DENTAL PRACTICE ASSOCIATESHIPS

By H. Jack Stockton, DMD, CFP, MBA, FICD

Introduction

This document should help members (both owners and associates) of the Alberta Dental Association and College better understand and deal with dental practice associateships.

Dental practice associateships generally refer to arrangements between dentists whereby a principal (an owner-dentist or Professional Corporation owned by a dentist) engages another dentist (the associate) to provide professional dental services at the principal's practice. Typically the principal provides most or all of the facilities, supplies and staff, and the associate provides professional dental services to the practice's patients. These business arrangements have many variations, which will be discussed in this document.

Dental practice associateships have become very popular in recent years. Today, in most regions of Canada, about 25% of dentists in private practice are associate dentists. At present most new graduates choose not to establish or purchase a dental practice when first starting practice. In fact, more than 90% of new dentists begin private practice as associate dentists (some may first opt for dental internships or specialty programs before entering private practice). Also, a recent trend is that many senior dentists are choosing to sell their practices and become associate dentists during the latter part of their careers.

Dental Practice Associateships

Types of Arrangements:

As mentioned, typically the principal provides most or all of the facilities, supplies and staff, and the associate provides professional dental services to the practice's patients. However, some dental associates provide some of their own staff, equipment and/or supplies. The two main types of associateships are: (a) employee-employer arrangements and (b) independent contractor-principal arrangements.

The main differences between employee-employer and independent contractor arrangements relate to income tax consequences and liability issues. Generally it is to both the associate and owner-dentist's benefit to have the associateship classified as an independent contractor arrangement, certainly from an income tax point-of-view. Also, the owner-dentist will usually have less liability for the actions of the associate with an independent contractor arrangement.

With independent contractor associateship arrangements the owner-dentist is not required to pay Employment Insurance premiums, make Canada Pension Plan contributions, nor withhold

and remit income tax on behalf of the associate. The associate in turn, operating as a self-employed independent contractor, is able to deduct reasonable business expenses (such as auto, promotion and continuing education expenses). Also, independent contractor arrangements are not subject to the red tape associated with the provincial Employment Standards Act.

In the United States, where the Internal Revenue Service (IRS) has been very aggressive in attacking independent contractor arrangements, the majority of dental associateships are structured as employee-employer arrangements. However, the Canada Revenue Agency (CRA) has been less aggressive and most dental associateships in Canada operate as independent contractor arrangements, to the benefit of both the associate and the principal.

To date the CRA has not been too aggressive in attacking independent contractor dental associateship arrangements, although the author understands it has successfully reassessed a few of these arrangements. Therefore, when structuring associateship arrangements it is critical that the associateship agreement not only state expressly that the arrangement in an independent contractor agreement, but that the terms of the agreement fully reflect typical independent contractor characteristics. This is analogous to saying that if you call a bird a duck, it should walk like a duck, quack like a duck and swim like a duck.

Employee versus Independent Contractor – Criteria:

Many authors have discussed the criteria that the CRA uses when determining whether a dental associateship is an employee-employer or an independent contractor arrangement. One of the most relevant articles was written by Dr. Robert Hicks and was published a number of years ago by the Canadian Dental Association for its members. This article states that the important criteria are: (a) control the principal has over the associate? (b) ownership of tools? (c) financial risk? and (d) is the associate an indispensable and integral part of the business?

No single criterion alone will determine whether the associate is an employee or an independent contractor: rather, one must look at all aspects of the arrangement to see on balance whether the associate qualifies as an independent contractor. Generally, the less control the principal has over the associate, the more likely the associate will be deemed to be an independent contractor by the CRA. For example, if the principal examines all patients, develops the treatment plans, and directs the associate how to perform the treatment, then the associate would appear more like an employee. If the associate provides some of the instruments, equipment or staff, that arrangement would favour an independent contractor designation. Fixed associate compensation paid every two weeks would tend to make the arrangement look more like an employer-employee arrangement: whereas, as percentage commission paid once per month would be more typical of a compensation arrangement for an independent contractor. Also, if the duties of the associate were critical to operation of the practice, and if the practice could not function properly without an associate, that would favour an employee designation. Using this criterion, it would be difficult to argue that a receptionist was an independent contractor, but in most cases an associate dentist or a dental hygienist

would not be critical to the operation of the practice and could reasonably be viewed as an independent contractor.

Compensation Methods:

1. *Fixed salary or contract fee* – These arrangements, where the associate is paid a fixed hourly, daily, monthly or annual fee, or not very common in Canada. Although in recent years, with the more frequent us of "locum" dentists, this has become a more popular method of compensation (note: locum dentist are simply short-term associate dentists, often engaged to "baby-sit" the practice when an owner-dentist is disabled or away on an extended vacation). Another group of associate dentists that are quite often compensated using a fixed salary or contract fee are associate orthodontists; they are often paid a per diem rate.

