifications or Designation of Assets, e.g., what you wish to acquire with the loan proceeds.
- G. Annual Legal Audit
1. Practice Tax Planning
  2. Practice Succession Plan
  3. Employment Matters
  4. Retirement Plan(s)
  5. Facility Lease and Building Ownership
  6. Contracting Practices
  7. Insurance
  8. Maintenance of Corporate Records
  9. Individual and Estate Planning Considerations
  10. Strategic Practice Plan

Figure 21-1

**Notes**

**Figure 21-1**  
**THE STRATEGIC PRACTICE PLAN**

1. The Practice Mission
2. Practice Objectives
3. Financial Analysis
4. Practice Analysis
  - A. External Factors, e.g., Patient Demographics, Competition
  - B. Internal Factors, e.g., Systems
5. Practice Opportunities, Threats, Strengths, Weaknesses — Assess Your Practice Identity
6. Decision Alternatives — Time and Money
  - A. Defensive
  - B. Neutral
  - C. Aggressive
7. Compare Decision Alternatives and Make Decisions
8. Organizational Structure and Management — e.g., One or More Doctor(s)?
9. Implementation of Decisions
10. Evaluation and Control

## **XXII. IMPLEMENTING EFFECTIVE MEASUREMENTS & CONTROLS**

- A. What are You Trying to Manage?
- B. Managing Your Systems
- C. To What Extent Do You Need Practice Management?

Figure 22-1

Figure 22-3

### **Notes**

**Figure 22-1**  
**CATEGORIES TO MONITOR**

1. Practice Production/Collections
2. Doctor Production/Collections
3. Doctor Productions/Collections per Hour
4. Hygiene Production/Collections per Hour
5. Hygiene Production/Collections per Hour
6. Collection Percentage to Production
7. Total Accounts Receivable
8. Accounts Receivable Percentage to Production
9. Accounts Receivable Report; 30, 60, 90, over 120 Days
10. New Patients — Referral
11. New Patients — Outside Marketing
12. Dollar Amount Diagnosed
13. Dollar Amount Accepted
14. Case Acceptance Rate
15. Percentage of Practice in Hygiene, if Applicable

**Figure 22-2**  
**PRACTICE SYSTEMS**

1. Quality of Services
2. Production
3. Staffing — Work Group Effectiveness, Responsibilities, Compensation, including Bonuses, Fringe Benefits and Retirement Planning Contributions
4. Scheduling
5. Financial - Expense Management, Overhead Control and accounts Receivable
6. Marketing — Referrals, External Marketing
7. Hygiene and Recall Systems
8. Method of Patient Payment - Fee for Service, Insurance, Managed Care, Capitalization
9. Patient Records Management
10. Consultation and Diagnosis
11. Facility Use

### **XXIII. MANAGED CARE CONTRACTS — WHAT THE ECONOMICS & PROVISIONS MEAN**

- A. Required Documents
- B. Terms of and Parties to the Agreement
- C. Definitions of Terms
- D. Compensation
- E. Modifications to the Agreement
- F. Liability Insurance
- G. Patient Acceptance
- H. Most-Favored Nation
- I. Referral Restrictions
- J. Emergency Care
- K. Utilization Review Procedures
- L. License to Practice Dentistry
- M. Peer Review
- N. Grievance System
- O. Independent Contractor
- P. Hold Harmless/Indemnification
- Q. Non-Competition
- R. Liquidated Damages
- S. Assignment/Transfer
- T. Termination

- U. Arbitration
- V. Jurisdiction and Venue
- W. Entire Agreement
- X. Impact of Managed Care on Your Practice

Figure 23-1

**Notes**

**Figure 23-1**

**THE IMPACT OF REDUCED FEE AND MANAGED CARE PLANS**

Revenue	\$1,000,000
Overhead	<u>&lt;\$600,000&gt;</u>
Overhead Without Reduced Fees	<\$600,000>
Owner Profit	\$400,000

