

Quarterly Supplement To

# Business, Legal, And Tax Planning for the Dental Practice

Second Edition

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 current business, legal, tax and pending legislative matters that affect your practice. These Quarterly Supplements also reflect my ongoing experiences as an attorney representing dental and dental specialty practices. At times, articles will be written by friends who consist of tax attorneys, accountants, actuaries and dentists. The articles contained in the Quarterly Supplements are consistent with the chapters contained in my book, which you may download at no charge at [www.WickensLaw.com](http://www.WickensLaw.com) — click Dental Law.



**William P. Prescott, E.M.B.A., J.D.**

Author

Practice Transition Attorney

Former Dental Equipment and Supply Representative

## Summer, 2010 In This Supplement

### Taxing Developments

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**William P. Prescott, E.M.B.A., J.D.**  
**Wickens, Herzer, Panza, Cook & Batista Co.**  
35765 Chester Road  
Avon, Ohio 44011-1262  
Direct: 440.930.8067  
Fax: 440.930.8098  
[WPrescott@WickensLaw.com](mailto:WPrescott@WickensLaw.com)  
[www.WickensLaw.com](http://www.WickensLaw.com) – click Dental Law

This Quarterly Supplement is not intended to provide the reader with specific legal or tax advice. For specific solutions to legal and tax matters, please consult with your legal counsel and CPA.

#### IRS CIRCULAR 230 DISCLOSURE

To ensure compliance with the requirements imposed by IRS Circular 230, we inform you that any tax advice contained in this communication is not intended or written to be used, and cannot be used, for the purpose of (1) avoiding tax-related penalties under the Internal Revenue Code or (2) promoting, marketing or recommending to another party any tax-related matter(s) addressed herein.

## TAXING DEVELOPMENTS

Before the economic downturn in late 2008, the Internal Revenue Service (IRS) indicated that of the estimated \$346 billion of tax gap, 75% was attributable to small businesses, which include your practice. Tax gap is the estimated difference between the amount of taxes collected and what the IRS believes it is owed. I have been informed by the Small Business/Self Employed Division of IRS that the tax gap is primarily comprised, in order of importance, of unreported income, S-corporation distributions and worker classification. With Federal spending increasing at this time, it doesn't surprise me that four developing issues are imminent. They are worker classification, S-corporation distributions, Forms 1099 and employment audits under the National Research Project (NRP).

### Worker Classification.

Practices sometimes attempt to classify associates, retired owners, and even hygienists, as independent contractors in order to eliminate payroll taxes and exclude the doctor/worker from the retirement and health insurance plans. For the worker, an independent contractor relationship can be beneficial because direct business expenses can be deducted from income. However, the IRS is wary of independent contractor relationships probably because it believes that the business, your practice, and not the doctor/worker should bear the responsibility of collecting the taxes. Under a worker classification audit, your practice can use what is called Section 530 relief as a defense, provided that all workers in the same class (e.g., doctors) are treated the same, all Forms 1099 were filed and there is a reasonable basis for treating the worker as an independent contractor.<sup>1</sup>

Currently, there are two pending Bills, one in the House<sup>2</sup> and one in the Senate,<sup>3</sup> that would effectively render Section 530 unusable as a defense in most circumstances. Additionally, the IRS now has referral relationships with 37 states and the DOL for worker classification purposes.<sup>4</sup> These 37 states will share any and all information obtained in a state worker classification audit with the IRS and, conversely, the IRS will share its worker classification audit information with those 37 states, a number that is increasing.

If worker misclassification is found under the significantly increased audits, the price is steep. Your practice would be assessed all federal income tax, penalties and interest, irrespective of whether the worker paid all applicable taxes. For the worker, those direct business expenses and benefits would, for the most part, be lost. Where the practice bills the patients, sets and collects fees and schedules patients, and where the doctor is subject to a restrictive covenant, there is usually an employer/employee relationship, even though the work may be provided on a

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<sup>1</sup> Section 530(e)(2).

<sup>2</sup> H.R. 3408, 111th Congress, 1st Session, July 30, 2009.

<sup>3</sup> S. 3254, 111th Congress, 2d Session, April 22, 2010.

<sup>4</sup> GAO Report, GAO-09-717, August, 2009, Employee Misclassification, Page 29.

part-time basis.<sup>5</sup> While incorporating, entering into a written independent contractor agreement and working at more than one location are helpful, these factors are not determinative of worker classification.<sup>6</sup>

### **S-Corporation Distributions.**

The IRS also frowns upon S-corporation distributions, which escape the Medicare tax, currently 2.9%, above the Social Security Wage Base that is currently \$106,800 for 2010. Recently, the GAO issued a report that found that 68% of S-corporation returns filed for tax years 2003 and 2004 were non-compliant with tax rules and unreported income.<sup>7</sup> This report also sites the recent growth of S-corporations, as well as the estimated revenue lost to the IRS due to non-compliance; \$23.6 billion, estimated for tax years 2003 and 2004.<sup>8</sup> Additionally, the American Jobs and Closing Tax Loopholes Act of 2010 (HR 4213) passed in the House on May 28, 2010, and now goes before the Senate. If this Bill is passed, every dollar of profit distributed by your S-corporation would be treated as ordinary income, unless there are four or more shareholders in your practice, which is very unlikely. For those of you who practice through S-corporations, ask your accountant what the economic effect of this situation will specifically be for you.

