

DENTAL LEGAL UPDATE

Ownership Options for Your Dental Practice

by Jeanine Lehman, Attorney

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Special points of interest:

- Choose a practice entity which shields against liability
- For group practices, have a buy out agreement among the owner dentists

A stitch in time saves nine when structuring a Texas dentistry practice. With pressing scheduling and financial demands, dentists may fail to define the legal structure of their practice and the attendant responsibilities of their colleagues. Such a failure can be devastating when a lawsuit looms, or when the five D's strike - death, disability, divorce, dispute, and disinterest.

For the dentist owning a Texas dental practice, there are five common practice structures. These are sole proprietorship, partnership, professional corporation, professional association, and professional limited liability company. A much less common structure is the limited liability partnership.

Sole Proprietorship: The sole proprietorship is the easiest to form. A single dentist owns the practice personally and most commonly, operates the practice under his or her own name. If a trade name is used, for example "XYZ Dentistry," a governmental filing is required to place the name in the public records. Otherwise, no governmental filings are needed to form a sole proprietorship. (There are governmental filings for the actual operation of the dental practice.) The dentist owner has unlimited personal liability of all types, including, for meeting his contractual obligations, for example, on leases and debts, for satisfying judgments and awards for "tort" liability, for example, when an employee has a car accident on an office errand, a patient slips and falls in the waiting room, or the dentist is found to have committed professional malpractice. The sole proprietorship

terminates upon the death of the dentist owner.

General Partnership: For group practices, dentists often form practice partnerships, either intentionally or by happenstance. A partnership is an association of two or more persons to carry on as co-owners a business for profit, which may include the business of operating a dentistry practice. The most common form of partnership is the general partnership. Like the sole proprietorship, no governmental filing is required to form a general partnership. Nor is a written partnership agreement required. Instead, a "handshake" or even a course of conduct, alone, which evidences intent to be co-owners of a business operated for profit, can be enough to establish a partnership.

The ease of unplanned partnership formation starkly contrasts with the expense of dissolution and the extensive personal liability of the partners. Generally, every partner is an agent of the practice partnership for the purpose of the practice's business. Therefore, the act of a partner, including the signing of an agreement in the practice partnership name, for apparently carrying on in the usual way the practice's business, binds the partnership, unless the partner lacked real authority and the person with whom he dealt knew of the lack of real authority. This carte blanche to be an agent can be painful, for example, when one of the dentist partners decides to buy a \$100,000 computer system in the partnership name without consulting his partners. In most cases,

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Professional corporations offer significant shielding from personal liability for dentists.



Some dentists prefer their building being owned by a separate non-professional entity, such as an LLC, to:

- *Lower associate's practice buy-in price*
- *Allow family or trust ownership interest in building*
- *Shield the building asset*

Ownership Options (cont.) --

the partnership will have incurred the whole \$100,000 liability, even though the individual partners were never consulted by the high-tech buff. Generally, a practice partner will have unlimited personal liability for the debts and obligations of the partnership which were incurred after the time he became a partner. These obligations include both contractual liabilities and tort liabilities for damage to persons or property, including professional malpractice.

In a practice partnership, absent a partnership agreement provision to the contrary, losses generally are divided in the same percentage as profits among the partners. Also, when a partnership is dissolved, the individual partners are required to equalize capital accounts. The capital account is the account in which a partner's cash and property contributions to the partnership is recorded. Generally, unless provisions are made among the partners, no accounting is made for contributions of services. Not surprisingly, a common source of discord among partners is the belief that some of the partners are working harder and longer than the other partners. Absent an agreement addressing the "sweat equity" of the partners, at dissolution time, the law is blind to the service contributions. Generally, the partners who have negative capital account balances must ante up the negative balance in cash to the practice partnership.

The termination of the partnership may be caused at a disadvantageous time by events beyond the dentist partners' control, such as the death or bankruptcy of a partner or, by one or more of the partners bailing out. To cover these events and also to cover the responsibilities of the partners and partner buy outs, practice partnerships should have a written agreement. Additionally, since Texas has community property laws, the agreements concerning buy outs may need to be signed by the

dentists' spouses, to minimize practice disruptions caused by divorce.

