NON-TAX SUCCESSION PLANNING — FOR DENTAL PRACTICES

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CLOSELY HELD BUSINESSES COMMITTEE
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I. **SUCCESSION PLANNING ISSUES**

A. Can You Afford to Retire?

B. What Will You Do With Your Time?

C. Prepare Your Personal Financial Plan.

D. Adjust the Financial Plan to Reflect Life Changes

E. Determine Whether Your Retirement is Complete or Partial

F. **Assess Health Care Availability and Cost**

G. Authorize Preparation of the Practice Valuation

H. Maximize System Effectiveness and Practice Profitability

I. Maintain the Practice, But Do Not Overspend

J. Prepare Your Succession Plan

K. How Do You Locate Your Successor?

L. Review and Update Estate Plans / Terminate Retirement Plan / Dissolve Practice Entity at Appropriate Times
II. PRACTICE SUCCESSION OPTIONS

A. Complete Sale

B. Hire Associate with Later Sale

C. Co-Ownership

D. Solo Group Arrangement

E. Merger

F. Walk Away
III. CALCULATING DENTAL PRACTICE VALUE

A. Summation of Assets

1. Dental Equipment, Office Equipment, Furniture and Technology
   a. Book Value, Plus 1/3 Accumulated Depreciation
   b. 10 year Straight Line Depreciation, With 20% Salvage Value

2. Dental Supplies
   a. 3 - 4 Months on Hand

3. Dental Instruments
   a. ½ of 1% of Most Recent Year Collections

4. Goodwill – 30 Factors, But Most Recent Year Collections and Profit Most Significant
   a. ADA Publication
      i. .2 - .5 of Most Recent Year Collections
      ii. 1.0 – 1.5 of Most Recent Yearly Owner Profit in All Forms
   b. Goodwill Registry, 2010 41% of Most Recent Year Collections – Slightly Higher for Specialists

B. Capitalization of Earnings

C. Multiple of Gross Revenue / Similar Practices
Example

Asset Summation

A. Dental Equipment, Office Equipment, Furniture and Technology
B. Dental Supplies
C. Dental Instruments
D. Collective Subtotal.................................................................$ 150,000
E. Agreed Goodwill Value — Determine Personal or Corporate ........$ 500,000
F. Estimated FMV of the Practice.....................................................$ 650,000

See Figure 5-3 of Materials for Verification Analysis
### Example

**Capitalization of Earnings**

<table>
<thead>
<tr>
<th></th>
<th>Most Recent Year Collections</th>
<th>$1,000,000</th>
<th>$1,000,000</th>
<th>$1,000,000</th>
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</thead>
<tbody>
<tr>
<td>Owner Profit Percentage</td>
<td>x 38%</td>
<td>x 40%</td>
<td>x 42%</td>
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<tr>
<td>Available Profit</td>
<td>$380,000</td>
<td>$400,000</td>
<td>$420,000</td>
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<tr>
<td>New Owner Compensation at 27.5%</td>
<td>&lt;$270,500&gt;</td>
<td>&lt;$270,500&gt;</td>
<td>&lt;$270,500&gt;</td>
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<tr>
<td>Available Profit to Capitalize at 20% Rate</td>
<td>$109,500</td>
<td>$129,500</td>
<td>$149,500</td>
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<tr>
<td>20% Capitalization Rate</td>
<td>÷ .2</td>
<td>÷ .2</td>
<td>÷ .2</td>
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<tr>
<td>Estimated FMV of the Practice</td>
<td>$547,500</td>
<td>$647,500</td>
<td>$747,500</td>
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Small Increases in Profitability Have Significant Effects Upon Practice Value
**Example**

*Multiple of Gross Revenue / Similar Practices*

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most Recent Year Collections</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Multiplier</td>
<td>65%</td>
</tr>
<tr>
<td>Estimated FMV of Practice</td>
<td>$650,000</td>
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IV. THE IMPORTANCE OF DUE DILIGENCE — WHAT TO ASK / WHAT YOU WILL BE ASKED

A. Compatibility of Purchaser and Seller

B. Financial Information

C. Practice Facility

D. Lease and Real Estate

E. Operations

F. Employment Relations and Benefits

G. Litigation — Pending / Threatened

H. Organizational Matters
V. **HIRING THE ASSOCIATE**

A. Locating an Associate — How?
B. The Associate Interview Process
C. Spouse in the Practice
D. Length of Association, 1-3 Years, Then What?
E. When Will You Relocate or Expand?
F. Proposal for Employment
G. Worker Classification
H. Key Employment Agreement Provisions
   1. Compensation
      a. Collections
      b. Adjusted Production
      c. Base Salary vs. Draw
      d. Benefits, Insurances and Direct Business Expenses
      e. Bonuses, Based on Production or Discretionary?
   2. Restrictive Covenant
      a. When Does it Start?
      b. A Buy-Out?
      c. Associate's Patients
   3. Termination Provisions
      a. Notice
      b. Cause — Cure Period?
      c. Death, Disability
      d. Loss of License
I. Associate to Ownership
VI. CO-OWNERSHIP

A. Practices Consisting of Two or More Owners Are Becoming More Common as the Number of Practices That Expand or Relocate Increase

B. We Can't Deal With the Buy-In, Unless We Deal With the Buy-Out.

C. Buy-In Business and Tax Structures are Similar, But Not Identical, to Buy-Out Business and Tax Structures – The Three Methods.
   1. Purchase and Sale of Stock/Voting Units, Reduced by the Tax Detriment to Purchaser Purchasing Stock or a Membership Interest in After-Tax Dollars – The Only Method Without Risk?
   2. Purchase and Sale of Stock/Voting Units at a Low Value without Goodwill, Coupled With Compensation Adjustments for the Buy-In and the Entity's Purchase of Personal Goodwill or Payment of Deferred Compensation for the Buy-Out.
   3. Three Entity Method – an LLC of Professional Corporations or Individual Doctors as Members.

D. Practical Considerations.
   1. Optional Versus Mandatory Buy-Outs.
   2. Dispute Resolution Mechanisms.
   3. Owners Approximately the Same Age.
   4. Three or More Doctor Practices — Doctor Two Does Not Want to be Affected by the Buy-Out of Doctor One by Doctor Three.
   5. Lease Assignments, Renewal Options and Building Ownership.
   6. Relocation or Expansion – It Will Happen!
   7. Cost of Technology and the Importance of a Return on Investment.

E. Operations
   1. Decision-Making Control.
      a. Close Corporation Statutes or 51% / 49% Versus 50% / 50%.
b. Certain Decisions Require Unanimous Consent

2. Dispute Resolution Mechanisms.

3. Allocation of Compensation.
   a. Percentage of Collections of an Owner As a Percentage of Collections of All Owners
   b. Fixed and Variable Costs Allocated Equally to Each Owner and Available Compensation Allocated By Respective Collections.
   c. Payment of Benefits, Insurances and Direct Business Expenses.

4. Employment of Family Members.
VII. SOLO GROUP ARRANGEMENTS.

A. Amortization of Goodwill Permitted, Except for Family Members.

B. Usually, No Mandatory Buy-Out.

C. Sharing of Staff Permitted.

D. Separate Retirement Plans Permitted.

E. Usually Not for Dental Specialists.