

# Entering Practice — Make the First Choice the Right Choice!

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# Practice Entry Choices

- Associates Employment.
  - Private.
  - Corporate.
- Acquire a Practice.
- Become Associate With Later Purchase of Practice.
- Co-Ownership.
- Solo Group Arrangement.
- Establish a Practice.

# Advisory Team

- Assemble Early, Then Put Them On Hold Until You Need Them!
- Understand How all Advisors are Paid.
- Consider Signing Bonus for Co-Ownership.
- Locating Opportunities — How and Who?
- Evaluating Multiple Opportunities, But Two Choices — Apples and Oranges!

# Valuations in a Complete or Fractional Sale — Verification Analysis

- Purchaser Will Not Want to Incur a Pay Cut/Reasonable Compensation Rate.
- Pay the Lender(s).
- Pay Your Operating Expenses.
- Within a Measured Period of Time.
- Accountant's Confirmation of the Valuation Report.

## Valuations (cont'd)

- Accounts Receivable Versus Prepaid Contracts in Orthodontic Practices.
- What Percentage of Patients Will Stay and Referral Sources Refer?
- What Percentage of Last Year's Collections Should Be Used to Value the Practice If I Expect Some Reduction of Patients or Referral Sources?

## Example — Capitalization of Earnings

Most Recent Year Collections	\$1,000,000	\$1,000,000	\$1,000,000
Owner Profit Percentage	<u>      x 38%</u>	<u>      x 40%</u>	<u>      x 42%</u>
Available Profit	\$380,000	\$400,000	\$420,000
New Owner Compensation at 27.5 %	< <u>\$270,500</u> >	< <u>\$270,500</u> >	< <u>\$270,500</u> >
Available Profit to Capitalize at 20% Rate	\$109,500	\$129,500	\$149,500
20% Capitalization Rate	<u>      ÷ .2</u>	<u>      ÷ .2</u>	<u>      ÷ .2</u>
Estimated FMV of the Practice	\$547,500	\$647,500	\$747,500

Small Increases in Profitability  
Have Significant Effects Upon Practice Value

# Associate Employment

- Working For a Corporate Practice.
- Associate Needs Analysis — If all Variable Costs are Covered and Contribution to Fixed Costs — Go!
- Worker Classification — You Are an Employee!

## Associate Employment (cont'd)

### ➤ Important Considerations.

- What do I want and where?
- Full versus part-time, associateship leading to ownership, private versus corporate, what's available where I want to live in light of my school debt?
- Associate needs analysis.
- Associate interview questions.
- Personality profiling tools.
- The spouse and/or other family members in the practice.
- Length of associateship.
- Anticipating ownership — preparation of practice valuation/valuation date, detailed letter of understanding, ownership agreements.
- Worker classification.

## Associate Employment (cont'd)

- Contract Provisions.
  - Restrictive covenants.
  - Associate compensation.
  - Discretionary bonuses.
  - Benefits, direct business expenses and insurances.
  - Vacations and other time-off.
  - Termination of employment.

## Figure 9-2 Effect of Dental Laboratory Costs On Associate Compensation

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### Figure 9-2A 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:	<u>\$29,010</u>
4.	Compensation Percentage:	<u>x 33%</u>
5.	Monthly Associate Compensation:	\$ 9,573

**Figure 9-2B**  
**Production, Times Percentage, Less Percentage Lab**

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

## Figure 9-2C Production, Times Percentage

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

**Figure 9-2D**  
**Production, Less 1/2 Lab, Times Higher Percentage**

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

**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.

## Example — Associate Needs Analysis

### ➤ Assumptions.

- Associate Will Work Full-Time — 32 Hours Per Week and Will Earn the Greater of \$120,000 (Includes Payroll Taxes and Benefits) Per Year or 30% of Adjusted Production, Including Hygiene Exam Fees, But Not X Rays or Hygiene Services.
- Assistant Will Cost \$35,000 Per Year, Inclusive of Compensation, Payroll Taxes and Benefits.
- Additional Equipment, Remodeling, Supply and Laboratory Costs, Payable Over 7 Years, Inclusive of Interest of \$10,000.

