



Tax Issues for the Transitioning Dentist

It is just about time for you to sell your practice and move onto the next phase of your life. You are planning for the money from your practice sale to go a long way towards your retirement nest egg, but you are not really sure how much Uncle Sam is going to take from the sale. This article will help you with the tax issues involved in a dental practice sale

Legal Structure of your Entity: In California there are generally two entities that can own a dental practice of a sole practitioner (we will not deal with partnerships in this article). First is a sole proprietorship. If you are very near retirement and you operate your practice as a sole proprietor, you will get the best tax advantages, and have the least amount of headaches. You should not incorporate if you are very close to retirement. By staying as a sole proprietor, you will avoid any possibility of double taxation.

If you are five years or more from retirement, we generally recommend our clients to incorporate. If you are incorporating we almost always recommend you make an election to be an S corporation. The biggest advantage of this is that you will receive liability protection (discuss this with your attorney) as well as avoiding double taxation if you make the S election as soon as you incorporate. Also if you are currently a C corporation, you have to be very careful in making an election to be an S corporation. If you make the S election and sell your practice within ten years of making the S election, you will be subject to possible double taxation (this is called a built-in gains tax). Art has helped hundreds of dentists in making these decisions.

Allocation of the Purchase Price: The buyer and the seller have opposing agendas when it comes to the allocation of the price.

It is the seller's desire to allocate as much as possible to goodwill. Allocation to goodwill is taxed at the most advantageous 15% capital gains rate for Federal tax purposes. The buyer is not as excited about allocating to goodwill, as the buyer has to amortize the amount allocated to goodwill over fifteen years.

On the other hand, the seller wants to allocate as little of the purchase price to dental equipment, furnishings, and computer equipment, as it is very likely that the seller has fully depreciated his or her equipment, and will have to pay ordinary income tax (currently the maximum rate is 35% for Federal income tax) on the amount allocated to equipment. The buyer wants to allocate as much as possible to equipment and furnishings, as the buyer can use the Section 179 election to expense some or all of the amount allocated to equipment and furnishings. The buyer also needs to remember that the more that is allocated to equipment and furnishings, the higher his or her personal property taxes will be each year.

Allocations to covenant not to compete are ordinary income to the seller and are amortized over fifteen years for the buyer, so generally very little is allocated to the covenant, as it does not matter the allocation for the buyer between goodwill and covenant, but it does make a big difference to the buyer.

The allocation process is generally performed by discussions between the CPA for the buyer and the seller. The IRS will accept any negotiated allocation (as long as it is reasonable) so before buying or selling, you need to check with your CPA as to the best allocation for you.

You also have to be careful in sales between related parties, as generally the buyer (usually son or daughter) is not allowed to amortize goodwill or covenant if bought from a parent. You must check with your tax advisor on this issue.

The tax issues on the sale of a dental practice can get complex (especially with the built-in gains tax), so early consultation with your tax advisor is critical. Art can have conversation with you and your CPA about this before listing your practice.

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