Reduced Fee Plans

		@ 50%		@100%	
@ 30% Revenue	x 30%	Revenue	50%	Revenue	100%
Subtotal	<u>\$300,000</u>		<u>\$500,000</u>		<u>\$1,000,000</u>
Reduced Fees Percentage	x 20%		x 20%		x 20%
Reduced Revenue	<u>&lt;\$60,000&gt;</u>		<u>&lt;\$100,000&gt;</u>		<u>&lt;\$200,000&gt;</u>

Revenue	\$1,000,000	\$1,000,000	\$1,000,000
Reduced Revenue	<u>&lt;\$60,000&gt;</u>	<u>&lt;\$100,000&gt;</u>	<u>&lt;\$200,000&gt;</u>
Revised Revenue	\$940,000	\$900,000	\$800,000
Overhead	<u>&lt;\$600,000&gt;</u>	<u>&lt;\$600,000&gt;</u>	<u>&lt;\$600,000&gt;</u>
Revised Owner Profit	\$340,000	\$300,000	\$200,000

Revised Owner Profit as a Percentage of Revenue	$\frac{\$340,000}{\$1,000,000} = 34\%$	Profit	$\frac{\$300,000}{\$1,000,000} = 30\%$	Profit	$\frac{\$200,000}{\$1,000,000} = 20\%$	Profit
	or \$60,000	Reduction of Profit	or \$100,000	Reduction of Profit	or \$200,000	Reduction of Profit — 50% Profit Reduction

## **XXIV. PROTECTING YOUR ASSETS**

- A. Asset Protection Planning Goals — Let's Go Offshore and Really Get In Trouble!
- B. Pitfalls In Asset Protection Planning
- C. Asset Protection Planning
- D. Methods of Asset Protection Planning
  - 1. Use of Insurance
  - 2. Entity Selection
  - 3. How Title to Assets are Held
  - 4. Protection of Retirement Plan Assets from Creditors

### **Notes**

## **XXV. PLANNING YOUR ESTATE — AVOIDING PROBATE & FAMILY FIGHTS**

- A. Economic Growth and Tax Relief Reconciliation Act of 2001 — Where Are We Now?
- B. Estate Inventory
- C. Applicable Exclusion Amount
- D. Effective Use of the Applicable Exclusion Amount and Marital Deduction
- E. Gifts
- F. Gifts Qualifying For the Annual Exclusion
- G. Gifts to Custodianship Accounts
- H. Irrevocable Crummey Trusts
- I. Section 2503(b) and 2503(c) Trusts
- J. Unlimited Exclusions for Gifts for Tuition and Medical Care
- K. Gifts to Spouses — The Gift Tax Marital Deduction
- L. Gift and Estate Tax Charitable Deduction
- M. Liquidity Planning
- N. Living Trusts to Avoid Probate
- O. Your Will

### **Notes**

## **XXVI. FINAL THOUGHTS & SUMMARY FOR THE FUTURE**

At some point in the future, you will leave your practice either voluntarily or involuntarily. When that time comes, you will want to maximize your practice value. In order to accomplish this, consider the following.

1. Operate and continually update your practice in accordance with a strategic practice or business plan, coupled with effective management systems.
2. Adopt and fund a tax-qualified retirement plan as early in your career as possible.
3. Develop your practice succession plan 15 years prior to anticipated retirement.
4. Seek assistance from your advisors to establish or relocate the practice.
5. Carefully consider the entity in which you will operate your practice, e.g., sole proprietorship, professional S or C corporation or a limited liability company.
6. Determine whether you will own or lease the practice facility. Set goals for the acquisition of the real estate in which your practice is located, e.g., year of purchase, financial requirements, etc.
7. Consider the circumstances whereby you would hire an associate.
8. Maintain written employment practices, including the use of employee handbooks.
9. Understand the value of your practice.
10. At the time you decide to transfer a portion or all of your practice, determine a time frame and structure for such transfer, how you wish to be paid, etc.
11. Prepare your personal financial and estate planning long before your retirement in the event of a contingency.
12. Commit yourself to the process of business planning. Your practice is not only a professional entity, it is also a business entity and should be treated as such.