The C&A

Advantage

Volume XLIII
No. 11
June 1, 2015

The following is a continuation of the discussion from the May 15th Newsletter on the subject of debt.

Should You Purchase a Practice (or Buy Into a Practice) if You Are Overwhelmed by Student Debt?

We're surprised but not shocked whenever a client tells us that their associate does not want to buy into the practice because of their student debt. High student debt is an unfortunate reality in dentistry. According to a 2013 ADA survey of senior dental students, the average debt level for a graduating student was $221,000. Adding a residency may boost the amount to $400,000+. The worst case we recall seeing is a periodontist with over **$800,000** of student debt after attending two very expensive private schools.

A high debt load is sometimes viewed as an impediment to a practice buy-in or purchase, and it leads young dentists in a different direction, like corporate dentistry or being a perpetual associate. But, when looking at this rationally, the buy-in or outright practice purchase is typically their best economic alternative.

This becomes evident after considering **two factors**.

First, the buy-in is not really a "buy"-in to begin with. As much as the junior doctor may not want to admit it, the buy-in is really a case of the senior doctor giving away the first portion of the practice, typically 50%. As soon as the associate goes from being an employee to a co-partner, the old associate compensation formula is replaced with a sharing of profits between co-partners. Simply by going from an associate to a co-partner, the associate will notice a big pay raise (and the senior doctor a big pay cut). One way or another, the associate will use the pay raise to pay for the buy-in. They can't afford it otherwise. After the buy-in payments are made, both doctors will be earning roughly what they earned prior to the buy-in. Dr. Senior's money went in a full circle, with the end result being that Dr. Senior owns 50%, not 100%, of the practice. (In fact, we often draft into our clients' buy-sell agreements some protection for Dr. Junior. After making the buy-in payments, Dr. Junior won't be left with less than he or she was earning during their best year as an associate.) In short, Dr. Junior can't lose.

Second, let's compare the rate of return on prepaying a debt vs. the rate of return on the alternative investment. In this case the alternative investment is the investment in the practice "asset."

The C&A Advantage is mailed first-class to subscribers twice each month – $265 annual subscription rate.

Brandon S. Collier, Editor

Collier & Associates, Inc.
30195 Chagrin Blvd., Suite #100
Cleveland, Ohio 44124
Phone: 216/765-1199
Fax: 216/831-8279
Email: newsletter@collieradvisors.com
Website: www.collieradvisors.com

The information contained in this Newsletter must not be construed as advice or consultation. Consult with your attorney, accountant or financial advisor.
To comply with certain U.S. Treasury regulations, we inform you that any federal tax advice contained in this Newsletter is not a covered opinion as described in Treasury Department Circular 230 and therefore cannot be relied upon to avoid any tax penalties or to support the promotion or marketing of any federal tax transactions.

This Newsletter or portions thereof may not be duplicated without permission of COLLIER & ASSOCIATES, INC.

Let's say that the interest rate on the student loans is a non-deductible 6%. Prepaying this loan is the equivalent of putting the money to work in an investment that pays guaranteed 6% interest.

What is the rate of return on the practice buy-in or outright practice purchase? It is hard to quantify precisely, but it is substantial. If, for example:

> * a 50% buy-in costs $500,000 and is payable at $100,000 per year for five years, and
>
> * the associate sees a pay raise from $200,000 to $300,000 by virtue of now being compensated as a co-partner,

then the associate will use the $100,000 pay raise to acquire an income producing asset, namely half the practice.

This is an asset (like stocks, bonds or real estate) that will continue to have value and should appreciate over time. And, once the buy-in payments are over, this asset will continue to generate an income of at least $100,000 per year. Compared to the $500,000 purchase price, this is a 20% taxable rate of return. The after tax-rate of return will be closer to 12%, but this sure beats the 6% rate on the loan prepayments and it will likely be quite a lot more than 12% in future years as the practice grows and the earnings rise.

To make these results look even better, remember that **the buy-in or outright practice purchase pays for itself**. The young doctor uses the excess profits (above what a fairly paid associate would earn for the same work) to pay for the practice over a few short years. The doctor's net take-home pay (after making the payments) will be at least what he or she would have earned had they remained an associate.

