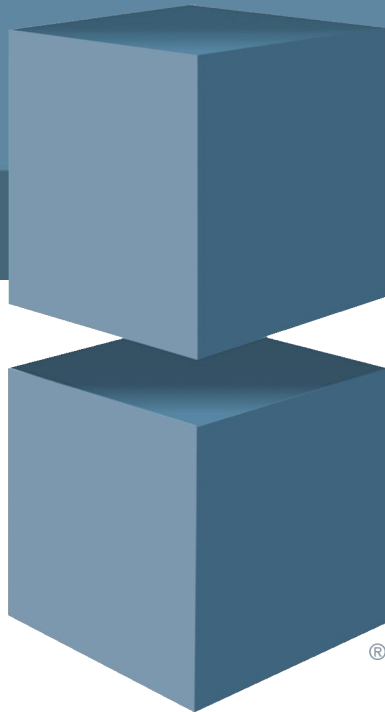


# The Life and Times of a Dental Practice from a Legal and Tax Perspective



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# Who am I and why am I here?

- **Corporate & tax partner at a large firm.**
  - I don't know everything and when we need an expert (e.g., labor law) we have it!
- **Helped a non-selling partner stuck in an S corporation.**
  - With proposed deal, she would have been stuck with substantial “phantom” (non-cash) taxable income.



# Why does this topic matter to you?

- You operate (or one day will operate) a small but sophisticated business.
  - Employees: labor law & tax compliance.
  - Leases/real estate.
  - Health law compliance.
  - Third party payor (insurance) compliance.
  - Your nest egg.



# Who do you need?

- A good accountant.
- A good insurance agent.
- A good business lawyer (esp one who knows taxes).
- A good estate lawyer: is your will in order?
  - What will happen to your practice?
- If you're buying a practice, a good banker.
- If you're selling a practice, a good broker.



# What Will We Discuss?

- Organizing a dental practice: choice of entity.
- Operating a dental practice.
- Buying or selling a dental practice.
- Closing a dental practice.



# Organizing a Dental Practice

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- Are you a sole practitioner or in a shared practice?



# Sole Practitioner: Choice of Entity

- In California:
  - Limited liability company? *No!*
  - Limited liability partnership? *No!*
  - Limited partnership? *No!*
  - General partnership? *No!*
  - C corporation? *No!*
  - S corporation? *Yes!*



# What is an S corporation?

- Regular (e.g., CA) corporation under state law.
  - For dentists, typically a “professional corporation” (see below).
- Makes an “S corporation” election with the IRS (Form 2553).
  - Within 2 ½ months of beginning of the year.
  - Every shareholder must sign.
    - In community property state (CA), spouse **must** sign.
      - *Trap for the unwary!*





# What is an S corporation? (Cont'd)

- What if you accidentally blow the S election?
  - There is no easy fix.
  - Means corporation is a regular “C corporation.”
    - Full entity level (corporate), double tax.



# What is an S corporation? (Cont'd)

- **Single class of stock.**
  - *Trap: deemed dividends.*
- **All shareholders must be U.S. individual residents.**
  - Some very narrow exceptions.
- **Other requirements.**



# Why an S corporation?

- **Single level of tax: pass-through.**
  - Small amount of state (CA) income tax: **1.5%**.
- **Liability protection.**
  - Creditor/plaintiff must “pierce the corporate veil.”
  - Generally cannot protect against own malpractice.
    - That’s why you have E&O (malpractice) insurance!
- **Helpful for retirement planning: tax deferred plans.**



# Why an S corporation? (Cont'd)

- **Dentistry can be practiced in a corporation.**
  - **Professional corporation under state (CA) law.**
    - **Only licensed professionals as shareholders.**
  - **S corporation under federal and state income tax law.**



# Shared Practice: Choice of Entity

## ■ S corporation? *No!*

- Easy to blow election (e.g., deemed dividends).
  - Example: corporation pays for partners' cars?  
Result: blown S election.
- **Not** tax efficient for a partner to sell.
- Need a complex shareholders' agreement.
  - Maintain S election.
  - Retirement/sales/death.

## ■ General Partnership? *No!*

- No liability shield.

