DENTAL PROFESSIONAL TAX GUIDE

This document provides guidance on tax issues commonly encountered by practitioners in the dental industry. While the document is intended to provide "quick, practical guidance" in a "bullet point format" as it relates to the industry, it does not take the place of tax advice from a tax professional, such as a Certified Public Accountant (CPA), an attorney specializing in tax issues, or an Enrolled Agent (EA). Issues covered are:

1. Choice of entity (pros and cons of each – including multitiered structures)
2. Self-employment taxes vs. payroll taxes
3. Reasonable compensation determination
4. Qualified Business Income Deduction
5. Self-rental income
6. Retirement accounts
7. Other benefit issues
8. Estate planning
9. Miscellaneous tax planning issues

Choice of Entity:

1. Sole proprietor/single-member limited liability company (LLC or PLLC)

a. Most common business structure among taxpayers. LLCs, a state law creation, are ubiquitous

b. Common strategies:
   - i. Retirement contributions (potentially larger with sole proprietorship)
   - ii. Legitimately converting some personal expenses to business expenses (professional dues and licenses, continuing education and home office, cell phone, or vehicle with mixture of business and personal use; of limited effect given dollar amounts involved).
   - iii. Tax accounting elections (e.g. cash basis reporting)

c. Pros:
   - i. Ease of formation and operation (e.g. formation of LLC with WA Secretary of State is a couple of hundred dollars with easy record keeping requirements)
   - ii. Ease of tax reporting (Schedule C on personal tax return) with lower reporting cost.
   - iii. Certain lower profit figures *can* result in overall lower tax after considering QBI deduction (QBID, below) when compared to pass-through entities (partnerships and S corporations). This is fact pattern specific and requires a "crunching of numbers," though more likely to be the case where income is below the indicated "phase-in" ranges of QBID limitations discussed below.

d. Cons:
   - i. Self-employment taxes on net earnings from self-employment.
   - ii. Higher audit probabilities (favorite of IRS to audit given self-employment tax exposure).

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2. S corporation (e.g. professional service corporation/PC or LLC/PLLC with S corporation election)
    a. Requires timely election on Form 2553. Often missed by the attorney with initial formation, so have to seek out a tax professional in a timely fashion (election can only be "backdated" up to 65 days from when it's filed, unless there's "reasonable cause" for failure to file timely). Recognize that in community property states, like Washington, spouse has to sign off as well.
    b. Creates separate tax return filing requirement on Form 1120S. Required to file so long as the S corporation election is in effect.
    c. Common structure for operating businesses without real estate and "simple" profit distribution arrangement (e.g. 50% ownership getting 50% of profit allocations for income tax reporting purposes and 50% of profit distributions).
    d. Common strategies:
        a. Retirement contributions (e.g. solo 401k)
        b. Legitimately converting some personal expenses to business expenses
        c. Tax accounting elections (e.g. cash basis reporting)
        d. "Managing" payroll taxes on owner wages trying to keep wages low, but not too low as to allow IRS audit
    e. Pros:
        a. Replaces self-employment tax obligation with requirement to pay "reasonable compensation," which can be easier to manage.
        b. Lower audit probabilities compared to sole proprietorship (0.1% audit rate of S corps for tax year 2021, maybe 0.1%-0.3% for individual tax returns for dental professional income range).
        c. Basis increase for deducting losses for loans from shareholder.
        d. Wages paid to owners count towards the "wage base" for purposes of the QBID, though this is of limited benefit in context of dental professionals on income being specified service trade or business (SSTB).
    f. Cons:
        a. Separate tax return filing requirement (can be costly; more expensive if records are messy; not uncommon for records to be messy).
        b. Lack of flexibility of income allocations for multiple shareholders. Remedied by wages to owners (e.g. bonuses), but this comes at the cost of payroll taxes.
        c. At lower income figures, can be more costly on the net when compared to a sole proprietorship/LLC after considering QBID
        d. Corporate structure requires more formality for state law compliance (e.g. minutes of meetings)
        e. Reporting requirements on Form 1120S increasing over time, increasing cost of compliance.
        f. Potentially lower deductible retirement contributions based on deduction limitations being based on wages to owner (e.g. 25% of wages limitation; net profits by S corp not included in self-employment earnings base for purposes of retirement plan contribution limitation).
        g. Notable limitations on owners participating in employee benefit plans (e.g. can't participate in HSAs).
        h. Basis limitation issues for highly indebted S corps (from third party debt without adequate owner capital contributions and/or retained earnings) can delay deduction timing.

