



SELECTING THE RIGHT LEGAL ENTITY FOR YOUR PRACTICE

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Selecting the right legal entity for your practice is an important first building block to a successful and enduring practice. The inquiry into what legal entity will best suit your objectives should start with the following considerations: tax ramifications, lawsuit exposure, transferability and expandability.

Regarding taxes, you need to have a basic understanding of how the legal entity is taxed; and, more importantly, you need to get your accounting/bookkeeping system in place from day one to ensure a smoothly running practice. Your exposure to lawsuits from your own conduct as well as the conduct of others should be examined to minimize your liability. Transferability relates to your capability to move the dental practice to a new location. This would involve moving clearly identifiable assets (dental chairs, equipment etc.) and intangible assets (goodwill and patient loyalty) to a new location. Lastly, you want to ensure that the legal form of your practice allows you to expand to fit future needs.

As you contemplate which legal form your dental practice should take, you need to remember the rule "If it is not in writing, it does not exist" as applied to business relationships. Any time you are building a business

relationship with another dentist – whether a family member, best friend or respected colleague – a comprehensive written agreement entered into at the start, while the relationship is upbeat, is the best insurance for a smooth relationship.

SOLE PROPRIETORSHIP

The most common dental practice entity is the sole proprietorship. As the name implies, this entity is for a single practitioner. It is not appropriate for two or more dentists, except a husband and wife dentist team. With a sole proprietorship made up of married dentists, one spouse would be the sole proprietor with the other spouse having a community property ownership interest in the sole proprietorship.

Legal: Setting up a sole proprietorship is as simple as opening your dental office, obtaining a business license and registering your office with the Board of Dental Examiners (B&P 1650 et seq.). In completing the paperwork for the business license and registration with the board, you designate your practice as a sole proprietorship. Incidentally, the failure of a dentist to register his or her dental office for a period of six months or more will result in the automatic forfeiture of the dental license (B&P 1655).

Taxes: For a sole proprietorship, a Schedule C, which attaches to the federal tax Form 1040, is used for tax reporting related to the practice. You also need to obtain a tax identification number from the state Franchise Tax Board and the federal Internal Revenue Service. The state and federal identification numbers are necessary for such items as quarterly payroll tax reports and quarterly estimated income tax payments.

Liability: In a sole proprietorship, the dentist is directly liable for his or her own actions, such as in cases of patient treatment that leads to dental malpractice, and his or her own financial obligations, such as in cases of office or equipment leasing and in cases of judgments for on-the-job injuries, wrongful termination and sexual harassment. The sole proprietor is also indirectly (vicariously) liable for actions of his or her employees, such as an injury inflicted to a patient by an associate dentist, hygienist or dental assistant.

Advantage/Disadvantage: This business form is easy to set up and costs nothing to maintain. Its disadvantage is that it cannot be used when two or more dentists wish to jointly own the dental practice, except for a married dentist couple as discussed above.

DENTAL CORPORATION

Legal: A dental corporation is a legal entity formed by filing articles of incorporation with the California Secretary of State's Office and running the corporation according to bylaws. When a dentist incorporates, the result is called a professional dental corporation.

Once such a corporation is formed, a permit must be obtained from the BDE. The dental corporation issues stock to its dentist shareholder(s), and the shareholders meet at least annually to discuss corporate business and elect directors and officers to run the dental corporation. An attorney or accountant is usually required to file the paperwork to form or dissolve the dental corporation and to document the annual shareholder and director minutes.

Taxes: A dental corporation is subject to state and federal taxation on any net income of the corporation that is not paid out as expenses, salaries or bonuses. Money paid as a salary or bonus to the dentist shareholder is taxable to the individual dentist as income. The dental corporation must pay a minimum tax to the state, currently \$800, for the privilege of being incorporated. Most such entities try to leave an income in the dental corporation at year end to avoid double taxation, and the Internal Revenue Code Subchapter S election is popular to allow the treatment of income and losses as an individual rather than a dental corporation.

Liability: It is a common misconception that the corporate status protects the individual against all liabilities of the dental corporation. The dentist who incorporates remains personally liable for malpractice suits under California law and by alleging that the dental corporation is the "alter ego" of the dentist, a plaintiff attorney can include the individual dentist in any other type of lawsuit that arises from the corporate practice. Limited liability can be achieved if

leases, purchase agreements or lines of credit are entered into on behalf of the dental corporation without the dentist providing a personal guarantee for the obligation. In these situations, if the dental corporation defaults, the creditor theoretically can only pursue corporate assets, not individual assets.

Advantages/Disadvantage: While many years ago incorporating would provide the dentist with a variety of tax advantages, those have been eliminated through tax reform to such an extent that few tax planners now recommend incorporation. Incorporation does have the advantage of allowing for practice expansion, multiple dentist ownership, sale of an identifiable practice entity, and long-term perpetuation of the business entity. The cost of incorporating, minimum tax payments, annual minutes and annual corporate returns must also be factored into the decision regarding incorporation.

DENTAL PARTNERSHIP

Legal: A partnership involves two or more dentists who agree to jointly own and operate a dental practice. It is formed by a written agreement between the parties, and the partnership as an entity can own such things as the patient base of a practice as well as office equipment and the real property where the office is located. The partners owe each other a "fiduciary" responsibility to act in the best interest of the dental partnership at all times. If the parties do not agree in their dental partnership agreement to how the partnership will termi-

nate or dissolve, California law dictates that all of the assets of the dental partnership be sold and the proceeds applied to the liabilities and any remaining money split between the partners.