### **Forms 1099.**

Currently, a Form 1099 must be issued only to individuals who provide services above \$600 per year. As part of the health care legislation signed into law this year, beginning in 2012, your practice will be required to issue a Form 1099 to any vendor of services or property, including corporations, to which your practice has paid more than \$600 in any year.<sup>9</sup> These Forms must also be sent to the IRS. In addition to issuing the Forms, your practice will be required to obtain a Taxpayer Identification Number (TIN) from all vendors. If the TIN is not provided, your practice will be required to withhold 28% from vendor payments, including those by check or credit card, until the IRS receives the TIN. However, IRS Commissioner, Douglas H. Shulman, said that the IRS plans to use its administrative authority to exempt transactions using credit cards, as these transactions will already be covered by reporting requirements for credit card processors.<sup>10</sup> Of course, if this happens, taxpayers will use credit cards for almost all

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<sup>5</sup> "Worker Classification in Professional Practices", The Practical Tax Lawyer, Summer, 2010, American Law Institute/American Bar Association, William P. Prescott, EMBA, JD; Mark P. Altieri, JD, LLM, CPA, PFC; and Kelly Means, JD, Page 45.

<sup>6</sup> Independent Contractor or Employee?, Training Materials, Department of the Treasury, Internal Revenue Service, October 10, 1996, Training 3320-102 (10-96) TPDS 842381 ("Training Materials") Pages. 2-22, 23, 30.

<sup>7</sup> GAO Report, GAO 10-1-95, Tax Gap., page 46, December, 2009.

<sup>8</sup> Ibid, pg 25.

<sup>9</sup> RIA Federal Taxes Weekly Alert, April 1, 2010, Thompson Reuters, Page 149.

<sup>10</sup> RIA Federal Taxes Weekly Alert, June 3, 2010, Thompson Reuters, Page 263.

transactions, which should have an interesting impact on banks and the credit card industry, along with higher interest rates. Payments for airlines, hotels, rental cars and restaurants must also be reported. Moreover, all of your suppliers are vendors under the new law. Ask your CPA to estimate the number of additional Forms 1099 that your practice will be required to issue. And assuming that all taxpayers are compliant, what will this reporting requirement do to the IRS computers?

### **NRP Audits.**

Notwithstanding an increasing number of audits in general, the IRS is conducting approximately 6,000 comprehensive employment audits, roughly 2,000 each for the years 2010, 2011 and 2012 for small businesses including professional practices under the NRP. The purpose of the NRP audits is to provide the IRS with information on areas of concentration for future audits, elevate taxpayer compliance and raise revenue. These audits will cover four areas: worker classification, Form 1099 compliance, executive compensation and fringe benefits. Under the area of worker classification, the IRS will audit employee versus independent contractor status for your associate, you (if you are retired and working part-time) and hygienists. The area of executive compensation includes auditing S-corporation distributions for the period of audit, compensation shifts used in associate buy-ins, deferred compensation compliance and business expense reimbursements. For the area of fringe benefits, I am told that there are 39 audit points. Included is the requirement of a written health plan for providing health insurance to you and your staff; not just an insurance booklet. The written plan is required in order for your practice to deduct the health insurance premiums. Except for the selection of employers of various sizes, e.g., 1-5 employees, 6-15 employees, 16-50 employees and larger employers, the NRP audits are supposedly random.

### **Summary and Thoughts.**

#### **Worker Classification.**

If you have a new or retired dentist or specialist working in your practice, this doctor is probably not an independent contractor. If you do or intend to classify this individual as an independent contractor, understand that except in rare circumstances, the dentist or specialist, and certainly the hygienist, should be classified as an employee.

#### **S-Corporation Distributions.**

S-corporation distributions that currently escape the Medicare tax will probably be eliminated at some point. Thus, S-corporation earnings will be taxed like any other entity. However, unlike C-corporations, S-corporation shareholders will not have to be concerned about the double taxation on the sale of practice assets upon your retirement. So, S-corporations are still okay.

### **Forms 1099.**

The health care legislation included a law that I do not believe that the IRS intended. Unfortunately, getting laws repealed is very difficult and I suggest that you contact your Senator and Congressional Representative to voice your concern as a small business owner.

### **NRP Audits.**

The IRS is trying to figure out where to focus efforts in particular industries where it wants to both increase compliance and generate revenue. Don't take unnecessary risks and run your practice as your business.

My recommendation is to meet with your accountant and attorney on a yearly basis and discuss these and any new issues so that you operate your practice in compliance with the increasing administrative burdens under the law.