

Entering Practice — Make the First Choice the Right Choice!

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**THIS PROGRAM IS NOT INTENDED TO PROVIDE
SPECIFIC LEGAL OR ACCOUNTING ADVICE**

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.

The sequence and Figure numbers for this program correspond to **Joining And Leaving The Dental Practice**, Second Edition and **Business, Legal And Tax Planning For the Dental Practice**, Third Edition.

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I. PRACTICE ENTRY CHOICES.

- A. Associates Employment.
 - 1. Private.
 - 2. Corporate.
- B. Acquire a Practice.
- C. Become Associate With Later Purchase of Practice.
- D. Co-Ownership.
- E. Solo Group Arrangement.
- F. Establish a Practice.

Attachment:

- Figure 3-1 — Entry Considerations

Figure 3-1
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Entry Considerations

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.

II. ADVISORY TEAM AND EVALUATING OPPORTUNITIES.

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

III. VALUATIONS IN A COMPLETE OR FRACTIONAL SALE — VERIFICATION ANALYSIS.

- A. Purchaser Will Not Want to Incur a Pay Cut/Reasonable Compensation Rate.
- B. Pay the Lender(s).
- C. Pay Your Operating Expenses.
- D. Within a Measured Period of Time.
- E. Accountant's Confirmation of the Valuation Report.
- F. Accounts Receivable Versus Prepaid Contracts in Orthodontic Practices.
- G. What Percentage of Patients Will Stay and Referral Sources Refer?
- H. What Percentage of Last Year's Collections Should Be Used to Value the Practice If I Expect Some Reduction of Patients or Referral Sources?

Attachment:

- Figure 5-3 — Verification Analysis
- Figure 5-7 — Capitalization of Earnings

Figure 5-3
—
Verification Analysis

	<u>No Revenue Decrease</u>	<u>Revenue Decrease of 10%</u>
1. Practice Revenue:	\$1,000,000	\$900,000
2. Proposed Selling Price of the Practice at 65% of Revenue: (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 @ 5%):	<\$110,244>	<\$110,244>
4. Less: Working Capital — Assumes Account Receivables Not Purchased (Yearly Payment of \$60,000, Payable Over Seven Years @ 5%):	<\$10,176>	<\$10,176>
5. Less: Remodeling and Equipment Replacement Costs (Yearly Payment of \$50,000, Payable Over Seven Years @ 5%):	<\$8,480>	<\$9,654> <\$8,480>
6. Practice Operating Expenses @ 60% of Revenue/10% Lab; 6% Supplies:	\$600,000	\$584,000
7. Adjusted Yearly Owner Compensation @ 40% of Revenue/Reduced Revenues: (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)	\$400,000	\$316,000
8. Less: Total of Items 3, 4 & 5:	<\$128,900>	<\$128,900>
9. Yearly Available Compensation for Purchaser:	\$271,100	\$187,100
10. Ratio of Compensation for Purchaser to Average Revenue where Initial Remodeling, Equipment Costs and Working Capital are Considered ($\$271,100/\$187,100 \div \$1,000,000/\$900,000 = 27.11\%/20.78\%$) (Includes Hygiene) :	27.11%	20.78%

11. Ratio of Compensation for Purchaser to Average Revenue where Initial Remodeling, Equipment, and Working Capital Are Not Considered
 (\$400,000/\$316,000, Less: Yearly Payment of the Selling Price of \$110,244 = \$287,750/\$205,756)
 (\$289,756/\$205,756 ÷ \$1,000,000/\$900,000 = 28.98%/22.86%) 28.98% 22.86%

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 for 5 or 7 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?
15. Is the practice located in a "destination" area?

Figure 5-7
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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

IV. ASSOCIATE EMPLOYMENT.

- A. Working For a Corporate Practice.
- B. Associate Needs Analysis — If all Variable Costs are Covered and Contribution to Fixed Costs — Go!
- C. Worker Classification — You Are an Employee!
- D. Important Employment Agreement Provisions vs. The Six Month Letter.
 - 1. Restrictive Covenants — Time, Radius, Non-Solicitation, Confidential Information and Buy-Out.
 - 2. Compensation — The Greater of \$_____ or _____% of Collections or Adjusted Production.
 - 3. Benefits, Insurances and Direct Business Expenses.
 - 4. Termination of Employment — Notice, Cause, License and Cure Periods.
- E. Equity Purchase Provisions.
 - 1. Contained in Employment Agreement.
 - 2. Confidentiality Letter.
 - 3. Letter of Understanding.
 - 4. Preparation of Agreements.

