

Quarterly Supplement To Business, Legal, And Tax Planning for the Dental Practice

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The purpose of the Quarterly Supplement is to continually update the material contained in **Business, Legal, And Tax Planning for the Dental Practice**, Second Edition, as "free-standing" articles relative to both current business, legal, tax and pending legislative matters that affect your practice and my ongoing experiences as an attorney representing dental and dental specialty practices. At times, articles will be written by my partners and friends who consist of tax attorneys, accountants, actuaries and dentists. The articles contained in the Quarterly Supplements all relate to material contained in my book, which I hope you will purchase after reading this Supplement if you haven't already.



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**The ABCs and the XYZs
for the Dentist
Based Upon ...**

**Business, Legal,
And Tax Planning
FOR THE DENTAL PRACTICE**

Second Edition

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DISPUTE RESOLUTION — FINDING MIDDLE GROUND

One of the most significant obstacles to successful co-ownership is the problem of disputes. Co-ownership is relatively complex to manage in that you have a business partner and cannot make decisions independently. The fact is, most dentists do not want answer to another doctor(s). This is one reason why the solo the group format works well. Your practices share expenses and remain separate. The benefits of co-ownership are enjoyed, such as coverage, but the burdens, such as one owner's nose in the other's checkbook and the unwillingness of one owner to buy out the other, are avoided.

With co-ownership, disputes can easily develop; often over allocation of compensation, work effort, quality of work, ethics, philosophical values, a non-doctor spouse or other relative in the practice, decision making and operational control, activities relative to the operation of the practice (e.g., managing practice expenditures, the size and layout of the practice facility, expansion or relocation or establishing or acquiring an additional practice location). However, the single biggest problem that I see in co-ownership is competition for new patients. In short, there may not be enough business for every doctor and if compensation is productivity/collection based, one or more doctor(s) may become unhappy with his or her paycheck.

To add fuel to the fire, some owners have stronger personalities than others and staff members may become attached to one owner at the expense of the other owner(s).

Here are my observations in attempting to resolve disputes among co-owners.

Litigation

Stay out of the courtroom. Judges often have both criminal and civil dockets and just do not want to hear about doctors who cannot get along. Consider that a judge thinks that you make more money than other litigants whom the judge sees in the course of any day. That doesn't "sit" well with the judge. The judge or other arbitration panel also does not know what you do, what your problems are, or how to resolve what's bothering you. As a result, a judge or arbitration panel may not provide the best forum to resolve your problem. Further, litigation is enormously expensive, time consuming, and emotional. Once you start, litigation will take much longer than you think it should, at both a very high personal and emotional cost, not to mention the financial burden. And once you're in, you usually cannot get out.

Board Meetings

As co-owners, schedule monthly board (in a corporation) or membership (in a limited liability company) meetings to discuss practice business, e.g., the fourth Friday of each month at 7:00 a.m. The monthly meeting should last approximately two hours, notes should be taken and a written agenda should be followed in accordance with Robert's Rules of Order. Most doctor disputes involve misunderstandings concerning the business of the practice and the good news is that significant problems and misunderstandings can be avoided through scheduled, monthly meetings.

Advisory Boards

Consider forming an advisory board that would include outsiders who can assist in providing objective guidance for strategic planning decisions facing the practice. Such individuals may include the CPA and lawyer for the practice, a business psychologist or a practice management consultant. The advisory board should meet at least on a quarterly basis relative to setting practice policy and determining (on an on-going basis) long range practice goals and objectives, along with measurement standards for practice operations. It is the shareholders of the practice who have the authority, take the responsibility and who are accountable for implementation of the strategic plan. The advisory board provides support and guidance to the shareholders.

Advisory board meetings should last approximately two hours in accordance with a written agenda prepared by an individual who, as agreed upon by the other advisory board members, takes the responsibility to do so.

Annual Meetings

Meet with your accountant and attorney once each year with an agenda, prepared in advance by those advisors, to discuss practice business; compensation, bonuses, fringe benefits, retirement plan design and contributions, buy-sell agreement values, growth, operations, practice succession, new doctors, staff performance and compensation/benefits, the facility, the practice location, lines of credit and other matters. This meeting should serve to avoid later misunderstandings concerning practice operations, management, buy-out obligations and the payment of compensation and bonuses.

