

DANZIGER & MARKHOFF LLP

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Danziger & Markhoff LLP
123 Main Street
White Plains, NY 10601

Telephone 914.948.1556
Fax 914.948.1706
www.dmlawyers.com

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IRS ALLOWS MID-YEAR ELIMINATION OF 3% SAFE HARBORS

Recognizing the stress that the downturn in the economy is having on businesses of all sizes, the IRS recently announced a relaxation in the rule applicable to employers who have 401(k) plans with a 3% safe harbor feature. Previously, employers with such plans could not eliminate the mandatory 3% of compensation contribution obligation mid-year.

Under the new rule, an employer that incurs a substantial business hardship, amends its plan and provides its employees with advance notice may eliminate the 3% feature for the balance of the year after the change becomes effective.

While this new IRS rule is welcome news that can be helpful for certain employers who are going through difficult times, the details that are embedded in the rule will make it unattractive to many employers. Most significantly, employers who revoke their election remain subject to the top heavy rules which often require employers to make minimal contributions even if the plan does not have a 3% safe harbor feature. ■

Please contact Andrew E. Roth, Esq. or your Plan Administrator to discuss how this new development relates to your particular situation.

AN ALTERNATIVE EXIT STRATEGY FOR MEDICAL DOCTORS

A concern of every sole practitioner is what to do with his or her medical practice upon retirement. A common approach has been to employ an associate several years before retirement with the intention of having that associate purchase the practice. Finding a suitable associate, analyzing whether the practice can support two physicians financially, and working closely with a physician employee (to which the owner of the practice has not been accustomed) should be carefully considered when evaluating this option.

Alternatively, a sole practitioner can transfer his practice to a large multispecialty group or local hospital.

Here, the practitioner should consider the possibilities of loss of autonomy, a mandatory retirement age, or a nominal purchase price for the assets of the practice.

There is another alternative which has become popular with sole practitioner medical doctors: selling the assets of the practice to another private practitioner or to a physician who has recently completed training. This type of transaction (which is widely used by dentists, accountants and physical therapists) will typically yield greater sales proceeds for the seller than the transactions mentioned above. Also, this type of trans-

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INCREASING BUSINESS CASH FLOW WITH AN ESOP

In the current economic environment, business owners are searching for strategies to increase their available cash flow. One such strategy involves the sale of all of the stock of a corporation to an employee stock ownership plan ("ESOP") where immediately after the transaction the sponsor corporation, if an S corporation, maintains its election or, if a C corporation, converts to an S corporation.

Tax Shield

As previously discussed in a prior newsletter, if an S corporation is 100% owned by an ESOP, all of its taxable income flows through to its sole ESOP shareholder, and there is no current federal or state income tax on its annual income. Because the corporation has no current income tax liability, more money can be kept in the business for working capital, capital improvements or to meet the cash operating needs of the business. For example, if a company that is not owned by an

ESOP has an annual profit of \$2 million and is paying 40% in state and local income taxes, then it would have \$1.2 million available after taxes for working capital and capital improvements. However, if the same company is an S corporation and is wholly-owned by an ESOP, the entire profit of \$2 million is retained and there is an additional \$800,000 in free cash flow.

Sale Structure and Terms

In a typical structure involving a 100% stock sale to an ESOP sponsored by an S corporation, the selling shareholder receives as the purchase price of his stock a combination of cash, an installment note from the ESOP and warrants to purchase additional stock of the company, thereby preserving his upside potential. The exercise price for the warrants will generally be equal to the value of the shares immediately after the sale which will be reduced by the indebtedness incurred by the company to finance the ESOP purchase transaction.

The selling shareholder will ultimately realize value through the warrants by selling them to a third party or having them redeemed by the corporation and, provided he holds the warrants for a year or more, will be taxed at long-term capital gains rates at such time.

Owner Participation in ESOP

Subject to certain limitations contained in Internal Revenue Code Section 409(p), which prohibits concentrated direct and indirect ownership of S corporation ESOPs, the selling shareholder may also participate in the ESOP, with his share allocation based on his proportionate share of the company's payroll (subject to a limit on maximum compensation of \$245,000 in 2009). For companies with high employee turnover, allocations will over time benefit longer-term employees, including the selling shareholder, since allocations to employees who leave

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REMINDER: UPCOMING REGULATORY DEADLINES FOR HEALTHCARE PROFESSIONALS:

Office-Based Surgery Accreditation Deadline

July 14, 2009 is the date by which all office-based surgical facilities in New York State must be accredited; a physician who performs OBS after such date without having his office accredited may be guilty of professional misconduct. OBS is defined as any operation other than "minor procedures" and procedures requiring "minimal sedation", in each case as defined in the OBS statute.

"Red Flags" Rule

The Federal Trade Commission has delayed enforcement of the new Red Flags rule until August 1, 2009. This regulation requires creditors (defined broadly in a way which the FTC has interpreted to date as including physicians) to develop identity theft prevention programs. Several medical trade associations, including the American Medical Association, have developed tem-

plate programs for physicians to use. The FTC itself has posted an interactive do-it-yourself program on its website at www.ftc.gov/bcp/edu/microsites/redflagsrule for entities with a low risk of identity theft. Medical trade associations continue to lobby the FTC to exclude physicians from the definition of creditor before the new effective date. ■

If you have questions about either of these Regulations, please contact Joshua S. Levine, Esq.

