

Slide 1 - Introduction

This presentation is designed to acquaint practicing dentists with a couple of charitable options to consider as they develop or revise their plans to either transition or sell their dental practice. There are two parts to the presentation. The first few slides describe a strategy for bypassing the capital gains tax on the sale of the practice. This option became law in December 2006.

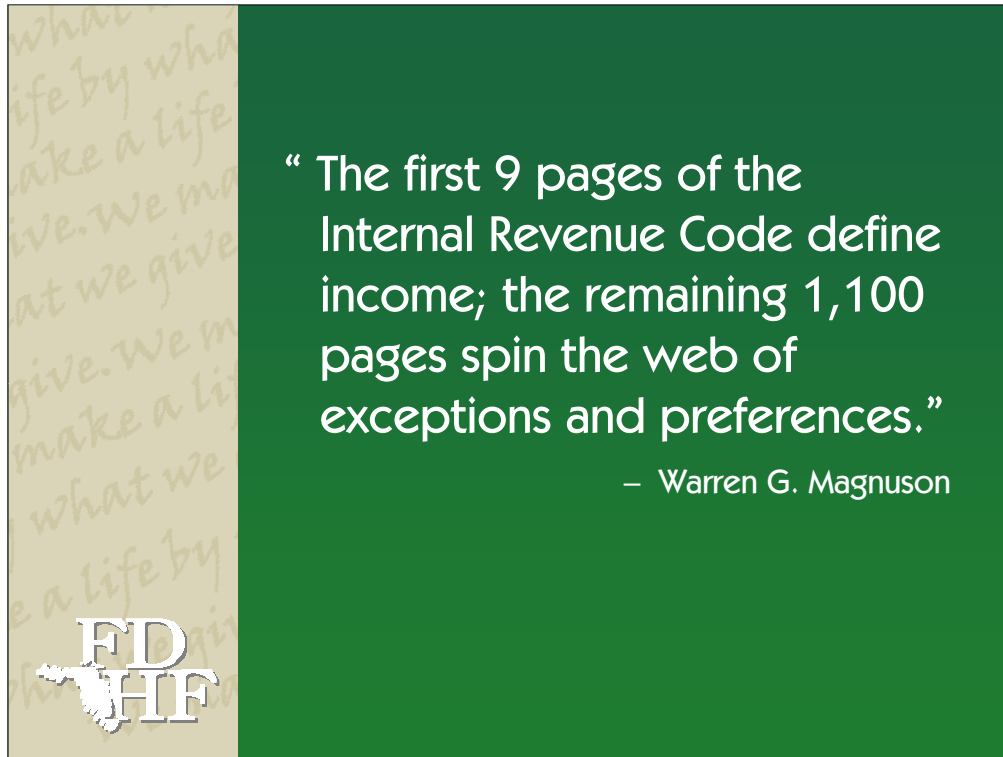
The second alternative permits the dentist to minimize or even zero-out the tax on the sale of individual practice assets, such as land, a building or dental equipment.

What you are about to see is an illustration that is designed to acquaint you with the basics; a general description of how both options work. It will briefly explain how dentists benefit from the tax savings of the sale of their practice (or business asset) by using a charitable remainder trust. It also describes how to receive a portion of the value of the practice or asset in cash at the time of sale.

If you find one of these options attractive, contact the Florida Dental Health Foundation for a no-cost illustration that fits your factual situation.