### ➤ Costs and Required Collections.

■ Associate .....	\$	120,000
■ Assistant .....	\$	35,000
■ Capital Expenditures, Supplies and Lab .....	\$	10,000
■ Marketing and Advertising Costs .....	\$	10,000
■ Estimated Yearly Associate Cost .....	\$	175,000
■ Divided by 12 Months .....		<u>          </u> ÷ 12
■ Minimum Monthly Collections Before Administrative Profit .....	\$	14,583

## Example — Associate Needs Analysis

### ➤ Analysis.

- Practice Should Earn a 10 - 15% Administrative Profit On the Associate.
- Consider Mentorship Time, New Patient Flow, Facility Use, Practice Systems, Reduction of Practice Owner's Collections.
- How Many Active Patients Are There in the Practice?
- Why is the Associate Being Hired?
- Note, \$120,000 is 30% of \$400,000.
- Business Rule — If Variable Costs are Covered and Associate Contributes to Fixed Costs, the Decision to Hire is Economically Sound.

# Acquire a Practice

- Will the Referral Sources Continue to Refer and Patients Stay?
- Letters of Intent — Provisions — Are they Necessary?
  - Earnest Money Deposit — Dollar Amount, Promissory Note or No Deposit and Practice is Not Taken Off the Market?
  - Agreements are Prepared from the Letter of Intent.

## Acquire a Practice (cont'd)

- Family Practices.
  - Treat Like Third Party Transactions.
  - If the Practice was Formed Prior to August 10, 1993, Asset Sale is Unavailable — The Anti-Churning Rules.
- Financing — From the Lawyer's Perspective.
- Contingent Sales.
- Due Diligence and Making a Decision.
- How Long Should the Selling Dentist or Specialist Remain Employed With Your Practice?

# Become Associate With Later Sale of Practice

- Associate, Then Purchase in One – Three Years.
- Two Contracts.
- Earnest Money Deposit in Form of Promissory Note.
- Reverse Earnest Money Deposit.
- One Year Walk Away.
- Restrictive Covenant and Its Buy-Out.
- Continued Employment of Selling Dentist or Specialist as Employee — At Your Discretion?
- Don't Forget the Lease and Real Estate.
- What About Financing and When Is the Process Started?

# Co-Ownership

- Associate Employment, Confidentiality Letter and the Valuation.
- The Three Categories — The Agreements are the Net Underneath the Cliff.
  - The Buy-In.
    - ❖ Will or Should Dr. Junior Incur Pay Reduction?
    - ❖ Financing?
  - Operational Issues.
    - ❖ Allocation of Compensation — Always Use an Example and Monitor.
    - ❖ Decision-Making Control — Unanimous Decisions vs. Founder's Rights.
    - ❖ Employment of Family Members — Great for Retirement Plan Contributions / Difficult for Relationships.
    - ❖ Debt.

## Co-Ownership (cont'd)

- The Buy-Out — Believe it or Not, the Most Overlooked Category!
  - ❖ Triggering Events — Easy to Get In, Tough to Get Out.
  - ❖ Use of Insurance — Ownership Tracks Business and Tax Structures.
  - ❖ Optional vs. Mandatory Buy-Outs — Most Difficult Aspect of Co-Ownership.
  - ❖ Financing?

## Co-Ownership (cont'd)

- The Three Business and Tax Structures of Co-Ownership.
  - Purchase and Sale of Stock in After-Tax Dollars, Adjusting Tax Neutral Purchase Price for the Tax Detriment of Purchaser Purchasing Stock in After-Tax Dollars with Seller Receiving Capital Gains.
  - Stock Excluding Goodwill, Couple with Compensation Shift for the Buy-In and Corporation's Payment of Deferred Compensation or Purchase of Personal Goodwill for the Buy-Out — the Buy-Out is the Problem!
  - Three Entity Method — Only Works for Practices Formed after August 10, 1993.

## Co-Ownership (cont'd)

- Tax Issues.
  - ❖ Compensation Shifts.
  - ❖ Personal Goodwill — Owners cannot be Subject to Restrictive Covenants with the Practice, the Personal Goodwill Must Be Appraised and Other Difficult Issues.
  - ❖ Internal Revenue Code Section 197, Anti-Churning Rules, Including Examples 17 and 20 of the Ginsburg Treatise.
  - ❖ Example 19 — IRC Reg. 1.197-2(k) Example 19.
  - ❖ Worker Classification.

## Example — Compensation Allocation

- For each consecutive month of the Employment Term, Employee shall be entitled to Basic Salary equal to:
  - the monthly collected revenues attributable to professional dental services rendered to Corporation's Patients by Employee;
  - less fifty percent (50%) of Corporation's fixed overhead expenses (prorated on a monthly basis);
  - less fifty percent (50%) of Corporation's variable overhead expenses (prorated on a monthly basis); and
  - 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.