FLORIDIANS WITH NEW YORK, NEW JERSEY OR CONNECTICUT REAL ESTATE

In a previous newsletter we discussed how New York, New Jersey and Connecticut have “decoupled” from the federal estate tax system and now impose their own estate taxes, whereas Florida does not impose a separate estate tax. This has created a problem for clients who are Florida domiciliaries (or domiciliaries of any state outside New York, New Jersey and Connecticut) since New York, New Jersey and Connecticut will impose an estate tax on the value of their real estate located in those states.

We have avoided this problem for clients by transferring ownership

of their New York, New Jersey or Connecticut real estate to a limited liability company (“LLC”). By doing so, there will be no New York, New Jersey or Connecticut estate tax because an LLC interest is deemed to be intangible personal property which would not be taxed either in the state in which the real property is located or in Florida. The added benefit of the LLC is that it creates another layer of liability protection in case the property becomes the subject of a lawsuit.

The New York State Department of Taxation and Finance has recently ruled that ownership of an interest in a single member LLC

owning New York real estate will not avoid New York estate tax. However, this problem can be avoided by gifting a small percentage of the LLC interests to your spouse or children and amending the Operating Agreement to admit the new members. If you created a single member LLC in the past in order to avoid New York estate tax, please contact us so that we can help you make the necessary amendments in order to comply with the Department of Taxation and Finance's new guidance. ■

Kindly contact Michael Markhoff, Esq. to discuss the need for amendments to your estate plan.

AN ALTERNATIVE EXIT STRATEGY FOR MEDICAL DOCTORS

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action appeals to a young physician buying the practice because he does not have to wait years to become an owner of a practice or to build a patient base. Many young practitioners have discovered that merely being appointed to the panels of managed care companies does not draw sufficient patients to establish a new medical practice.

Medical doctors should consider the following when selling or purchasing a medical practice:

1. Regulatory Concerns. The terms of a sale of a medical practice must be structured carefully so that they do not violate the anti-kickback and self-referral laws. For example, in most cases, the seller cannot provide services to the purchaser for more than one year after closing. Additionally, the purchase price cannot be

tied to ongoing revenue of the practice.

2. Purchase Price. The purchase price of the practice is determined by many factors, including the demographics of the patients, growth of the practice over the past several years, quality of the physical plant, and specialty of the medical doctor.

3. Payment of the Purchase Price. In most cases, the purchaser obtains bank financing and pays the purchase price at closing. If the purchaser is unable to pay the entire purchase price at closing, the seller will often accept a promissory note for the balance due. Typically, the purchaser personally guarantees this obligation and grants the seller additional sufficient security to ensure payment.

4. Allocation of Purchase Price. The tax allocation of the purchase price is extremely im-

portant as it will dramatically impact the net sales proceeds received by the seller. Allocation to assets where the seller receives capital gains tax treatment is most beneficial to the seller. Allocation to assets that can be depreciated more rapidly or expensed are most beneficial to the purchaser. Of course, all allocations must reflect fair market value for the assets purchased.

5. Seller Providing Services After Closing. Paramount to a successful transition of the practice to the purchaser will be the seller's obligations after closing. The seller should be required to introduce his patients and referral sources to the purchaser and help him obtain medical staff privileges at the local hospital, if necessary. The seller is typically compensated at a percentage of his production or a set amount for each day he provides services to

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AN ALTERNATIVE EXIT STRATEGY FOR MEDICAL DOCTORS

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the purchaser. As indicated above, the term of such post-closing services must be structured properly to avoid regulatory issues.

6. Restrictive Covenant. The purchaser will typically require that the seller execute a covenant not to compete, with terms that are reasonable as to geographic scope and duration.

7. Real Estate Lease. The purchaser can either require the seller to assign his current lease to him or the purchaser can seek a new lease from the landlord for the office premises. The purchaser should require at least a five year lease with several renewal options. The purchaser should be required to indemnify the seller from any post-closing liabilities under

the lease. In addition, the seller should seek a release of obligations from the landlord. The purchaser should request from the landlord a cancellation clause if he is unable to continue to practice due to death or disability.■

*If you would like to discuss this exit strategy in more detail, please contact
Robert B. Danziger, Esq.*

INCREASING BUSINESS CASH FLOW WITH AN ESOP

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prior to vesting (generally on a graded basis over a six-year period) will be forfeited and reallocated based on participant compensation in the year of the forfeiture. Moreover, once the funds borrowed by the ESOP from the company to purchase the selling shareholder's stock are repaid, the net profits of the company (free of federal and state income taxes) can be distributed to the participants' tax-deferred ESOP

accounts, thereby building up cash accounts within the ESOP.

Benefits to Owner

The selling shareholder thereby achieves the best of all worlds: First, principal payments on the installment notes will generally be taxable at capital gains rates as received, thereby converting ordinary income previously received in the form of compensation and/or corporate earnings into capital gains. Second, the corporation pays no tax and thereby has more available cash

flow to service the note obligation to the selling shareholder. Third, the selling shareholder continues to benefit from future appreciation in the value of the company through his warrants and ESOP stock account, both of which increase in value as the company prospers.■

Please call Stanley E. Bulua, Esq. or Jay Fenster, Esq. to assist you in evaluating whether an ESOP transaction will achieve the benefits described above.

Complimentary Qualified Plan Review

In these tough economic times, we want to help our clients and friends reduce business costs and also help them save for retirement. Accordingly, for our non-pension administration clients, we are offering a complimentary, no obligation review of your qualified retirement plan. Often expenses can be reduced by limiting the contributions necessary to be made to an existing retirement plan for employees. Alternatively, in many cases the amount contributed to the plan for the owner of the business can be increased.

We of course will notify our current pension administration clients of any enhancements that can be made since we review the terms of their plans annually.

Please call Andrew E. Roth, Esq. if you would like us to prepare a complimentary proposal.