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3. Personal Service Corporation (PSC):
    a. Less common structure. Seen more with older practices.
    b. Pays corporate tax rate of 21%
    c. Dividends from PSC: taxed up to 23.8% (preferential long-term capital gain rate up to 20% + possible 3.8% net investment income tax).
    d. Reasonable compensation issue is reversed compared to S corporation structure (i.e. desire to reduce profits with high owner wages to reduce corporate tax).
    e. Pros:
        a. Profits can be potentially “zeroed out” to avoid corporate tax at 21% through bonuses where there’s no to no practice value from non-owner employees (various tax court justifications for this).
        b. Simple tax structure.
        c. Greater owner eligibility to participate in employee benefit plans
        d. Potentially preferable to other structures if business is highly indebted and will be paying debt off in lieu of dividends to owner (e.g. separate practice purchase with a payout to the former owner taking most existing cash flows of the practice). An S corporation election could be considered later once this debt is paid off and cash it no longer needed for debt servicing.
    f. Cons:
        a. Double taxation: corporate tax at 21% on profits + tax on dividends at up to 23.8%, if not managed well by tax planning
        b. Passive activity loss (PAL) rules under sec 469 can affect taxability/ability to deduct losses on passive activities owned by business (e.g. PSC owns a passive partnership interest or rental real estate directly).

4. Partnership (e.g. multimember LLC or PLLC)
    a. Less common structure among dental professionals. More often seen in “tiered” structure below.
    b. Pros:
        a. Flexibility: great flexibility allowed in allocating income, deductions, distributions, etc. based on operating agreement indicating how profits/losses are allocated (without operating agreement listing details, it defaults to pro rata allocation under Washington law).
        b. Tax basis for business losses: third-party debt creates “tax basis” in partnership interest, reducing likelihood of loss limitations on personal tax return (useful for buy-outs of existing dental partnerships by purchaser if losses are initially larger).
        c. Potentially higher income base for purposes of retirement plan contribution deduction limitations (25% of net earnings from self-employment, which includes owner compensation in the form of guaranteed payments).
    c. Cons:
        a. Cost of tax return compliance: reporting requirements on Form 1065 partnership returns has increased notably over the last several years, increasing compliance costs.
        b. Self-employment taxes due on net earnings of the business.
        c. Audit issues: audit rates are low, but audit rules are *cumbersome*, especially for larger partnerships and those with more than 10 members.

5. Multitiered structures – multimember LLCs owned by S corps
    a. Mixed structure allowing for flexibility in allocating profits based on LLC + self-employment tax limitation based on “blocker” S corp.
        a. Operating business set up as multimember LLC
        b. Owners hold their LLC member unit interest through S corps.
        c. Structure allows for flexible profit allocations (e.g. dental professional providing capital gets all profit allocations up until they are repaid, followed by some later pro rata split, like 50/50, etc.). Written operating agreement practically needed in order to specify how profits are allocated to partners when it’s not intended to be purely pro rata (e.g. required profit allocations for tax purposes for those partners with deficit capital accounts).
        d. Guaranteed payments made by operating LLC to S corps based on the services performed by the dental professionals. S corp then declares reasonable compensation to payroll some level of payroll taxes.
    b. Pros:
        a. Flexibility in profit allocation
        b. Self-employment tax mitigation
        c. Ability for owners to set up their own retirement plans
    c. Cons:
        a. Cost of structure: imposes additional tax return filing obligations, so increased cost of tax compliance.
        b. Complicates legal agreements based on various parties being involved.