Attachments:

- Figure 9-1 — Associate Compensation
- Figure 9-2 — Effect of Dental Laboratory Costs On Associate Compensation
- Figure 9-3 — Bonus(es)
- Figure 9-4 — Proposal for Employment and Future Ownership
- Figure 9-5 — Associate Needs Analysis
- Figure 9-6 — Associate Interview Questions
- Figure 9-7 — Job Application Release Provision
- Figure 9-8 — Confidentiality Letter
- Figure 9-10 — Worker Classification Chart

Figure 9-1

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 9-2
Effect of Dental Laboratory Costs
On Associate Compensation

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:	\$29,010
4.	Compensation Percentage:	x 33%
5.	Monthly Associate Compensation:	\$ 9,573

Figure 9-2B

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 9-2C

Production, Times Percentage

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

Figure 9-3

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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

PROPOSAL FOR EMPLOYMENT

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:

- (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").

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 a 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 Needs Analysis

A. Assumptions

1. 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.
2. Assistant Will Cost \$35,000 Per Year, Inclusive of Compensation, Payroll Taxes and Benefits.
3. Additional Equipment, Remodeling, Supply and Laboratory Costs, Payable Over 7 Years, Inclusive of Interest of \$10,000.
4. Marketing and Advertising Costs of \$10,000

B. Costs and Required Collections

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

C. Analysis

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

Figure 9-6

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?

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?

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 9-7

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 9-8
—
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]

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 9-10

Worker Classification Chart

Revenue Ruling 87-41	IRS Training Manual — 1996 Determining Worker Classification Status
<ol style="list-style-type: none">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; and20. Right to Terminate.	<ol style="list-style-type: none">1. Behavioral Control;2. Financial Control;3. Relationship of the Parties. <p>* Collectively includes the 20 factors from Revenue Ruling 87-41.</p>

V. ACQUIRE A PRACTICE.

- A. Will the Referral Sources Continue to Refer and Patients Stay?
- B. Letters of Intent — Provisions — Are they Necessary?
 - 1. Earnest Money Deposit — Dollar Amount, Promissory Note or No Deposit and Practice is Not Taken Off the Market?
 - 2. Agreements are Prepared from the Letter of Intent.
- C. Family Practices.
 - 1. Treat Like Third Party Transactions.
 - 2. If the Practice was Formed Prior to August 10, 1993, Asset Sale is Unavailable — The Anti-Churning Rules.
- D. Financing — From the Lawyer's Perspective.
- E. Contingent Sales.
- F. Due Diligence and Making a Decision.
- G. How Long Should the Selling Dentist or Specialist Remain Employed With Your Practice?

Attachment:

- Figure 7-1 — Due Diligence Checklist

Figure 7-1
Due Diligence Checklist¹

*** 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; |

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

- | | | | |
|-------|-------|-------|---|
| _____ | _____ | _____ | *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. |

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.

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. |

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; |

- | | | | |
|-------|-------|-------|--|
| _____ | _____ | _____ | 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; |
| _____ | _____ | _____ | 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; |
| _____ | _____ | _____ | 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.

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.

VI. BECOME ASSOCIATE WITH LATER SALE OF PRACTICE.

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

VII. CO-OWNERSHIP.

- A. Associate Employment, Confidentiality Letter and the Valuation.
- B. The Three Categories — The Agreements are the Net Underneath the Cliff.
 - 1. The Buy-In.
 - a. Will or Should Dr. Junior Incur a Pay Reduction?
 - b. Financing?
 - 2. Operational Issues.
 - a. Allocation of Compensation — Always Use an Example and Monitor.
 - b. Decision-Making Control — Unanimous Decisions vs. Founder's Rights.
 - c. Employment of Family Members — Great for Retirement Plan Contributions / Difficult for Relationships.
 - d. Debt.
 - 3. The Buy-Out — Believe it or Not, the Most Overlooked Category!
 - a. Triggering Events — Easy to Get In, Tough to Get Out.
 - b. Use of Insurance — Ownership Tracks Business and Tax Structures.
 - c. Optional vs. Mandatory Buy-Outs — Most Difficult Aspect of Co-Ownership.
 - d. Financing.
- C. The Three Business and Tax Structures of Co-Ownership.
 - 1. 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.
 - 2. 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!
 - 3. Three Entity Method — Only Works for Practices Formed after August 10, 1993.