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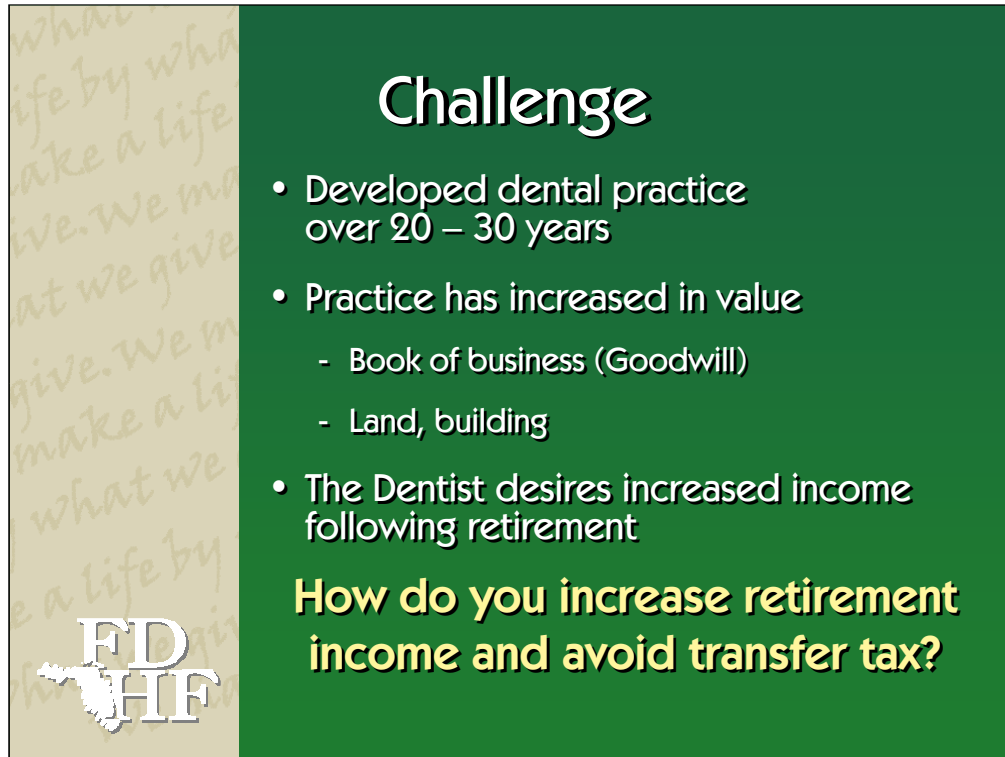
“ The first 9 pages of the Internal Revenue Code define income; the remaining 1,100 pages spin the web of exceptions and preferences.”

– Warren G. Magnuson



Slide 2 – The Tax Man Givith.....


Mr. Magnuson states facts that confirm the obvious.....the Congress takes from you while granting breaks to the special interests. The web of exceptions and preferences is dynamic...always changing.....most of the time without our knowledge. Financial advisors and attorneys must vigilantly keep up on the fast breaking changes so that they can properly posture their clients to take advantage or at least prepare for the changes. A perfect example is the December 2006 change in the rules addressing active income inside a charitable remainder trust (CRT). As you will see you may now transfer an active business, including a physicians or dentist's practice, using a tax advantaged CRT.



Challenge

- Developed dental practice over 20 – 30 years
- Practice has increased in value
 - Book of business (Goodwill)
 - Land, building
- The Dentist desires increased income following retirement

How do you increase retirement income and avoid transfer tax?