Professional Corporation: For most group practices and solo practices, the practice structure, which offers significant protection from liability, is the professional corporation. The professional corporation is formed by filing formation documents with the State of Texas. Dental professional corporations operate in a similar manner to business corporations, with the exceptions that (i) the purpose of the professional corporation is to practice dentistry, (ii) all of the owners, officers and directors of the professional corporation must be licensed Texas dentists and (iii) the owner of the professional corporation remains personally liable for his own professional malpractice, even if services were rendered in the corporate name.

Like business corporations, professional corporations offer significant shielding from personal liability for the practice owners. Generally, provided a contract is in the professional corporation's name and not co-signed or guaranteed by the dentist owners, the dentist owners, in most cases, will not be personally liable for obligations under the contract. Also, shielding from personal liability for the dentist owners will, in many cases, be present for some types of tort liability such as the slip and fall in the waiting room or the employee errand car accident. However, the professional corporation will not insulate a dentist owner from his own malpractice.

As a general caveat, in order to attain the benefit of the shielding from certain liabilities, the dentists must maintain the professional corporation as a separate entity and not an alter ego for the individual owners. Steps that help to establish the separate entity status are maintaining separate books, records, and bank accounts for the corporation, with no commingling of corporate funds and assets with personal funds and assets, holding regular meetings of the shareholders and

directors of the corporation, issuing stock certificates to show ownership of the corporation, and operating the practice in the name of the corporation. Failure to maintain the separate entity status could result in personal liability being imposed on the dentist owners of the practice when the "corporate veil is pierced" in a lawsuit. Also, in extreme cases, for public policy reasons, courts may impose personal liability on owners of a corporation. In a textbook case, a taxi cab business incorporated each of its cabs separately because that was cheaper than buying liability insurance on the cabs. The court imposed personal liability on the owner of the corporation in spite of the incorporation on the grounds of public policy. Due to the result in that case, even with an incorporated practice, dentists will want to consider maintaining adequate liability insurance. Also, incorporating a practice will not get a dentist owner off the hook for personal liability for employee income tax and Social Security withholding, which may be imposed, in some cases, for failure to make required tax deposits under the Internal Revenue Code.

The professional corporation offers distinct advantages over other practice options in its characteristics of centralized management, continuity of life, and transferability of ownership. Professional corporations, like business corporations, have shareholders who own the corporation. The shareholders then elect a board of directors. The board of directors is responsible for setting the overall policies and direction of the corporation. The board of directors elects the officers who run the day to day operations of the incorporated practice. Generally, there is a clear demarcation of responsibilities in the incorporated practice. This centralized management is often more effective and efficient than the decentralized consensus management of the partnership structure. Also, the feature of continuity of life increases flexibility. Generally, the professional corporation continues after the death of one of the owners. This is helpful because the contracts of the incorporated practice may stay in existence after the death of one of the owners. Also, when selling the practice, greater flexibility is present because the practice may be able to be sold as a going concern with its contracts in place, when ownership in the professional corporation itself is transferred in the sale. Finally, due to the transferability of shares feature of the professional corporation, greater flexibility is present for bringing in new owners and for buying out owners.

Professional Association: Beginning in 1999, dentists could form Texas professional associations, joining the ranks of physicians and podiatrists who previously had this privilege. This was a great advantage because professional

associations were not subject to the Texas franchise tax. Beginning with tax returns due in 2008, professional associations became subject to the Texas franchise tax, like professional corporations and professional limited liability companies, so the tax advantage was discontinued. Professional associations offer liability protection that is similar to professional corporations.

Professional Limited Liability Company: A newer type of practice structure is the professional limited liability company. This structure has liability protection that is similar to professional corporations.

Registered Limited Liability Partnership: A more rare type of practice structure is the registered limited liability partnership (LLP). An annual renewal with the State of Texas is required to maintain the LLP. The LLP must also satisfy insurance or financial responsibility requirements, including for malpractice claims.