Close Corporation, Shareholder and Operating Agreements

Approximately eight states permit the use of a close corporation agreement which vests decision making or operational control of the business or practice in the founder or senior owner, often called "founder's rights." These founder's rights vest the "tie breaking" vote in the event of a voting deadlock or dispute in the favor of the senior doctor(s). For example, two senior doctors may share the founder's rights. If one doctor departs, the other retains the founder's rights until he or she is no longer a shareholder. So long as the senior doctor(s) owns at least one share of the professional corporation's stock, the senior doctor(s) retains the tie-breaking vote, irrespective of the percentage of stock owned by the newly admitted shareholder/doctor(s). This means that the senior doctor(s) cannot be fired or outvoted by less senior doctor(s). However, the senior doctor(s) has certain fiduciary duties to the other less senior shareholder(s) in accordance with applicable state law. These agreements, where permitted, resolve the problem of a senior doctor(s) retaining 51% ownership in the practice or the complexity of issuing voting and non-voting stock. Members of a limited liability company typically can use an operating agreement, depending upon the state, to allocate decision making and voting control. The point is, decision making and operational control can usually be designated by contract and should be specifically agreed to in advance of the co-ownership.

This agreement also resolves disputes because all doctors know who is in charge and who is not. Future control of the practice can also be vested by agreement. For example, when the senior doctor retires, dies or becomes disabled, the second most senior doctor is vested with decision making authority, then the third, etc.

However, certain matters can be designated for unanimous consent to make the decision. If unanimous consent is not provided, the decision to proceed with a proposal is vetoed. Examples of items that may require unanimous consent may include hiring an additional doctor, practice expenditures above a specified amount, change of compensation and/or benefits for doctors, the decision to relocate, acquire another practice or expand.

In the event that the founding or senior doctor does maintain decision making control, the incoming doctor may request a minority or a lack of control discount that should serve to balance the lack of equal control to the incoming owner.

Associate buy-ins are almost always internally financed. Perhaps a balance of decision making control would be to grant equal decision making control to the incoming doctor at the time that the incoming doctor has fully paid for his or her interest in the practice, e.g., 50%; typically over five to seven years.

Independent Third Party

In cases where there are an even number of owners, another dispute resolution device may be to appoint an independent third party as the third member or uneven member of the professional corporation's board of directors or the limited liability company's management committee. In the event of a deadlock among the owners, the third party would hold the deciding vote.

Split Off

A "split off" provision may be used to resolve deadlock in professional corporations. Specifically, the professional corporation can be divided by patients and its assets in the event of a deadlock. The split-off would result in the formation of a new professional corporation to which a portion of the practice assets would be transferred. One shareholder would then receive the outstanding shares in the new professional corporation in exchange for his or her shares in the prior professional corporation. If properly structured under Internal Revenue Code Section 355, split-off would be currently nontaxable or "deferred" for federal income tax purposes. A split-off is a useful tool to split one practice into two, sometimes in the same practice facility.

In the event that one shareholder would leave the premises and the other would remain on the premises, the parties can agree, in advance to share or allocate the cost of one doctor moving to the new location. However, it should be noted that the doctor who moves to the new facility has new equipment and an updated facility design and the doctor who remains in the existing facility will have the existing equipment and facility design. Unfortunately, most dental practices have at least one or more significant design flaws and/or heating, ventilation and air conditioning problems.

Dissolution

Dissolution may be utilized as a deadlock remedy. For example, a particular owner may be granted the right to dissolve the practice at any time. In the event that the parties cannot get along and litigation results, the court may order judicial dissolution to resolve the dispute, depending upon state statutes.

Buy-Sell Agreements

A buy-sell agreement can serve as a deadlock remedy. Stated differently, deadlock would serve as a triggering event under a buy-sell agreement. This would require that one owner sell his or her ownership interest in the practice to the other owner(s) upon deadlock. There are several methods to determine which owner would sell his or her practice interest upon deadlock. The buy-sell agreement may predetermine the seller. That is, the owner(s) can decide the identity of the seller prior to a deadlock. For example, it could be agreed that the founder or senior doctor of the practice would remain and the incoming shareholder would relocate. Let's say that Dr. Smith thinks he will like working with young Dr. Jones. Dr. Jones' shareholder employment agreement may include a provision whereby Dr. Smith can terminate Dr. Jones' employment upon 60 days notice. However, the parties could agree that if Dr. Jones' employment would be terminated by notice from Dr. Smith, then in such a case, Dr. Jones' restrictive covenants (except for solicitation of patients, referral sources or employees and rights to proprietary information such as patient lists) would be null and void. Additionally, such a triggering event may provide for a cash buy-out.