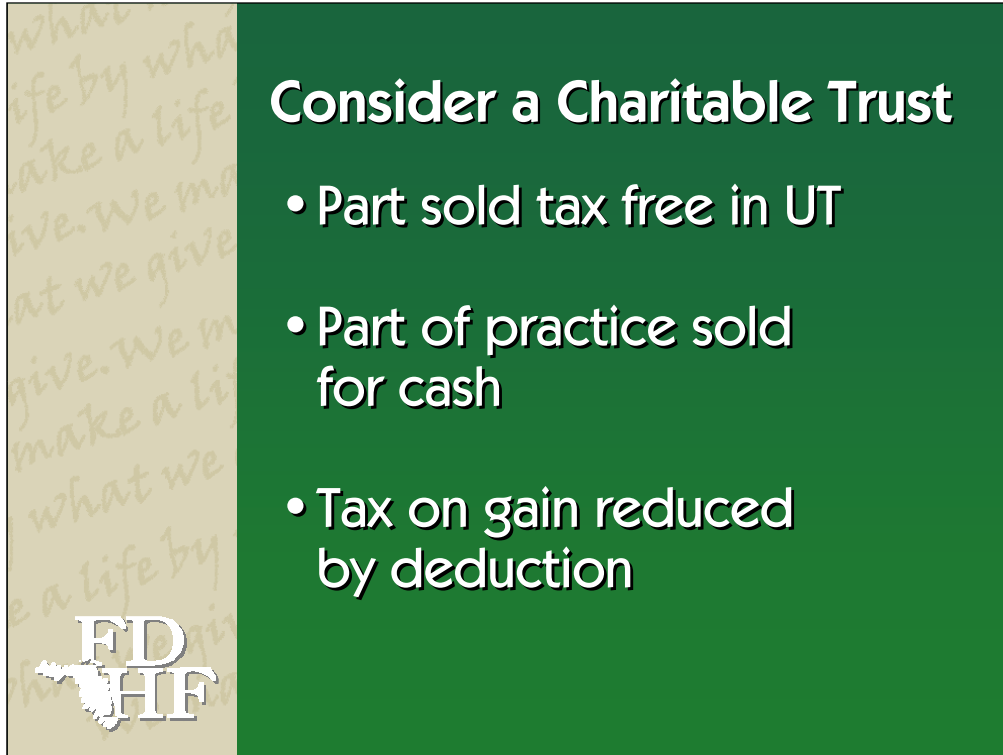


Slide 3 - Challenge

The good news is that the vast majority of dental practices increase in value. However, as you near retirement age, for diverse reasons there may be a falloff in production resulting in lower practice income. Feeling the strain of investing more personal hours to reap less return, retirement begins to look pretty good. However, the prospect of additional reduced income and the capital gains tax on the sale of your practice puts you off.


You dream about more income and paying Uncle Sam little or no tax.

In today's tax environment you can make that happen when you sell your dental practice!



Consider a Charitable Trust

- Part sold tax free in UT
- Part of practice sold for cash
- Tax on gain reduced by deduction



Slide 4 –Solution

One solution is to consider a combination of a sale and a trust. A percentage of the practice is sold tax free in a charitable trust. This produces a bypass of capital gain plus a charitable income tax deduction while the seller retains a lifetime income stream. The balance of the practice is sold for cash. Of course, there is gain on the cash sale. Fortunately, using this strategy the gain on the cash sale portion is offset in part or, sometimes offset entirely, by the charitable deduction and resulting income tax savings produced by establishing the trust.

Advantages of the charitable remainder unitrust include:

- (i) Bypass of Capital Gains Tax,
- (ii) Increased Income, and
- (iii) Charitable Income Tax Deduction.

With a sale and unitrust, the tax deduction from the charitable trust may offset part or all of the taxable gain from the portion that has been sold outside the trust. It may be possible to structure the sale and trust so that a donor ends up with cash from the sale and no net taxable gain because the taxable gain is offset by a charitable deduction. In addition to the above three benefits, the donors receive income for both of their lives and enjoy additional savings in probate costs and estate taxes. This combination sale and gift is excellent for converting highly appreciated low yield property into both liquidity and an excellent investment asset with little or no capital gains tax.

The net result is a sale of the practice with little or no taxation and a trust paying you annual income for one or two lives.



Potential Capital Gain

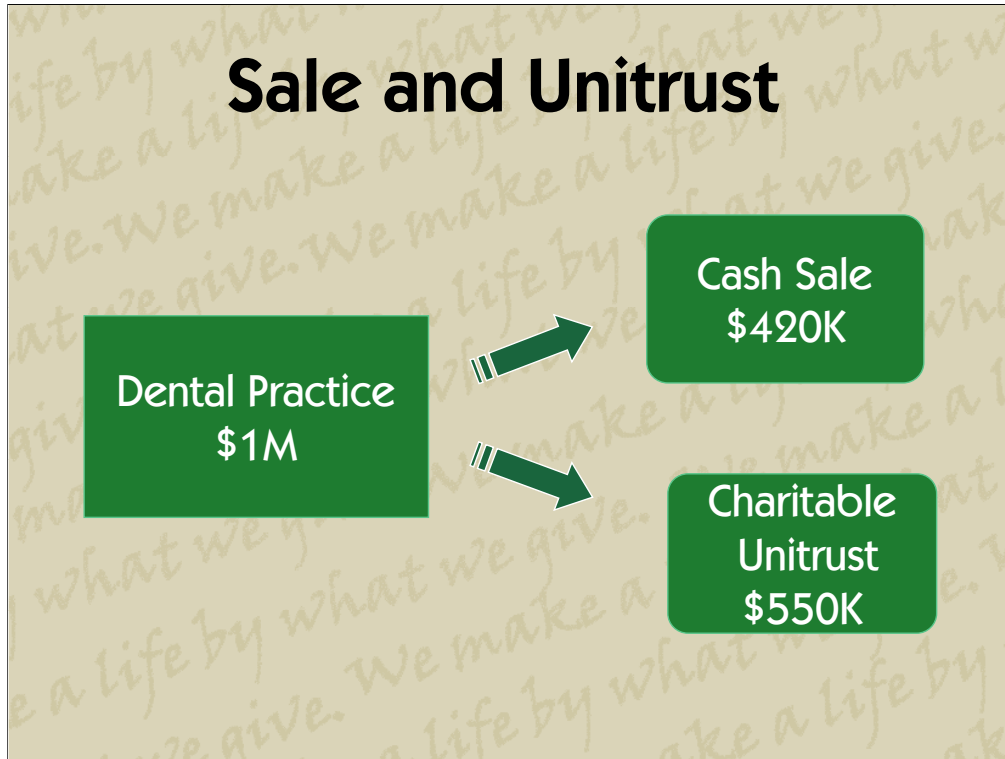
- Practice value — \$1 million
- Cost/Expenses — \$300,000
- Gain — \$ 700,000
- Save Taxes — \$105,000