## Overhead Allocation Chart – 2

Category	Practice Pays Overhead		Pro Rata Overhead	
	Dr. Senior	Dr. Junior	Dr. Senior	Dr. Junior
1. Practice Revenue	\$2,000,000	\$2,000,000	\$2,000,000	\$2,000,000
2. Overhead	-1,200,000	-1,200,000	-1,200,000	-1,200,000
3. Available Compensation	<u>\$ 800,000</u>	<u>800,000</u>	<u>800,000</u>	<u>800,000</u>
4. Doctor Revenue	x .6	x .4	1,200,000	800,000
5. Overhead	<u>N/A</u>	<u>N/A</u>	<u>-600,000</u>	<u>-600,000</u>
6. Doctor Compensation	\$ 480,000	320,000	600,000	200,000
7. Doctor Compensation as Percentage of Available Compensation	<u>\$ 480,000</u> <u>\$ 800,000</u> = 60%	<u>320,000</u> <u>800,000</u> = 40%	<u>600,000</u> <u>800,000</u> = 75%	<u>200,000</u> <u>800,000</u> = 25%
8. Doctor Compensation as a Percentage of Practice Revenue	<u>\$ 480,000</u> <u>\$1,200,000</u> = 40%	<u>320,000</u> <u>800,000</u> = 40%	<u>600,000</u> <u>1,200,000</u> = 50%	<u>200,000</u> <u>800,000</u> = 25%

# Solo Group Arrangements

- What This Is and Why It Makes Sense!
- Separate Practices Resolve the Buy-Out Obligation.
- Tax Deductible Asset Purchase, Except for Family Members and Practices Formed Before August 10, 1993.
- Who Stays and Who Goes if a Dispute?
- The Lease.
- Separate Staff With Some Exceptions.

# Finding and Retaining Quality Employees

- Your Leadership.
- The Seller's Practice, Be Careful of Who You Hire!
- Treat Everyone the Same.
- Wallpaper the Personnel Files.
- Applicant Testing.
- The Importance of Systems.
- Performance Reviews.
- Employee Raises and Bonuses.
- The Front Desk — Employee Theft.
- The Termination Process.
- Providing Health Insurance To You, Your Family and Staff.
- Retirement Plan Design.

# Personal Issues

- Retirement Plans.
- Asset Accumulation and Protection.
- Estate Plans.
- Leadership and Change.

# Establish A Practice

- Cost Analysis.
- At Least 30 Patients per Month and a Job.

# Technology Versus Cost

## Example 1 Technology Versus Cost

- Rule 1:** Retiring dentist should not be spending large sums on technology that may not be used by the purchasing general dentist or specialist.
- Rule 2:** Purchase technology only with sufficient patients in your practice.
- Rule 3:** Have your attorney review contracts for the technology to ensure that you understand what you have agreed to.
- Rule 4:** If you invest in technology and have or plan to have an associate in your practice, limit the associate pool to those dentists or specialists who can or will learn to effectively use and pay for the technology.
- Rule 5:** Partners may allocate technology on the basis of usage.
- Rule 6:** Involve your advisers in the decision making process for technology purchases.
- Rule 7:** Authorize your CPA to calculate your anticipated return on investment.
- Rule 8:** Match the repayment period for the technology to its useful life.

# Forming Your Practice and Real Estate Entities — Which Ones and Why?

- The Practice.
  - S-Corporation.
    - ❖ Distributions.
    - ❖ Double Tax Avoided at Sale of Practice.
    - ❖ Corporate Maintenance.
  - C-Corporations.
    - ❖ Double Tax Issues.
    - ❖ Dividend Problems.
    - ❖ All Income Must Be Distributed or Double Taxed Yearly.
  - Limited Liability Companies.
    - ❖ Check the Box Regulations.
    - ❖ Disregarded Entity Problem.

## Forming Your Practice and Real Estate Entities (cont'd)

- The Practice Real Estate.
  - Limited Liability Company Preferred.
  - S- or C-corporations.
- Sole Proprietorships.
  - Liability Concerns.
  - Simple From a Tax Perspective.

# Summary and Thoughts

**Live Your Dreams,  
Never Quit and  
Do Not Compromise!**