6. Miscellaneous tax planning issues based on entity structure:
    a. Non-operating assets held by practice: ownership of appreciating, non-operating assets by a corporation is generally not advisable. This is given any future distribution of that asset to an owner or owners will be at fair market value and can trigger gain or "phantom income." Holding non-operating assets inside of a corporation can also complicate buy-ins by partners as the value of the asset should be taken into account for the fair market value of the business buy-in. That provides potential sources of conflict for differences in approaches for investing "excess funds" generated by the practice.
    b. Real estate ownership: real estate owned and used by a dental practices is often held in a separate LLC (whether single-member LLC or multimember LLC). The practice then leases the property from the separate LLC, with the rental activity claiming ordinary and necessary rental expenses.
    c. Tax elections:
        a. Cash basis accounting most dental practices use cash-basis accounting where revenues are recognized as collected and expenses deducted as paid. This method most clearly reflets the ability for the tax to be paid on business profits.
        b. Accrual basis accounting: the alternative is accrual basis accounting, which while it allows for the deduction of expense as they are incurred revenues are recognized as earned. This latter recognition of revenues as earned results in paying tax on revenues not yet collected in the form of accounts receivable, which can cause distortions on tax obligations created vs. ability to pay tax by the practice (whether at the entity level or owner level for its pass-through effect of income on the owner's personal tax return). The accrual basis accounting method can be especially costly in the context of slower collected receivables and those receivables where the ultimate collection is notably below initial revenue recognition. The accounts receivable issues of accrual basis accounting *can* be mitigated to an extent in the context of dental professionals based on the incorporation of the "non-accrual experience method," which allows for a "write down" of accounts receivable based on expected collections though the accounting method has limitations imposed on its use (e.g. accounts receivable can't charge interest/penalties on unpaid balances).

    d. Pass-through entity tax (PTET) elections: pursuant IRS Rev. Proc. 2020-75, roughly 40 states have adopted a form of state taxation that allows for pass-through entities (partnerships and S corporations) to pay tax at the entity level on their state apportioned pass-through income otherwise reportable by the owners. This allows for a business deduction for the practice that would otherwise only be deductible on a personal tax return, subject to the $10,000 cap on state and local taxes.

Self-employment taxes on net earnings from self-employment vs. payroll taxes on wages

1. Self-employment taxes:
    a. Self-employment taxes are the equivalent for social security and Medicare payroll taxes on wages and are due on net earnings from self-employment (sole proprietorship and partnership interests).
    b. Due on net profits from sole proprietorships and net earnings from partnership interests
    c. Paid normally through quarterly tax payments (due April 15th, June 15th, September 15th, and January 15th of the year following).
    d. Rate: 12.4% social security + 2.9% Medicare rate for overall rate of 15.3%. Taxable self-employment earnings are calculated as 92.35% of net earnings from self-employment (think 100% - "employer" share of FICA of 7.65%). Federal unemployment taxes due as well, but capped at low wage base of $7,000 at 6% or $480). Additional Medicare tax potentially due at 0.09% rate for self-employment earnings over $250,000 for married taxpayers filing jointly ($200,000 threshold for single taxpayers).
    e. Social security taxes capped at social security wage base limit ($176,100 for 2025), while Medicare taxes not capped.
    f. ½ self-employment tax deduction: personal tax return has a "For-AGI" deduction for ½ of self-employment taxes due for the year.
    g. "Limited partnership interests" and LLCs: some professional practices are operated as limited partnerships, which have both general partners who perform management functions and do not receive limited liability protection on debts of the partnership and limited partners who do not perform management functions and *do* have limited liability on debts of the partnership. Limited partners *do not* pay self-employment tax on income from their partnership interest (though they do on guaranteed payments for services performed for the partnership). This lack of self-employment taxes generally *does not* extend to LLCs as LLC members may participate in management. Accordingly, assume that an LLC member unit interest *will* pay self-employment taxes on its income from their LLC interest.