FDHF

Slide 5 - Potential Capital Gain

The dentist in this illustration has realized substantial growth in the practice. If the practice is sold outright the seller would be subject to a substantial capital gains tax. The difference between their cost basis and the property value is the capital gain. This amount would be subject to the capital gains tax. For more information on how and which taxes might affect the sale of your practice contact your business broker, CPA or other tax advisor.

We should also note that the actual value of a dental practice depends on a number of important variables including location, age of equipment, size of practice, and annual income over the past five years . Valuation of a dental practice is a matter for the experts and requires special documentation for the tax man



Slide 6 – Strategy Flow Chart

This slide illustrates the process; how to divide the practice to generate zero tax while taking the maximum cash from the sale. In the illustration we have selected a dentist aged 60 with spouse aged 58. Seller and wife receive approximately \$35,000 in annual income over the two lives. Current tax tables indicate that the income stream would be paid annually for 32 years with a total income benefit to dentist and spouse of close to \$1.5 million. (note: figures above have been rounded – actual figures appear on the next page)

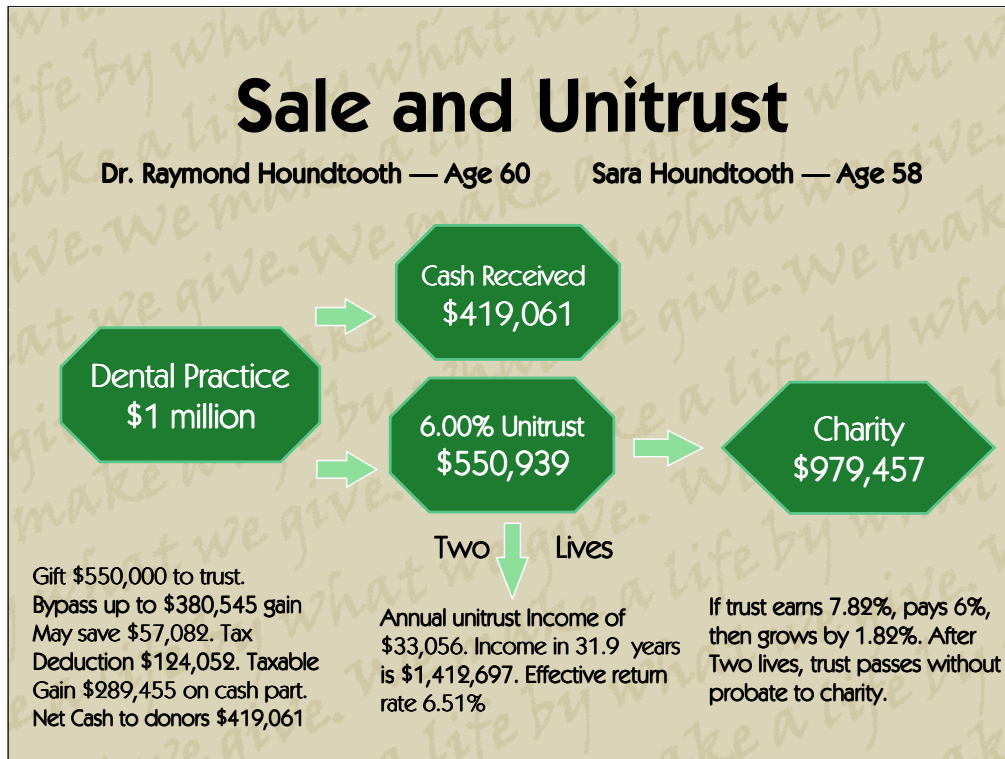
The seller controls the amount of tax paid by the size or percentage of the practice transferred to the charitable trust. The larger the contribution to the trust, the less tax you have to pay. Also, the more cash taken from the sale, the higher the tax.

