

Miscellaneous Points to be Considered in Practice Transition

Whether adding an associate, transitioning an associate into a partner, or purchasing a practice outright, there are a number of aspects to be considered. The following points, concerns, and definitions may be helpful to the dentist as he or she considers some form of practice transition. The terms are listed in no particular order of importance:

Hard costs of hiring an associate:

- Advertising to find candidates
- Screening candidates
- Interviewing time and expenses
- Fees for the practice lawyer and accountant---advice, contracts, etc.
- Announcements about new associate via various media
- New signage for office
- New letterhead and other paperwork
- Training and meeting time with new associate
- More staff needed?
- Additional chairs, equipment and/or instruments needed?
- Associate's compensation, benefits, etc.

If purchasing accounts receivable:

- Current -- \$.90 to \$.95 on the \$1.00 depending on the average collection rate
- 30 – 60 days -- \$.70 to \$.75 on the \$1.00
- 60 – 90 days -- \$.50 to \$.55 on the \$1.00
- 90 – 120 days or longer -- \$0

How are costs to be paid by the associate calculated?

Whether costs (for example, lab costs) paid by the associate are deducted from the associate's production or from the associate's compensation affects the associate's income significantly.

Example:

\$30,000 – month's production
- \$2,000 lab costs
\$28,000
x .35 associate's percentage
\$ 9,800 associate's income

\$30,000 – month's production
x .35 associate's percentage
\$10,500
- \$2,000 lab costs
\$ 8,500 associate's income

Terminology in Practice Transition

The following terms demonstrate the lexicon which might be used in practice sale or purchase. Obviously, the list is not exhaustive, but meant to present an example of the terminology which the dentist's accountant and/or practice transition expert should be asked to define and discuss. Be aware that tax rates listed under some terms are subject to frequent change. The advisors at the time of sale/purchase must know the current tax ramifications and give the best-scenario advice to each participating dentist. The seller and the buyer should have different advisors, accountants, lawyers, etc.

Market value – Price at which an asset can be sold

Book value – cost of an asset minus accumulated depreciation

Net book value – book value minus liabilities (payables)

Intangible assets

- Patient records
- Office location, signage
- Telephone numbers
- Lease availability
- Staff retention
- Restrictive covenant
- Practice numbers and statistics that indicate sound fiscal management and future growth
- Goodwill – going-concern value based primarily on projected future earnings, dentist's reputation, practice visibility, practice age, overhead control, and sound management systems in place and functioning effectively.

Tangible assets

- Equipment and instruments
- Furnishings and fixtures
- Supplies
- Leasehold improvements

If the office building is to be purchased at the time of sale, that evaluation is done as a separate negotiation.

Immediate deduction – Reduces your income dollar for dollar. Example: If you have an immediate deduction of \$5,000 and your income prior to the deduction is \$100,000, the deduction reduces your taxable income by \$5,000. If your tax bracket is 35%, the deduction saves you \$1,750 in income tax.

Depreciation – This term relates to an asset on which tax deductions are allowed over the depreciable life of the asset. The life for most furniture and fixtures is five to seven years; three years for software; up to 39 years for leasehold improvements, etc. Tax schedules for depreciation vary frequently; make certain your accountant is up to date on allowable depreciation.

Amortization of intangibles – This term relates to intangible assets that are allowed to be deducted over 15 years. These include goodwill, covenants-not-to-compete, patient lists/charts, and all other forms of going-concern value.

Tax credit – An item carrying tax credit reduces your tax by the allowed value of the item, dollar for dollar.

Ordinary income – This term describes income that is taxed at normal rates. No preferential treatment is afforded this type of income. Depending on the amount of ordinary income and marital status of the payer, the tax rate varies from no tax to maximum federal tax rate. Your accountant must be knowledgeable about the varying rates and the full scope of deductions.

Capital gains – This income is afforded favorable tax rates (lower than income tax rates) subject to the current maximum federal capital gains rate. Seek information from your accountant.

Recapture – This term describes the recapturing of previously-taken tax benefits that are taxed as ordinary income, referring specifically to the recapture of previously-taken depreciation on equipment. Example: assume the equipment was originally purchased for \$10,000 and had been fully depreciated at the time of sale to the purchaser of the practice. If the equipment were sold for \$5,000, all of the gain (\$5,000) would be recaptured and treated as ordinary income for the seller. If the equipment were sold for \$12,000, the first \$10,000 (the original purchase price) would be subject to recapture (taxed as ordinary income), and the remaining \$2,000 of the sale price would be taxed as capital gain (at a lower rate than ordinary income).

Sales – sales are either (1) asset sale or (2) stock sale (of an incorporated practice). Shares of stock are not depreciable to the buyer, the purchasing dentist; whereas, an asset sale allows depreciation for the buyer's use at various rates distributed among the purchased assets.