2. *Percentage commission* – This is by far the most common method for compensating associate dentists in Canada. Compensation is usually based on "net collected billings", meaning that compensation is based on collections net of laboratory and hygienist billings (the associate's laboratory bills are normally paid by the principal). Sometimes credit card transaction fees are also deducted in a similar manner to laboratory fees. Regarding billings related to recall visits with the practice dental hygienist(s) – the professional examination fees are almost always included in the associate's "net collected billings", whereas the X-rays (taken by the dental hygienist and interpreted by the associate dentist) are typically excluded from the compensation calculation. However, this is one of the many compensation issues open for negotiation between associate and principal, and sometimes these X-ray fees are included in the calculation of the associate's compensation. Both parties should be clear on who these fees are credited to, since a misunderstanding can lead to hard feelings between the associate and principal.

The percentage of "net collected billings" paid to associate dentists varies from 25-60% or more, but is typically in the 35-45% range. Generally, specialist associates are paid a higher percentage than general dentists, and typically associates in rural or remote locations are paid a higher percentage than associates in urban locations such as Calgary or Edmonton. Since the business of dentistry typically has high fixed expenses and relatively low variable expenses, principals can afford to pay high-producing associates a higher percentage. Therefore, new dental graduates are often offered a lower percentage than more experienced dentists. Also, for the same reason, some associateship arrangements provide for a bonus to the associate above a certain level of billings.

Example:
Let's assume that an owner-dentist decides to engage an associate dentist. They agree that the associate will be paid 40% of net collected billings (net of laboratory and hygienist billings). For a given month the associate's collected billings are $27,000 (including fees for the professional exams at the hygienist recall visits) and the associate's laboratory bills for the month total $2,000.

In this case, the compensation calculation for the month would be as follows:

Collected billings for the month	$27,000
less, Laboratory expense	(2,000)
Net collected billings	$25,000
Commission percentage	X 40%
Associate's compensation for the month =	$10,000

Although not common, there are some combination arrangements. For example, an associate might be paid the greater of a fixed monthly fee or a percentage amount. When this type of compensation guarantee is included, the percentage amount might be lower than normal (again, a point for negotiation).

Higher percentages are usually paid when the associate provides some staff, instruments, supplies or equipment. For instance, if the associate provides his/her own chair-side dental assistant, an extra 10% is typically paid.

The CRA seems to have conceded that if an associate dentist is paid a percentage commission and is providing treatment for the principal's patients, then GST does not have to be paid. However, if it is really a cost-sharing arrangement, where the principal is simply providing facilities, supplies, staff, etc. to the associate dentist for a fee, and the associate is treating his/her own patients, then the principal would have to charge the associate GST on the services provided.

Attractive Situations for Dentists Seeking an Associateship:

Most associate dentists want to be busy and new graduates want to have the opportunity to learn more about both clinical dentistry and the business of dentistry. Therefore, the following situations should be attractive to most dentists seeking an associateship:

- A "saturated" practice; that is, a practice where the owner dentist is as busy as he/she wants to be and patients are waiting longer than they want for appointments.
- A dental practice with a high volume of new patients, since this will be the source for most of the associate's patients.
- A dental practice where the owner dentist wants to slow down and work fewer hours, and perhaps stop doing certain types of treatment; e.g., children's dentistry, endodontics, etc.. This situation should make it easy for the associate to get referrals from the owner-dentist.
- A dental practice with an experienced, competent owner-dentist who will be in the office a significant portion of the time when the associate is working at the practice. This is very valuable for new graduates who what to improve their clinical and practice management abilities. Also, the opportunity to do a wide range of dental treatments at the practice is important in providing a good learning experience.
- It is also important for the office to have good accounts receivable control, since associates are typically paid a percentage of collected billings.

- For those dentists who want to be practice owners in the near future, a buy-in opportunity at the practice will be important. Be aware that some owner-dentists want to be the sole owner of the practice and are not interested in having the associate buy-in.

Associate Dentists should have Reasonable Expectations:

Dentists wanting to associate should have reasonable expectations and be aware why the owner-dentist is seeking an associate. Different owner dentist can have very different reasons for wanting an associate. New associates should expect some or all of the following:
- To be asked to work some evening and weekend hours, especially in urban dental practices.
- To be asked to treat most of the practice emergency patients.
- To be asked to provide certain treatment that the owner-dentist does not enjoy; e.g., treating children or providing endodontic treatment.
- To be asked to sign a non-competition agreement (see details later in this document). Most principals want to protect their practice goodwill and will insist that the associate sign a non-competition agreement.