Charitable Remainder Unitrust or CRUT: A “unitrust” is the name for a special type of charitable remainder trust that pays for the life of the creator of the trust (and spouse if so desired) a specific percentage of the trust principal as valued annually at the first of each year. In other words, the income payout from a “unitrust” follows the markets. As the assets grow so will the income. In like manner, should the market value of the assets decline in a particular year so will the income payout.

Sale and Unitrust

Dr. Raymond Houndtooth — Age 60

Sara Houndtooth — Age 58



Slide 7 – Detailed Flow Chart

Let's now view the plan again with a more detailed flow chart. The detailed flow chart for the Sale and Unitrust provides more information about the property and the sale. At the lower left section of the chart, the value and the gain are listed. By not paying the tax on the gain, there may be a substantial savings. In addition, when the property is transferred into the trust there will be an income tax deduction. This deduction is based on the payout rate of the trust and the age or ages of the donor or donors. In addition, there will be gain on the portion sold. When all of the tax benefits and capital gains are calculated, there will be a net cash benefit to the donors. This could be slightly more or slightly less than the actual cash paid on the sale portion, depending on whether or not there are more taxes payable or more tax savings from the trust.

The center portion of the detailed chart shows the charitable trust and the cash received. After the property is transferred to the charitable trust there will be a sale both by the trustee and by the donor on the retained portion. After selling the assets the trustee will reinvest, usually in a portfolio of high quality stocks and bonds, and then pay income to the beneficiary. At the lower portion of the chart, the income and the comparison of the trust income over the prior income are described. Please note there also will be income from the investment of the cash. The total income will be the income from the trust plus the income from the cash. Over the life or lives of the donors, there will be a very substantial income. While the income is dependent upon the investment and is not guaranteed, in the past 10 years many of these trusts have paid out the estimated amount of income and, on quite a few occasions, have grown substantially and paid more income. If the plan is designed correctly, part of the payout may be taxed at the lower capital gains tax rates. Based upon the tax saving, the actual effective payout rate is slightly higher than the stated unitrust percent.

The third section of the flow chart explains the benefit to charity. If the trust has earned more than it has paid, there could be growth of the principal. This growth of principal can then produce an increase in income and also a greater benefit for the charity. One of the nice benefits of this plan is that the principal will eventually pass to charity without probate.

Sale & UT Benefits

Slide 8 - Summary of Benefits

Let's view the summary of the benefits of the plan. First, if the assets were merely sold there would be a substantial potential capital gains tax. However, if the combination Unitrust and Sale is used, the capital gains tax is significantly reduced and there is an income tax deduction that will produce a very nice tax savings. When the tax savings are compared to the capital gains tax, the net cash to donor can be determined. In addition, the donor will receive added unitrust income and, based upon the assumed return rate, the total unitrust income from the trust can be estimated. All in all, this plan provides some very nice benefits for the donor.