The doctor can still take part of this net take home pay and use it to prepay student debt and "earn" that 6%. If he or she chooses to do so, the effective rate of return becomes 18% (the 12% on the practice **plus** the 6% on the debt repayment.) For an indebted young doctor, the buy-in or practice purchase is what we'd call a no-brainer!

Practice Ownership is Also the Best Pathway for Young Female Doctors Looking for the Ideal Work-Life Balance: Despite the fact that over the past decade the majority of graduating dental students have been female, a preponderance of our clients and seminar attendees continue to be men. This is a complicated subject, but a key reason is that there are forces at work that convince young female doctors that practice ownership is simply too much. This feeling is generated internally, where many of these doctors may feel that starting a family and owning a practice will be overwhelming. And, the large corporate dental chains feed on this insecurity. They encourage these doctors to join with them and become career indentured servants. Owning your own practice, determining your own schedule, and treating patients the way you want is, in the words of one very successful pediatric dentist client with four young children, a "wonderful dreamland" by comparison.

This is the best way to achieve both a successful career and a loving family. These twin goals are mutually supporting - not in opposition to each other.

In speaking with some of our female seminar attendees who bemoan that there are not more female practice owners in attendance, we are in the early stages of planning a special seminar specifically targeted to female doctors. Some of the topics will include proven ways that female practice owners have built and grown their practices, the perks of ownership, time saving ideas for achieving the work-life balance, and the ways for female doctors to achieve financial security for themselves and their families.

Stock Market Update - We Would Welcome a 10% Market Correction as an Opportunity to Load Up on More Shares of Great Companies, But Until That Happens We Are Buying Stocks Selectively: What follows are some of the factors that I am considering as I invest for my family. ***This is not intended as advice for any individual reader. Whether anything I write is relevant to your situation is for you to decide based on your individual facts and circumstances.***

This Newsletter or portions thereof may not be duplicated without permission of COLLIER & ASSOCIATES, INC.

C&A

Issues that can affect those decisions would include such things as your goals, your age and time horizon (how long before you will need to sell an investment), your need for cash from your investments, your tolerance for volatility and risk, etc.

After five years of unimpeded growth, the stock market has been up and down this year - but essentially flat - and trading at its all-time high. Share prices of excellent companies are high by historical standards, but these prices are supported by super-low interest rates. When interest rates are low, income producing investments such as bonds and CD's are less attractive, so investors plow their money into stocks. While we don't see the makings of a recession or an imminent bear market, we also don't expect the overall stock market to rise significantly over the next several years.

Unless our investment approach was to dollar-cost-average our money into a stock market index such as the S&P 500 or the US Total Stock Market (a perfectly reasonable long-term strategy) we would not be buying the stock market indexes now.

If we owned shares of high-flying, low earnings, companies like Twitter, we'd consider paring back our positions. If volatility ramps up and we see a 10% correction, we expect those companies with poor fundamentals to be especially hard hit. Instead, we have been patiently accumulating cash waiting for a pullback so we can jump back in and buy shares of many fine companies we've had on our radar screen. But, we've also been buying selectively, including recent purchases of the following investments:

Actavis - Pharmaceutical and aesthetics Ticker: ACT)

Tortoise Energy - Energy infrastructure (TYG)

Monmouth Realty - Real estate investment trust (MNR)

The following is a list of several of our top holdings, none of which we have bought recently, but which we are looking to add to if we see a pullback:

Apple - Computer hardware (AAPL)

Berkshire Hathaway - Warren Buffett's diversified conglomerate (BRK.B)

Gilead - Biopharmaceuticals (GILD)

MasterCard - Credit cards (MA)

Novartis - Pharmaceuticals (NOV)

Pepsi - Food and beverages (PEP)

Henry Schein - Dental and medical supplies (HSIC)

Visa - Credit cards (V)

Take Advantage of New IRS Regulations that Permit Immediate Deduction for Depreciable Assets Costing $500 or Less: The IRS recently issued a huge amount of new regulations for deducting various types of business assets. These new rules deal primarily with the timing of the deductions and whether the assets can be expensed in the year of purchase or must be "capitalized" or depreciated in small amounts over a number of years.