2. Payroll taxes:
    a. Payroll taxes are paid on owner compensation (S corporations and PSCs).
    b. Payroll tax withholding and employer payroll taxes:
        i. Employee wages: must withhold 6.2% for social security taxes up to the social security wage base limit of $176,100 and 1.45% for Medicare. Potential additional Medicare withholding of 0.09% for married filing jointly taxpayers with wages over $250,000 ($200,000 threshold for single taxpayers).
        ii. Employer taxes: employer must contribute matching 6.2% for social security taxes and 1.45% for Medicare. Total of above reaches same 15.3% combined rate for employee and employer.
    c. Reasonable compensation: corporations (e.g. S corporations and PSCs) are required to pay owners "reasonable compensation" for the services that they perform for the business. In the S corporation context, the requirement is to pay an adequate level of compensation such that the IRS "gets its payroll taxes" and in the PSC context, the requirement is to not pay an excess amount of compensation such that the IRS "gets its corporate taxes."

       While reasonable compensation is an important issue for tax compliance, it appears to be routinely missed by the IRS under audit and may be a widespread compliance problem. For example, a Treasury Inspector General for Tax Administration (TIGTA) report dated August 2021 found that for all S corporation tax returns filed for 2015-2017, 30% of S corporations with a sole shareholder did not report officer compensation and that the reasonable compensation issue was raised during IRS audit only 14% of the time, resulting in an overall audit rate on the issue at 0.1% for filed S corporation tax returns.

        i. Tests for reasonable compensation: there is no "hard and fast" rules for determining what is reasonable compensation. Courts have outlined various tests that IRS auditors will emphasize or deemphasize, depending on the situation. Tests outlined by the IRS:
            1. Nature of the employee's duties
            2. Employee's background and experience
            3. Employee's knowledge of the business
            4. Size of the business
            5. Employee's contribution to the profit-making activity
            6. Time devoted by employee to the business
            7. Economic conditions in generally and locally
            8. Character and amount of responsibility of the employee
            9. The time of year when compensation is determined
            10. Whether alleged compensation is in reality, in whole or in part, payment for a business or assets acquired, and
            11. The amount paid by similar size businesses in the same aera to equally qualified employees for similar purposes

ii. Tests outlined by the courts:
   1. Employee's role in the company
   2. Comparison of compensation paid by similar companies for similar services (e.g. compensation surveys, industry surveys on owner compensation as a % of sales or pre-owner compensation business earnings).
   3. Character and condition of company (e.g. large, successful company is more likely to pay owner higher wages).
   4. Independent investor standard for returns on equity: what would an outside investor pay the individual for the services that they perform under the constraint that the investor wants to obtain a return on their investment? For example, if the required annual return for a small company is 20% (not unusual as its risks are not diversified), an IRS auditor may argue that compensation figures that significantly reduces the actual return (e.g. 5% return) from this 20% required return are disguised dividends.
   5. Internal consistency of compensation: is compensation paid out regularly or is it an annual bonus at the end of the year? The latter is more likely to be constructed as disguised dividends.

iii. Determining reasonable compensation: as noted above, there is no “hard and fast” rule for determining reasonable compensation as it is a “facts and circumstances” test. However, for practical purposes, using survey/benchmarking data under a comparison “market approach” is suggested for determining reasonable compensation. Some starting sources for determining reasonable compensation can be found below. Recognize that the IRS pays for access to compensation surveys and industry data so an auditor will have this data available, if they choose to use it. For practical purposes, “reasonable compensation” only matters when the owner is withdrawing cash from the business (e.g. unlikely to be an IRS audit issue if there are losses before considering owner compensation, owner is making capital contributions to keep the business “afloat,” etc.).