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

Attachments:

- Figure 11-10 — Overhead Allocation Chart

Figure 11-10
—
Overhead Allocation Chart

Category	Practice Pays Overhead		Pro Rata Overhead	
	Dr. Senior	Dr. Junior	Dr. Senior	Dr. Junior
1. Practice Revenue	\$1.00	\$1.00	\$1.00	\$1.00
2. Overhead	- .6	- .6	- .6	- .6
3. Available Compensation Percentage	<u>.4</u>	<u>.4</u>	<u>.4</u>	<u>.4</u>
4. Doctor Revenue	x .55	x .45	.55	.45
5. Overhead	N/A	N/A	<u>- .3</u>	<u>- .3</u>
6. Doctor Compensation	.22	.18	.25	.15
7. Doctor Compensation as Percentage of Available Compensation	<u>.22</u> = 55%	<u>.18</u> = 45%	<u>.25</u> = 62.5%	<u>.15</u> = 37.5%
	.4	.45	.4	.4
8. Doctor Compensation as a Percentage of Practice Revenue	<u>.22</u> = 40%	<u>.18</u> = 40%	<u>.25</u> = 45.45%	<u>.15</u> = 33.3%
	.55	.45	.55	.44

VIII. SOLO GROUP ARRANGEMENTS.

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

IX. FINDING AND RETAINING QUALITY EMPLOYEES.

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

X. PERSONAL ISSUES.

- A. Retirement Plans.
- B. Asset Accumulation and Protection.
- C. Estate Plans.
- D. Leadership and Change.

XI. ESTABLISH A PRACTICE.

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

Attachments:

- Figure 20-1 — Considerations for Establishing the Practice Facility
- Figure 20-8 — Coordination of Efforts for Establishing the Practice Facility
- Figure 20-9 — Establishing the Dental Practice
- Figure 20-10 — Cost Example
- Figure 20-11 — Revenue Projection
- Figure 20-12 — First Year Budget

Figure 20-1
—
Considerations for
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.

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
Establishing the Practice Facility**