Sale and Unitrust



- Buyer “In the Wings”
- No binding contract
 - Palmer v. Commr., 523 F.2d 1308 (8th Cir., '75)
 - Rev. Rul. 78-197, 1978-1 C.B. 83
 - Rauenhorst v. Commr., 119 T.C. 9 (7 Oct 2002)
- Fund the unitrust and sell

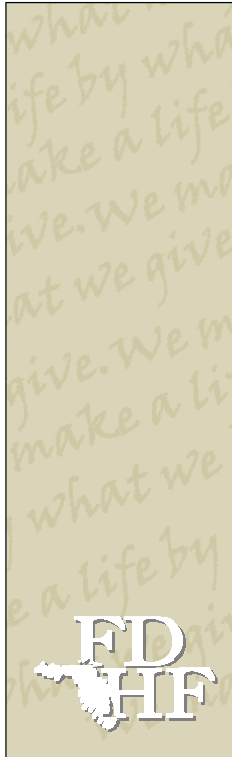


Slide 9 – Keep the Buyer in the Wings

There can be **no written contract** prior to the transfer of all or part of the practice into a charitable remainder trust – see case citations. You can, however, discuss a potential sale and effectively have a buyer waiting in the wings.

This is known as a prohibition against a **Prearranged Sale**. The seller must first transfer all or part of the practice to the CRT. The trustee of the trust would then enter into a contract with the buyer. If the selling dentist retained a portion of the practice (because they required cash at the time of sale), he or she would join with the trustee to sign a contract with the buyer that covered the retained portion of the practice

We would be happy to explain what that means and cite some examples for you.



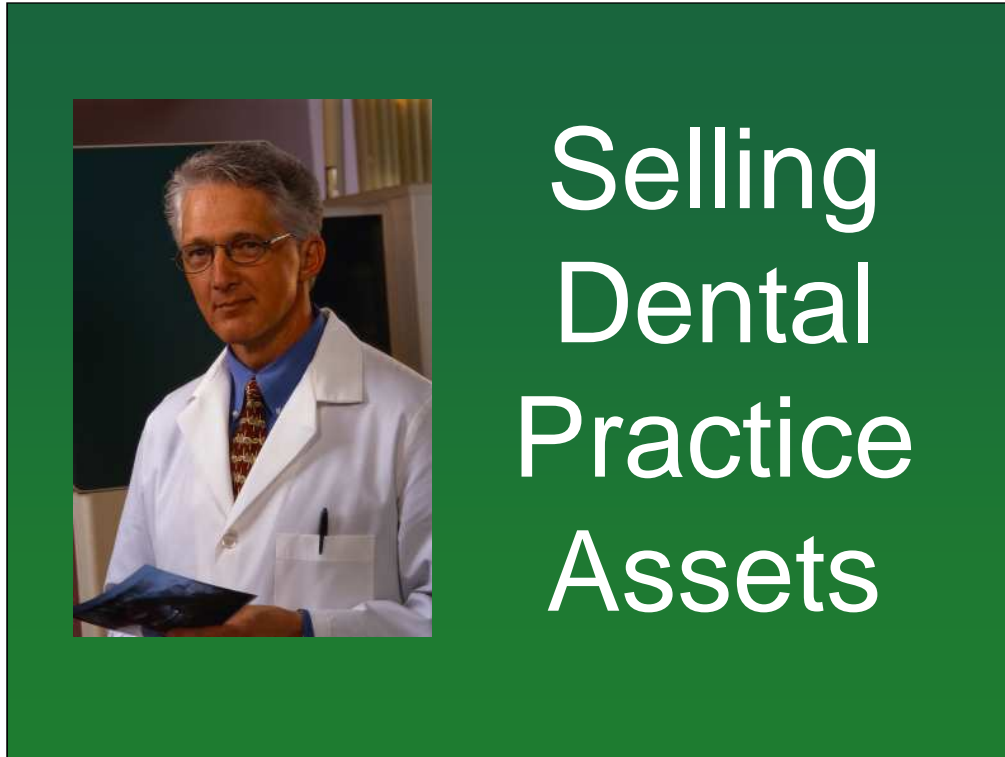
Tax Relief and Health Care Act of 2006

- UBI 100% tax
- Trust still exempt
- Permits business sales
- Signed into law 12/20/06

Slide 10 – Tax Relief and Health Care Act of 2006

Prior to the TRHCA 2006, a Charitable Remainder Unitrust (CRUT) could not earn active income. While there was no problem with a charitable remainder trust (CRT) earning passive income....under current federal law, \$1 of active income blows the charitable nature of the trust and the donor loses all of the charitable benefits of the CRT for the year in which the income is earned. In the past, there was no way to avoid or postpone active income in a transferred dental practice. That is why this charitable gifting strategy wasn't used to transfer an active business, especially a dentist's or physician's practice.