1. Compensation surveys: compensation surveys are available for purchase that break down salaries/compensation by specialty, experience, productivity metrics, etc. (e.g. Watson-Wyatt Salary Survey or Economic Research Institute Salary Survey).
2. Private company financial statement surveys: private company financial statements are compiled by survey by several companies that break down among other metrics, officer compensation as a % of sales (e.g. RMA Statement Studies). For example, from these studies the IRS generally expects officer compensation divided by taxable income of the company (so after officer compensation) to be under 1.0 or that officer compensation divided by sales to be 10% or less (varies significant on industry, size of company, etc.).
3. Public company annual reports with the Securities and Exchange Commissions: IRS auditors will look at compensation ranges listed among public companies within the same industry, though this is of limited usefulness (based on size and complication of companies involved).
4. Internet searching: internet queries on job search websites (e.g. ZipRecruiter, PayScale, Indeed, etc.). IRS auditors will at times just “Google” a particular role within an industry to determine reasonable compensation.
5. State sources: the WA Employment Security Department publishes occupational wage data on an annual basis (including county specific information). https://media.esd.wa.gov/esdwa/Default/ESDWAGOV/labor-market-info/Libraries/Occupational-reports/OES/2023-occupational-employment-and-wage-estimates-230809.pdf
6. Comparison with subordinates: as a “sanity check,” the compensation of an owner should typically be higher than their subordinates (presuming full-time work, performing management functions as well, etc.).
7. Practical “rules of thumb:” this has no basis in tax law, but at times owners will set their compensation to be a % of pre-compensation earnings (e.g. 40% as compensation, 60% as distributions from an S corporation).
8. BV Resources RCReports: Business Valuation (BV) Resources has an expensive subscription service ($1,500/year) that is intended to create defendable compensation choices, though it is geared towards CPA use (e.g. litigation support, IRS audits, etc.).

Qualified Business Income Deduction (QBID)

1. Deduction created by Tax Cuts and Jobs Act (TCJA) of 2017.
2. Law "sunsets" after 2025, though there are examples in the tax code of temporary provisions being extended year-over-year (e.g. R&D tax credit).
3. Deduction expanded and replaced the previous Domestic Production Activities Deduction.
4. Created intentionally to address the fact that the reduction of the corporate tax rate from 35% to 21% to make the US more in line with other advanced economies, was going to "wipe out" the comparative benefit of operating as a pass-through entity (or PTE = partnership or S corporation) based on PTE avoiding double-taxation.
5. Deduction: this deduction is generally 20% of the business income generated by eligible businesses (generally sole proprietorships/LLC, partnerships, and S corporations). Deduction does not extend to C-corporations, like PSCs. There is an additional limitation to the deduction equal to 20% of taxable income less income subject to capital gain rates (i.e. qualified dividends and long-term capital gains).
6. Limitations, phase-ins, and phase-outs: the "benefit" of the 20% QBID is reduced in certain scenarios involving high income and/or certain enumerated businesses involving professional services (Specified Service Trade or Business or SSTB).
7. Specified Service Trade or Business (SSTB): the benefit of the QBID is "curtailed" for certain professional service businesses, and affects medical practitioners, dentists, attorneys, accountants, actuaries, consultants, etc. QBI generated by an SSTB is subject to certain "phase-out" limitations where the benefit of the QBID is reduced for high income earners. The QBID for SSTBs is phased-out for taxpayers with adjusted gross income (AGI) between $394,600 and $494,600 for married taxpayers filing jointly ($197,300 and $247,300 for single taxpayers and married taxpayers filing separately). The deduction is a pro rata phase-out to the extent AGI exceeds the lower threshold over a $100,000 range for those married taxpayers filing jointly and $50,000 for those taxpayers filing single or married filing separately.
8. Availability to dental professionals: for practical purposes, assume the QBID is unlikely to be available unless profits and other sources of income are low.
9. QBI for separate trades or businesses: where a dental practice operates multiple lines of businesses, it's *possible* for there to be multiple sources of QBI (e.g. SSTB for the dental practice and non-SSTB for other sources of income). However, the regulations on this are not preferential and the "taint" of SSTB is likely to affect the other lines of businesses (low de minimis 10% threshold for SSTB "taint" to cause all revenues to be deemed SSTB). The separate trade or business would have to be clearly identifiable, maintaining separate books and records (including separate billing systems). While not directly applicable to the dental industry based difference in practice structure, an example in the regulations [*(iii) Example 3 to paragraph (b)(3)*] involves an outpatient separate surgical center from a medical practice where the surgical center bills patients for use of the facility while medical professionals separately bill the patient for their services rendered. The surgical center would be non-SSTB QBI while medical practice would be SSTB.
10. Interaction with choice of entity: the dental professional should compare the effects of the QBID based on levels and sources of income as a component of choice of entity. A useful, but slightly outdated resource is available through Intuit. There are other sources of this calculation available online, but they differ in quality, timeliness (e.g. are the phase-in ranges updated for inflation as published by the IRS?), and completeness of information. Recognize the differences in total tax (income taxes, self-employment taxes, and payroll taxes) are not necessarily "night-and-day" differences.