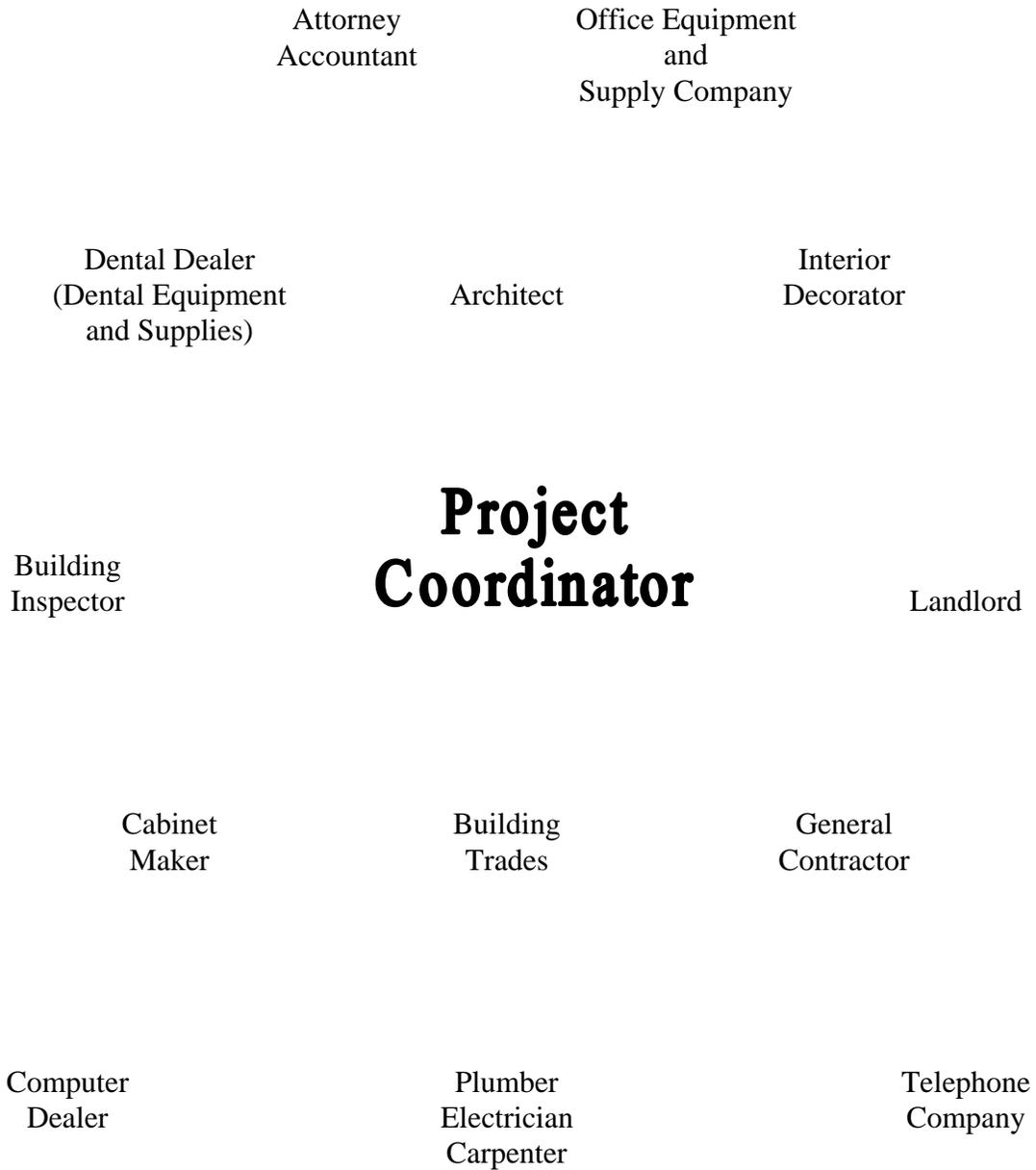


Figure 20-9

Establishing the Dental Practice

A. Prepare Personal Budget and Financial Statement Which Will Delineate Income Requirements — Monthly/Yearly

B. Establishing the Practice Costs

Dental Equipment, Office Equipment, Furniture and Technology

Dental Supplies, Instruments and Office Supplies

Leasehold Improvements/Remodeling Charges

 Plumbing

 Electrical

 Carpentry

 Decorating

 Painting, Wall Covering, Floor Covering, Ceilings

 Cabinetry — Non-Dental Equipment

 * Cost Segregation Study

Lease Versus Building Ownership — New Versus Existing Building — Single Tenant Versus Multiple Tenants — Lease Terms and Provisions

Total Costs

C. Complete Demographic Analysis

Income Study

Industry Study

Number of Dentists to Population

Access to Specialties

Short, Medium and Long Range Demographic Determination

D. Revenue Projection — Patients and Patient Charges

Realistically Assess the Number of New Patients Per Month/Year to Your Practice

Determine How Many New Patients Per Month/Year That Are Necessary To Cover Your Costs

Assess Monthly/Yearly Fees Per Patient — New Patient Exam Fees

Determine Procedures Performed Versus Referred

Assess How the Practice Will Be Paid — Fee For Service, Insurance, Reduced Fees

Assess Collection Percentage and When the Practice Will Be Paid

E. Determine Lending Requirements / Availability

Dental Lending Versus Commercial Bank

Interest

Loan Structure

Term of Loan

Governmental Loans — SBA, etc.

Determine Working Capital Requirements (e.g., the First Four Months — Line of Credit)

F. Determine Entity Selection for Practice and Real Estate, If Applicable

Sole Proprietorship

C-Corporation

S-Corporation

Limited Liability Company

Partnership

G. 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

H. Determine Additional Income Requirements

I. Project Analysis and Completion Dates — Sign Lease / Form Entity / Obtain Financing. What Else Do I Need To Do? Hire Staff?

J. 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	\$ 60,000	
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

*** What Are Interest Rates Now and When Will They Increase?
What Affect?
Should I Change My Decision?**

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>				
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>				
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

	Month (Budget Each Month Separately)	Year
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>

XII. TECHNOLOGY VERSUS COST.

Attachments:

- Example 1 — 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.

XIII. FORMING YOUR PRACTICE AND REAL ESTATE ENTITIES — WHICH ONES AND WHY?

- A. The Practice.
 - 1. S-Corporation.
 - a. Distributions.
 - b. Double Tax Avoided at Sale of Practice.
 - c. Corporate Maintenance.
 - 2. C-Corporations.
 - a. Double Tax Issues.
 - b. Dividend Problems.
 - c. All Income Must Be Distributed or Double Taxed Yearly.
 - 3. Limited Liability Companies.
 - a. Check the Box Regulations.
 - b. Disregarded Entity Problem.
- B. The Practice Real Estate.
 - 1. Limited Liability Company Preferred.
 - 2. S- or C-corporations.
- C. Sole Proprietorships.
 - 1. Liability Concerns.
 - 2. Simple From a Tax Perspective.

XIV. SUMMARY AND THOUGHTS.

Live Your Dreams, Never Quit and Do Not Compromise!