TRHCA '06 eliminates the active income prohibition. Now, when active income is reported you pay a 100% excise tax. With a turn-key CRT process in place, the transaction takes place over a short period of time rendering the excise tax on active income inconsequential as compared to the other tax benefits.



Slide 11 – Selling Individual Practice Assets

The following slides illustrates the tax savings of the sale of a practice asset, like a building. This strategy has been available for many years since it does not involve transferring a business (with the potential for active income) into the charitable trust.

Orchestrating a Tax Free Sale

\$2M Building

\$1M Debt
(Refinanced)

Dentist's Office

\$1M Basis

FD
HF

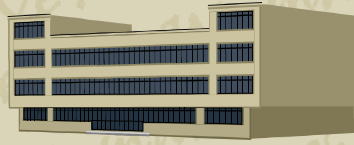
Slide 12 –Transfer of a Dental Office Building via a Charitable Remainder Trust (CRT)

While you may transfer a building or land to a CRT, the asset must not be subject to debt. Often, the largest asset in a dental practice is the office building (to include land, furnishings and lab equipment). This property is typically subject to debt. However, there are a number of ways to overcome this prohibition. The most efficient method is to pay off the debt prior to transfer of the building.

In our example, the building and land has a fair market value of \$2 million. Our dentist has a documented \$1 million in basis or equity, and an outstanding mortgage of \$1 million.

Before the building is transferred into a CRT, the debt must be eliminated.

Sale and Unitrust



Office

\$750K = CRT

\$250K = Rev. Tr.

Sale to
NewDocs LLC

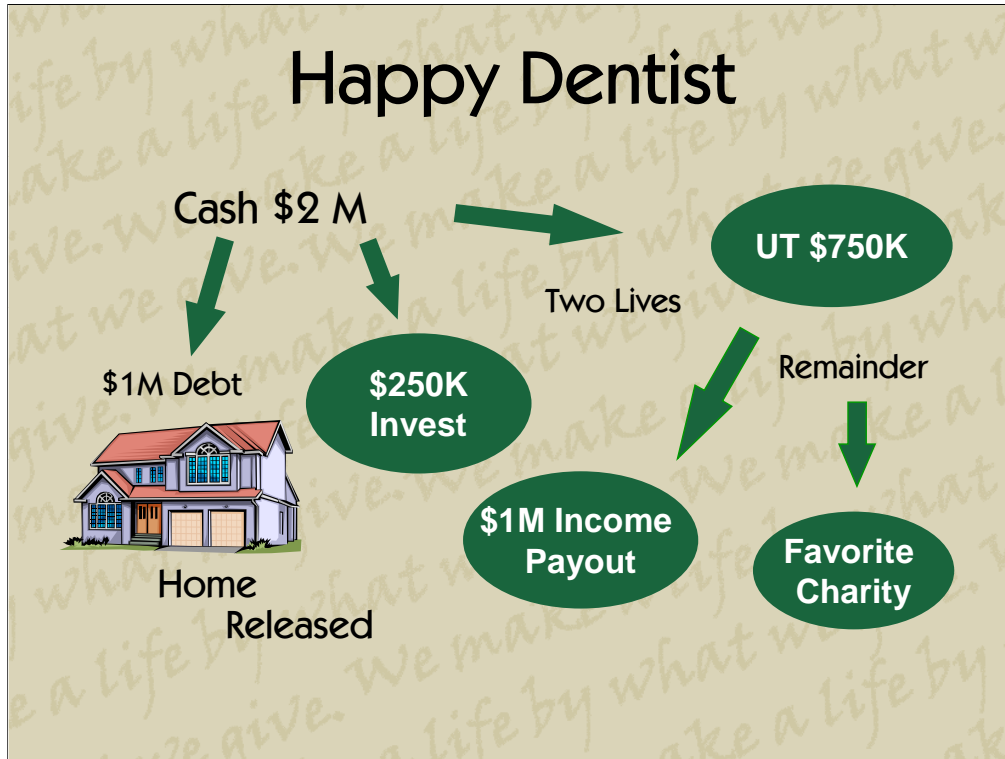


Home

\$1M Debt

Slide 14 – What it looks like before the sale

Using an IRS approved technique the dentist in our example retains \$.5 million (of the building) and transfers \$1.5 million of the building to the Charitable Remainder Trust. The dentist office is then owned by the Trustee of the CRT and the dentist, who join together to sell the property to NewDocs LLC, who are waiting in the wings.