Associateship Contract:

The first issue to decide is whether the associateship contract should be in writing or not. Verbal agreements can be valid contracts, but if push comes to shove and a dispute arises, proving the terms of a verbal contract can be difficult. It is the author's opinion that all associateship contracts should be in writing, even for an associateship involving family members. Not only can there be disputes between the parties to the agreement, but the CRA might choose to attack the independent contractor status of the associateship. An agreement in writing will make proving your case much easier.

Terms that are important to both the *principal and the associate* include:

- Starting date and term?
- How can the contract be terminated?
- Can the contract be renewed? If so, how?
- Is there an option to purchase or a right of first-refusal? If so, details.
- Confirmation of independent contractor or employee-employer status.
- The associate's work schedule – are weekends and/or evenings involved, how many hours per week, how many weeks per year?

Terms that are of particular importance to the *principal* include:

- A non-competition clause perhaps backed up by liquidated damages for breach.
- A statement clarifying ownership of the associate's patient charts/records (typically all are the property of the principal).
- A requirement for the associate to carry adequate malpractice and comprehensive general liability insurance.

Terms that are of particular importance to the *associate* include:

- What is provided by the principal – space, staff, supplies, equipment, etc.
- Compensation – how much and when paid? Any guarantees or bonuses?

There are a number of *other considerations* that may or may not be included in the written agreement, but that should be thoroughly discussed before the associate starts practicing at the principal's office:

- How are new patients assigned?
- Who sets the fees? Is the associate allowed to provide free dental services to relatives?
- Who controls selection of commercial laboratory services?
- Who provides coverage for after-hours emergencies? Is this shared?
- Is the associate provided with parking?
- What happens if some of the associate's dental treatment has to be redone following termination?

The principal should be certain that the associate has received competent, independent advice before signing the agreement. If not, the associate could later claim than he/she was unduly influenced to the sign the agreement, which could be grounds for the associate to later have the contract voided.

Additional Comments Regarding the Terms of a Written Associateship Agreement:

1. General comment:
The author has seen associateship agreements less than one page and more than 35 pages in length. In the author's opinion, if the agreement is too brief, key issues will not be addressed, but if the agreement is excessively long and legalistic it can be very intimidating to the associate, to the point where the associate will not sign the agreement and will look elsewhere for an associateship opportunity. An agreement 5-10 pages should be comprehensive enough to deal with all of the key issues, but still not too intimidating to the potential associate dentist.

2. Term of the agreement:
Although the term of the agreement can be any length, typically associateship agreements have a one-year term. Also, it is common to add a clause allowing the agreement to automatically renew for an additional one-year period on the anniversary date of the agreement unless one of the parties notifies the other party of his/her intention not to renew; typically 60-120 days notice is required if not renewing.

3. Termination issues:
The ability to terminate an associateship agreement varies considerably from case to case. Most agreements allow termination upon the death of either party, or for "just cause", but not always. Some agreements do not allow termination prior to the end of the term except for death or just cause. However, other agreements allow for termination at any time during the agreement by either party provided adequate notice is given (typically 60 to 120 days notice

required in this case). Also, some agreements allow termination during a "probationary period" upon short notice (as little as 7 days notice during the first 30 to 90 days).

Termination issues are very important and each party should be comfortable with the termination provisions. For example, an associate would not be happy if he/she signed a 2-year agreement with no termination provisions and found out that he/she was only seeing one or two patients per day for an extended period of time.

Owner-dentists who anticipate that they might sell their practices during the term of the agreement might want to specify that the agreement is assignable to a purchaser-dentist.

4. Associate's work schedule:
Usually an initial work schedule is agreed to, which can be modified by mutual consent; in particular, evening and weekend hours should be specified. The minimum hours per week and weeks per year should also be stated, as should the advance notice the associate must give the principal when the associate will be away from the office; e.g., for vacation or continuing education. Stating how much time the associate will be at the office (like an independent contractor) is better than listing how many holidays and continuing education days the associate will be allowed (like an employee).

5. Ownership of patient charts/records:
Although it is generally assumed that patient charts/records for patients seen by the associate are the property of the principal, ownership of the patient charts should be expressly stated in the agreement. If the associate brings some patients to the practice and wants to keep the charts upon termination of the agreement, then those patient names should be listed in an appendix to the agreement to avoid conflict when the associateship agreement is terminated.

6. Non-competition agreement:
Given today's significant goodwill values for dental practices, especially in urban locations, it has become very common for principals to insist that associate dentists agree to non-competition clauses in associateship agreements (note: non-competition agreements are also very common in dental practice purchase-sale agreements). These clauses are typically of two types:

a) A *restrictive covenant* against the associate practicing dentistry within a certain geographic area during the term of the agreement, except at the principal's office, and for a defined period of time following termination of the agreement.
b) A *non-solicitation* clause against an associate soliciting the principal's patients, referral sources and staff following termination.