Taxes: Partnership revenue, expenses, and income or losses are handled by way of a Schedule K-1, which is attached to each partner's federal Form 1040. Most tax planners agree that a dental partnership does not provide any tax advantages over the sole proprietorship form of practice entity.

Liability: Each partner is liable for the debts and liabilities of the dental partnership as well as for the other partners while performing partnership activities. Thus, each partner will be vicariously liable for malpractice actions filed against his or her partner even if only one partner treated the patient. Partners are also liable to one another and the partnership to act in the best interest of one another under the implied fiduciary duty.

Advantages/Disadvantage: Partnerships are often very successful for multidentist single-patient-base practices. Partnerships allow for the entry and exit of partners and can be customized so that all details regarding termination, death, disability etc. can be planned for the seamless perpetuation of the practice. Partnerships do not work as well when each partner wants his or her own separate patient base, and dissolution can be a difficult process if the agreement did not provide a specific game plan for dividing the tangible assets and

patient base between the partners. Lastly, the vicarious liability among partners is an undesirable aspect that cannot be eliminated.

SOLO-GROUP (PRACTICE ASSOCIATION AGREEMENT)

Legal: This is an agreement between two or more dentists who wish to maintain separately owned practices with shared overhead expenses and/or certain shared tangible assets. Although this agreement looks similar to a partnership, no legal entity is created by a practice association agreement. A written agreement should be entered into between the associating dentists that clearly identifies the business relationship as one between independent practices and that covers such things as how joint and separate expenses will be shared and how to handle a transaction in the event of sale, death, disability or withdrawal of a party from the agreement.

Taxes: Since no legal entity is created, there are no taxes to the practice association agreement. Each practitioner handles his or her own taxes consistent with the form of his or her business entity, whether a sole proprietorship or dental corporation.

Liability: One objective of the practice association agreement is to avoid the vicarious liability that exists with a partnership. Generally, dentists who take part in a practice association agreement will not be held liable for the actions of the other dentist members of the practice association agreement as long as a separateness of the practices is

maintained, such as separate letterhead, separate bank accounts and separate patient bases. There will be vicarious liability for jointly treated patients, jointly hired employees, and joint asset purchases, if any.

Advantages/Disadvantage: A practice association agreement gives the participating dentists the advantage of sharing overhead expenses with a minor risk of vicarious liability for the actions of the participating dentists. This business form also lends itself to a clearly identifiable independent practice that can be moved to a new location or sold to a new owner. The practice association agreement allows for multiple dentist participation and entry and exit of dentists and can be customized so that all details regarding termination, death, disability etc. can be planned for the seamless perpetuation of the association.

SPACE SHARING AGREEMENT

Legal: A practice-owning dentist (lessor) leases one or more operatories and support staff to another dentist (lessee) who establishes his or her own independent practice with a patient base separate from the practice owner. Typically, basic landlord/tenant law applies to this business relationship. The lessor dentist should check his or her office lease to ensure compliance with any provision on assignment or subletting because sometimes the master landlord's consent is required before a space leasing agreement can be created. The space leasing agreement should spell out if supplies are included or

excluded, that malpractice insurance is required of the lessee, and that each party's patient bases shall not be solicited or proprietary data copied by the other party.

Taxes: Since no legal entity is created, there are no taxes to the space leasing agreement. Each practitioner handles his or her own taxes consistent with the form of his or her business entity, whether a sole proprietorship or dental corporation.

Liability: The dentists who take part in a space leasing agreement will typically not be held liable for one another's actions as long as a separateness of dental practices is maintained, such as separate letterhead, separate bank accounts and separate patient bases. There will be a vicarious liability for jointly treated patients, jointly hired employees and joint asset purchases, if any.

Advantages/Disadvantages: The lessor dentist can generate income from an underutilized dental office; and, if the lessee is a specialist, some referrals can stay within the office, which is attractive to patients. The advantage to a leasing dentist is that he or she can begin to build a dental practice with-

out the capital outlay required to furnish a new office. If staff is included in the lease, they can sometimes be resistant to working for a new dentist or working longer hours. There is also a chance that an unscrupulous lessor or lessee will attempt to solicit the patient base or referral sources of the other party. Either party to this agreement may transfer his or her rights to another dentist typically with the consent of the nontransferring party.

TRANSFER OF BUSINESS ENTITIES

Whether dealing with a sole proprietorship, dental corporation, or a selling parent dentist and son or daughter purchaser, it is of primary importance to document the purchase with a comprehensive "buy/sell" agreement. Specific documentation of the sale and transfer of a practice from one dentist to another is very important to evidence in writing a whole series of complicated rights and liabilities between buyer and seller. The agreement typically covers the following items:

- Specific property being sold;
- Purchase price and payment terms;
- Use of seller's name;

- Handling of seller's accounts receivable;
- Covenant not to compete;
- Retreatment of patients;
- Malpractice coverage for buyer and seller;
- Tax allocation of purchase price;
- Handling of seller's active and inactive patient records;
- Notice to patients of the sale;
- Condition of equipment;
- OSHA compliance of the office; and
- Alternative dispute resolution, to name a few.

The cost of preparing a good buyer/seller agreement can prevent typically expensive and frustrating disputes. In any dispute relating to the sale of a dental practice, the evidence that governs who will win is contained in the buy/sell agreement. If the agreement contains specific reference to the area of the dispute, then the wording will be followed by a judge/arbitrator. If there is an ambiguity of the wording, then the intention of the parties and a reasonable application of the terms of the agreement will be made by the judge/arbitrator. If there is no written agreement, it is difficult to predict what a judge/arbitrator will do other than splitting the dispute down the middle since the court will not make an agreement for the parties. ❁