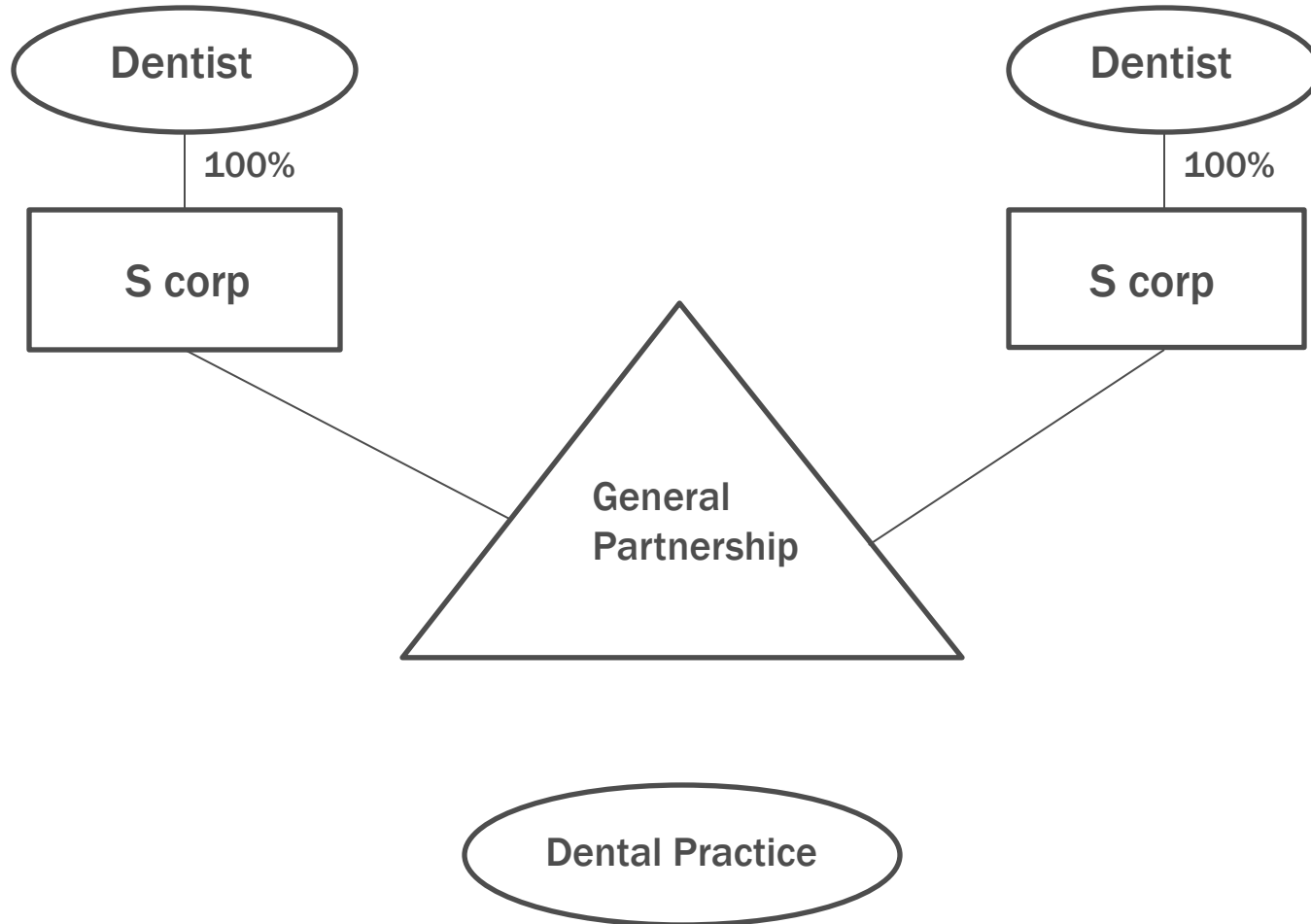


# Shared Practice: Ideal Structure

- **S corporation – general partnership two-tier structure? *Yes!***
  - Each partner forms his or her own S corporation.
  - Each S corporation is a partner in a general partnership.
  - General partnership conducts the dental practice.



# Shared Practice: Ideal Structure





# Shared Practice: Ideal Structure

- **General partnership agreement has all terms and conditions.**
  - Sharing of income and expenses.
  - Management.
  - **Exit: how do the parties separate?**
    - Death or disability/sale/retirement.
    - Easy to overlook; difficult to fix later.





# Benefit of Ideal Structure

- **Liability protection.**
  - With exceptions for own malpractice/supervising malpractice.
- **Each dentist is responsible for his or her own S corp.**
  - Another dentist can't blow your S election.
- **Single level of tax: all entities are pass-throughs.**
  - Avoid 1.5% CA tax: pay out all S corporation income as a salary!
- **Efficient exit structure.**
  - Discussed below.



# Operating a Dental Practice


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- **Issues with “fellow” dentists.**
  - Associates, partners or other dentists in the same office.
  
- **Day-to-day issues.**



# Issues with Fellow Dentists

- **What is the relationship?**
  - Employee or independent contractor (IK”)?
    - *If misclassified employee, huge tax exposure!*
    - If really an employee, you have employer liability.
      - Harassment/discrimination claims.
- **Why choose IK?**
  - Potentially no malpractice liability.
    - If not “supervising.”
  - No payroll tax responsibility.
  - No employee liability exposure.
  - But don’t get it wrong!




# Issues with Fellow Dentists (Cont'd)

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- **How to determine employee vs IK?**
  - No hard and fast rules.
  - IRS follows multi-factor test.
  
- **Some factors relevant to dentistry:**
  - Does the dentist have his/her own patients?
  - Does the dentist work for other dentists?
  - Do you supervise him/her?
  - How do you submit his/her third party payor (insurance) claims?