One new regulation - 1.263(a)-1(f) - will be particularly useful. This is called the "de minimis safe harbor election" and it says that if certain basic requirements are met, then **all asset purchases costing $500 or less** can be expensed in the year of purchase. This converts the slower small deductions of depreciable property into immediately deductible expenses. (Of course, tax code section 179 permits accelerated first year deductions of depreciable property. But for small items such as furniture, printers, computer monitors, etc., Section 179 is cumbersome from an accounting standpoint and requires taxes to be paid if the asset ends up being used 50% or less for business).

Here are the basics:

1. Each asset qualifies for an immediate deduction if it costs $500 or less.
2. Almost all assets qualify. There are a few exceptions that won't apply in the typical dental, medical or veterinary practice.

This Newsletter or portions thereof may not be duplicated without permission of COLLIER & ASSOCIATES, INC.

3. Delivery and installation costs are added in for calculating the $500 threshold.
4. You can't game the system by breaking more expensive assets into component parts.
5. To claim the deduction, you must do two things: (a) create an accounting procedure for your practice that says that assets costing $500 or less will be expensed, and (b) elect the $500 safe harbor on each annual tax return.

The accounting procedure has to be in place on the first day of the tax year, so for most readers, 2016 is the first year the safe harbor rule can be used. The following language should suffice and can be written into a corporate resolution or an individual statement if the practice is unincorporated:

"[Practice name] has put in place a new accounting procedure treating the following as costs to be expensed in the year of purchase:

(1) Amounts paid for property that cost $500 or less, unless that property is inventory; land; rotable, temporary, and standby emergency spare parts that the business elects to capitalize; rotable and temporary spare parts that the business accounts for using the optional method under Reg. Section 1.162-3(e); or the direct or allocable indirect costs of property that is produced or acquired for resale.

(2) Amounts paid for property that costs more than $500 and that qualify as expenses under applicable IRS Regulations."

To claim the election, the taxpayer has to attach a statement to each tax return. The statement must be titled "Section 1.263(a)-1(f) de minimis safe harbor election" and include the taxpayer's name, address, taxpayer identification number, and a statement that the taxpayer is making the de minimis safe harbor election under §1.263(a)-1(f).

Practice Buy-Ins That Are Bank Financed -- The Senior Doctor Should Understand What He or She is Guaranteeing if the Junior Partner Defaults:

If a junior doctor buys into the practice, the buy-in is most often financed by the senior doctor. A key reason is that if the buy-in were financed by the junior doctor getting the money from a bank, the bank will put a lien on the practice and require the practice to guaranty the loan. Often this is enough for the parties to avoid getting a bank involved. But when there is bank financing on the buy-in, the senior doctor must be sure what it is the practice is guaranteeing.

We review many of these loan documents on behalf our senior doctor clients (the "guarantor"), and the banks typically want the practice to guarantee not just the repayment of the loan, but to also guarantee all other loans that the junior doctor may take from that bank - whether or not those loans are related to the buy-in transaction. These guarantees are far too broad. Your lawyer must review these and make sensible revisions before you sign them. The banks will make a small fuss, but when pushed, they will agree to the changes.

Foreign Meetings of Boards of Directors: Can you deduct the travel expenses associated with holding a Board of Directors meeting for the corporation in Paris or London, etc? We seriously doubt that there is even a remote possibility that IRS will accept this deduction upon audit.

For board meetings to have even a chance of being deductible, the travel must be reasonable. You are making the case that you need to get away from the office and from home so you can clear your minds to better address the practice's long-term direction. The more exotic and upscale, the more this looks like a luxury vacation rather than a real business meeting.

Also, the IRS will want to see detailed records of business expenses and of the various matters covered in the business meetings. This is aggressive, and you may lose your travel, hotel and meal deductions. But, if you meet these basic requirements, the worst that should happen is the loss of the deductions plus some interest.

This Newsletter or portions thereof may not be duplicated without permission of COLLIER & ASSOCIATES, INC.