Building Ownership: Some dentists prefer to keep the ownership of their dental building separate from their practice entity. Reasons for this separation include protecting the building from liabilities associated with the practice, allowing a lower buy-in price by an associate who is buying into the practice entity and not the building, and allowing non-dentists to have ownership interests in the building, for example, spouses, family members or trusts. The building can be owned by non-professional entities, thus shielding owners from many liabilities. Ownership options for the building include the limited liability company or limited partnership.

Conclusion: For implementation and appropriate legal advice, dentists are advised to engage a Texas attorney with practice formation experience. As a part of prudent planning with the advice of their attorney, dentists in group practices should consider having a buy out agreement in place to handle the five D's - death, disability, divorce, dispute, and disinterest. © 2010 Jeanine Lehman.

Jeanine Lehman is an Austin, TX attorney who practices health, corporate, business, and real estate law. For reprints, please call Jeanine at (512) 918-3435 or write her at jeanine@jeanine.com or PO Box 202211, Austin, TX 78720.

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Texas & Federal Law Changes

Dental Practice Sale/Succession Workshops

Legal aspects of dental practice sale and succession:

- ✓ Legal Checkup
- ✓ Partner/Associate Recruitment
- ✓ Disability/Retirement
- ✓ Practice Sale
- ✓ Buy Sell Contract
- ✓ Real Estate Options
- ✓ Estate Planning

For information, call Jeanine Lehman at (512) 918-3435.

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Sales Tax on Dentistry?

In a March 25, 2010 hearing in Austin, the Texas House Ways and Means Committee considered imposing sales tax on elective and cosmetic physician and dental medical services, as well as on 23 additional service categories currently exempt from the tax. Facing an anticipated shortfall of \$11 billion to \$15 billion, Texas is looking for revenue sources. Testimony expressed concerns about increasing costs to dental patients and the difficulty of distinguishing between a purely cosmetic procedure and a restorative procedure. For example, crowns, veneers, and white fillings are used in restorative procedures. The committee asked what would be the most attractive tax if it were "revenue neutral" – with choices of sales, margin (franchise), and personal

property taxes. The committee also asked the occupation tax amount for each of the groups and when that tax was last raised. Currently, dentists pay occupation tax of \$200 per annum, collected upon licensure and renewal. The occupation tax is easy to collect from state licensees. Watch for increased taxes.

HITECH: Health Info. Breach Notifications

Under 2009 HITECH rules, health care providers (including dentists) and other HIPAA covered entities, generally, must promptly notify affected individuals of a breach of unsecured protected health information and when a breach affects more than 500 individuals, also notify U.S. Dept. Health & Human Services and the media. Breaches affecting fewer than 500 must be reported annually to HHS.

Business associates must notify the covered entity of breaches at or by the business associate.

Federal enforcement of the new rules can begin February 2010. Dental practices with breaches affecting more than 500 people include theft of a desktop computer. Breaches also include theft of laptop/electronic device, misdirected mail/email, theft/loss paper records, unauthorized access, loss of backups, and hacking. With legal counsel, it is prudent to review and revise dental practice HIPAA policies for compliance with HITECH and to make more information "secured", i.e. by encryption and other methods under the rules. If a dental practice suffers a breach of protected health information, a health lawyer should be consulted immediately to assist with HITECH rule compliance.

About Our Firm ...

Law Offices of Jeanine Lehman P.C. is a Texas law firm headquartered in Austin with a state-wide health law practice. Our health law practice is focused on business law, transactional aspects of individual and group practices, such as contracts and incorporations, office/facility leases, building purchases/condos, and build-to-suits, practice sales/purchases/buy-ins, employment agreements, financing, and consultation concerning the day-to-day legal concerns of running a health care practice. The firm is owned by Texas Attorney **Jeanine Lehman**. Jeanine has over 25 years experience as an attorney. She has had one book and over 70 articles published. She speaks to professional and business groups concerning legal topics. Jeanine is blessed to have one dentist and three dental hygienists in her family. Contact us at (512) 918-3435, jeanine@jeanine.com or PO Box 202211, Austin, TX 78720, and visit our website at www.jeanine.com.