These clauses can be backed up by liquidated (pre-determined) damages in the agreement for breach and/or by agreeing that an injunction (equitable remedy) for breach is reasonable. Liquidated damages can be stated as a fixed amount, but it is likely more reasonable if it is based on a formula; e.g., a percentage of the associate's billings in the previous 12 or 24 months.

To be enforceable these clauses must (i) be reasonable in the circumstances, (ii) not be against the public good and (iii) be required to protect a legitimate business interest. Even if these criteria are met, there is some degree of uncertainty concerning whether the courts will enforce non-competition clauses in associateship agreements. However, at the very least it will make an associate think twice before breaching the non-competition agreement, since he/she would be subject to a lawsuit. Even when a dentist wins a lawsuit he/she loses, because of the time lost and legal fees incurred.

A court decision in Ontario of *Lyons v. Multari*, on appeal, overturned the restrictive covenant clause but upheld the non-solicitation clause in an associateship agreement. This case involved oral surgeons, not general dentists, but it does point out that restrictive covenants can be overturned. Also, realize that it is rare for a judge to enforce an injunction for breach on a non-competition agreement; judges much prefer to award damages to settle such disputes. To enforce an injunction there would have to be special circumstances that made the awarding of damages an inadequate remedy.

In spite of the uncertainty, the author recommends that owner-dentists include restrictive covenants and non-solicitation clauses in associateship agreements whenever there is a significant business interest to protect. For a more complete discussion about restrictive covenants, readers are referred to an article published by the author in the March 1993 issue of the *Journal of the Canadian Dental Association*, "Restrictive Covenants – everything you wanted to know but were afraid to ask".

7. Hold-back on termination for possible retreatment of associate's dentistry:
Although not yet common in associateship agreements, in recent years more principals are inserting a hold-back clause for possible retreatment of dentistry done by associates during the term of the agreement. Associates do not like these clauses, and most of the holdback amounts specified by principals are less than $5,000, although some principals specify a much larger amount. It is the author's opinion that to be effective the hold-back amount needs to be quite significant, and good potential associates may balk at a large hold-back amount. Therefore, in order to attract top-notch associates, principals might want to consider monitoring their associate's treatment closely rather than insisting on a hold-back clause.

Economics of a Dental Associateship:

Many times associate dentists are engaged for non-financial reasons. But, if an owner-dentist is planning to make money by adding an associate dentist to the practice, then only certain situations will qualify.

Due to the high fixed costs associated with private dental practice, associateships are most profitable for owner-dentists when the practice has excess capacity and an associate can be added without any significant increase in fixed costs.

As well, there are a few other situations that can be financially rewarding, such as:

a) Adding an associate to a busy dental practice, which would allow the practice to continue to grow, resulting in increased market value of the owner's practice goodwill.
b) Engaging a very productive associate dentist who is able to cover both increased fixed and variable practice costs, and still generate increased profit for the owner.

But, engaging an associate dentist makes the most economic sense when no additional space or equipment is required.

Many private dental practices have the potential to be open 65 to 70 hours per week. And, since a lot of these practices operate only 30 to 40 hours per week, there are numerous opportunities for owner-dentists to add an associate by expanding the hours of operation without having to expand the office or purchase additional equipment. Of course, in addition to underutilized facilities, the practice must also have an excess supply of patients available for the associate to treat.

The following example illustrates the profit potential for an owner-dentist with underutilized facilities and an excess supply of patients:

Example:

Associate dentist net collected billings		$300,000
less,		
Associate compensation @ 40%	$120,000	
Dental assistant	40,000	
Additional administrative staff costs	20,000	
Variable expenses (supplies, etc.) @15%	45,000	
Total incremental expenses	225,000	225,000
Extra profit to principal		$ 75,000
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In addition to the profit earned on associate billings, the addition of an associate dentist often results in additional revenue for the practice hygienist(s) and additional profit for the hygiene department. What's more, the additional practice revenue and profit should result in increased practice goodwill value when it comes time to sell the practice.

Note: For busy owner-dentists currently operating without a dental hygienist, the economics of adding a dental hygienist to the practice are generally more favourable than adding an associate dentist.

Associateships Leading to Buy-ins or Buy-outs:

An associateship arrangement can be an excellent preliminary step prior to a dental practice buy-in or buy-out. It gives the parties a chance to see if there is a good fit between the vendor and the purchaser, especially for the more complex buy-in or buy-out arrangements. Also,

there is less risk to the purchaser, since he/she will already be treating practice patients, will be familiar with practice staff, and will fully understand the day-to-day practice operations prior to the purchase-sale. In turn, these benefits to the purchaser often allow the vendor to sell for a higher price to a practice associate than to an outside dentist.

Final Comment:

Associateship arrangements can be win-win arrangements for owners and associates, but the parties should fully understand their contractual agreement. If you are not experienced in associateship arrangements and contracts, seek advice from a professional advisor familiar with associateship arrangements *before* entering into such an arrangement.