Alternatively, where the owners share an equal interest in the practice, the buy-sell agreement may provide a "shoot-out" provision. A shoot-out provision may take the form whereby one party offers a price and payment terms and the other chooses to either buy or sell his or her interest in the practice according to such terms. For example, if Dr. Smith wants to break a deadlock or otherwise cause a practice separation, Dr. Smith submits a purchase price and terms per share or unit to Dr. Jones. Dr. Jones is required to sell his or her shares or units to Dr. Smith or buy Dr. Smith's shares or units for a stated purchase price and terms. The downside of this provision is that one owner may take advantage of the other owner's precarious financial condition. That is, if one owner perceives the other owner as not having the funds to effect the buy-out, the first owner can make an offer and the other owner would, in effect, be required to sell his or her shares or units in the practice.

Co-ownership is complex and requires time and effort of the owners to manage the relationship. If you are not willing to put in that time and effort, the simplest way to avoid a dispute is to remain a sole practitioner or enter into a solo group arrangement.

LONG-TERM CARE — A PRACTICE BENEFIT

Practices, particularly those operating as C-corporations, should consider long-term care coverage as a practice fringe benefit. Under the Tax Code, long-term care coverage is treated as accident and health insurance. This means that premiums are fully deductible and neither the premiums or benefits are taxable to the employee. In a C-corporation, the owner is an employee. As with accident and health insurance, the practice can discriminate in benefits between owners and staff members under a group policy. For example, the practice may purchase a significantly greater benefit level for a doctor(s) and doctor(s)'s spouse(s), than for non-doctor staff members. In addition, the practice may pay the full cost of doctor(s) and family premiums and require non-doctor participants to share in the costs of premiums, should such participants desire to elect long-term care coverage.

If benefits are reimbursed to participants on a per-diem basis by the carrier, there is a \$175.00 day limitation upon the benefit, indexed annually, or \$220.00 for year 2003.

Long-term care plans, unlike accident and health plans, are not subject to COBRA or state continuation coverage. Because most dental and dental specialty practices do not generally employ more than 20 people, state continuation coverage rules are typically applicable for health insurance, rather than COBRA.

At this time, long-term care insurance (unlike accident and health insurance, dental and vision insurance, disability insurance and dependent care assistance coverage) cannot be a benefit under a cafeteria plan or flexible spending arrangement. Cafeteria plans and flexible spending arrangements allow the staff member/participant to pay their portion of health insurance premiums and other permissible benefits on a pre-tax basis.

For those practices not operating as C-corporations (sole proprietors, S-corporations and limited liability companies), long-term care insurance premiums are deductible under Internal Revenue Code Section 162, but are subject to dollar deductibility limitations based upon age categories.

There is a downside to long-term care insurance in that this aspect of the insurance industry is relatively new. As a result, underwriting tables are not yet developed and premium costs vary widely among insurers. Some insurers will leave the industry. Others will raise premiums as soon as a covered group becomes economically undesirable due to claims history.

How do you protect yourself? As your insurance advisor to compare insurance companies that provide long-term care insurance. In particular, look at the overall quality of the insurance carrier. There are organizations that rate long-term care insurance companies. Second, assess how the carrier pays claims in its other lines of insurance. For example, if the carrier provides disability insurance, does it pay its claims or attempt to fight the insured and not to pay the claim? Third, compare how long a particular carrier has been in the long-term care insurance business as compared with other carriers. Fourth, look at whether "indemnity" insurance is being purchased

or whether the participant must submit claims for reimbursement. You do not want to be in your 80's in a nursing home, while your spouse of approximately the same age must fill out reimbursement forms to the carrier. Finally, while premium cost is a consideration, it should not necessarily be the primary consideration in selecting a long-term care insurance provider.