# Issues with Fellow Dentists (Cont'd)

- **Separate practice/sharing space?**
  - Clearly delineate relationship.
  - For example, sublessee/space sharing.
  - Who “owns” the patient?
  - Expense (e.g., payroll, lease) allocation.
  - No noncompete.
  - What is the exit/termination?
    - Always plan for the divorce/death/retirement.



# Issues with Fellow Dentists (Cont'd)


- **Third party payor reimbursement.**
  - Proper billing of other dentists?
- **Covenants not to compete: patient and employees.**
  - Generally not enforceable.
  - To be enforceable:
    - Must be a partner.
    - Only a sale of interest or dissolution of the partnership.
      - Doesn't cover “reverse solicitation.”
    - Reasonable geographic scope.
    - Reasonable time limit.



# Issues with Fellow Dentists (Cont'd)

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- **Should an associate incorporate?**
  - Employee: no.
  - IK?
    - Generally no economic benefit & higher costs.
    - But lower audit risk.



# Day to Day Operation of a Dental Practice

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- **Employee handbook.**
  - California labor law compliance is onerous!
  - Document and discipline policy violations.
- **Diversity and harassment training.**
  - Must be regular (e.g., annual) – best way to inoculate from a lawsuit.
  - But not legally required (up to 50 employees).
- **HIPAA compliance: office and staff.**





# Employee Issues

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- Health insurance for them.
- Retirement plans.
- Other fringe benefits.



# Taxes & Licensing

- Who is taking care of payroll taxes?
  - If they don't pay, you are liable.
- Business taxes and licenses.
  - Federal, state and local taxes.
  - State registration.
- “DBA” filings.
  - For example, fictitious name filing with dental board.



# Taxes & Licensing (Cont'd)

- **Before you pay anyone \$600 or more:**
  - Get an IRS Form W-9 from him/her/it.
  - After the end of the year, provide him/her/it (and IRS) an IRS Form 1099-MISC.
- **Do you sell products (e.g., Oral B)?**
  - Need a CA resale license.
  - Sales tax collection and filings.
    - Even if you don't collect, you must pay.



# Buying or Selling a Dental Practice

- **This is a business!**
- **Need a comprehensive purchase and sale agreement.**
- **Need competent & knowledgeable counsel and accountants.**



# Buying a Dental Practice

- **What should you pay?**
  - Really a question for a broker or banker.
  - Different formulas are used.
  - Historic rule of thumb: 70% of annual collections (gross receipts).
  - Accounts receivable isn't sold.



# Buying a Dental Practice

- **Buy assets, if possible!**
  - Avoid contingent liabilities.
  - Allows buyer to “step-up” the tax basis in assets for federal income tax purposes.
    - Would allow a buyer to amortize goodwill over **15** years.
      - “Tax shield.”



# What if you can't buy assets?

- In “ideal structure”: buying GP interests would be ok.
  - But consider contingent liabilities.
  - Good tax answer (Section 754 election).



# What if you can't buy assets?

## (Cont'd)

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- **100% of S corp stock: ok, but. . .**
  - Due diligence: was target *really* a good S corporation?
    - Easy to blow election. . .
  - Contingent liabilities.
    - Your watch/my watch.
  - Good tax answer (Section 338(h)(10) election).





# What if you can't buy assets?

## (Cont'd)

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- C corporation stock?
  - Bad result.
  - Double tax & no “step up.”
- Some (but not all) S corporation stock
  - Bad result.
  - Single tax, but no “step up.”
    - But consider *Martin Ice Cream*.
  - Pre-closing liabilities.
    - Your watch/my watch.



# Selling a Dental Practice

- **If own 100% of S corporation:**
  - Can sell assets to buyer
  - Generally long-term capital gains
    - Some exceptions (e.g., accounts receivable).
  - Some double tax: 1.5% CA income tax; “built-in gains” tax.
  
- **If sell less than 100% of S corp shares:**
  - No step-up in tax basis to buyer.
    - Therefore, buyer should pay less.
  - Generally long-term capital gains.



# Selling a Dental Practice (Cont'd)

- Sell portion of S corporation assets?
  - Buyer gets a “step up” in tax basis (15 year tax shield), but. . .
  - Triggers gain to all shareholders: including non-selling.
    - Very bad answer!
  - Maybe *Martin Ice Cream*. . .
- If you have the ideal structure:
  - Long-term capital gain for a seller.
  - Previously described benefits to buyer.



# Closing a Dental Practice

- Again, need good advisors.
- Should give employees notice.
  - Generally not legally required for “at will” employees.
- Review all agreements for termination.
  - For example, office lease.
  - Don’t want to breach.
- Withdraw all state, local registrations.
- Final tax returns.



# Who am I really?

**Raj Tanden** is a partner and business lawyer with Foley & Lardner LLP, where he represents clients in corporate and tax matters across a broad spectrum of domestic and cross-border transactions. Mr. Tanden chairs the firm's Southern California Tax Practice. His practice includes assisting clients with investment management transactions, including the formation of and investments by public and private investment funds and investors. Mr. Tanden advises business development companies, closely held businesses, public and private investment funds and real estate investment trusts (REITs). He has particular experience with retail, beauty and apparel companies, and also represents health care professionals and practices.