Slide 15 – What it looks like after the sale

This is how we split the proceeds of the sale:

- The \$1.5 million retained by our dentist is placed in his revocable trust.
- The revocable trust pays off the debt on the home and invests the balance of \$500,000
- The Trustee of the CRT invests the proceeds for income
- On an annual, semiannual or quarterly basis, the Trustee pays the designated percentage income to the dentist (and spouse) for their lives.
- At the death of the final income beneficiary, the balance remaining in the CRT is paid to charity.

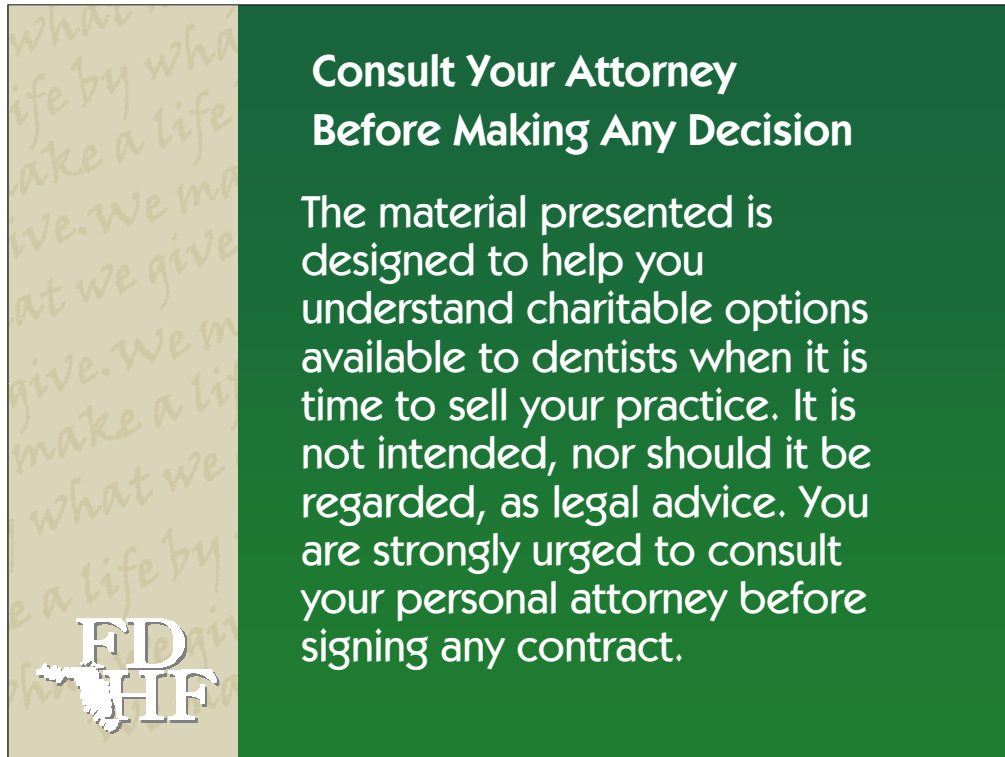
Tax Consequences:

There is tax generated by the transfer for cash (on the \$1.5 million), but this is normally offset in whole or part by the tax benefits that result from the Charitable Remainder Trust.

Bottom Line:

Anticipated \$3 million income spread over two lives, plus \$500,000 invested (in a revocable trust)

At the cost of \$500,000 the dentist establishes a \$2.5 million legacy that will forever benefit their charities of choice.



**Consult Your Attorney
Before Making Any Decision**

The material presented is designed to help you understand charitable options available to dentists when it is time to sell your practice. It is not intended, nor should it be regarded, as legal advice. You are strongly urged to consult your personal attorney before signing any contract.

Slide 16 – Consult Your Attorney and Financial Advisors

Consult your attorney and financial advisors prior to making a decision.

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