    QBI Entity Selection Calculator
    https://accountants.intuit.com/tax-reform/entity-selection-calculator/

Equipment purchases

1. Bonus depreciation: the TCJA extended the benefit of preferential depreciation on equipment purchases used in a business. For year 2025, 40% of the purchase cost + depreciation on the remaining tax basis (purchase cost – 40% initial year bonus depreciation) being claimed under the MACRS deprecation regime (e.g. accelerated depreciation calculated over the life of the asset, say 5 or 7 years).
2. Section 179 deduction: businesses may claim a deduction under sec 179 for tangible property acquisitions (e.g. 5-year or 7-year medical equipment) to expense the asset in year 1. For year 2025, the limit on the section 179 deduction is $1,250,000 and the deduction is phased out dollar for dollar for the amount of "investment" in fixed assets exceeding $3,130,000. This deduction is also limited to the extent to the extent of "business income," which equals pass-through profits + owner's compensation. Elections to take section 179 in excess of business income are carried forward to a future year where business income is adequate enough to "absorb" the section 179 deduction, "releasing" it as a deduction.

Accounting software: QuickBooks Online is a common choice for accounting software among practices, based on its ease of use.

1. Pros: ease of use, ubiquitous among small businesses.
2. Cons: limited "internal controls" to prevent records from being altered.

Employee reporting: many providers should payroll services, such as ADP, QuickBooks Payroll, or Gusto for low cost as it's a commodity service, which provide payroll and payroll tax reporting services (i.e. federal and state tax reporting, such as 941s, W2s, unemployment insurance, workers' compensation, benefit withholding, etc.). For medical practices with a sole-owner and no other employees, Gusto is a good option based on low cost.

1. Pros of payroll services: low cost and ease of use.
2. Cons of payroll services: inflexible if there are errors that have to be fixed.

Self-rental for rental income

1. Not uncommon for dental practice owners to own underlying real estate in which the business is operated.
2. Structured as separate LLC:
    a. Separate LLC is either disregarded and reportable on Schedule E of a personal tax return or as a separate partnership tax return if multimember LLC.
    b. Rental expenses: owners can claim ordinary and necessary rental expenses for the operation. This includes depreciation deductions on commercial real estate, depreciable over 39 years. Improvements on building are generally 15-year Qualified Improvement Property, eligible for bonus depreciation (40% of cost bonus depreciation in year 1, remaining depreciation under MACRS over 15 years).
    c. Cost segregation studies: cost segregation studies can be sought to "front-load" depreciation by using engineering reports and CPA specialists in cost segregation studies to support shorter lived assets based on tax court decisions (e.g. 5-year, 7-year, or 15-year improvements).
        i. Pros: front-loaded depreciation based on bonus depreciation and upon rare occasion sec 179 deductions.
        ii. Cons:
            1. Expensive (e.g. $10,000 for an in-depth study).
            2. Depreciation can be recaptured upon sale of the building.
    d. Liquidating the LLC: the treatment of a single-member LLC as disregarded or a multimember LLC as a partnership allows for tax-efficient liquidation of an entity in many situations. This is given assets held by the LLC are distributed at cost basis instead of fair market value, which prevents the triggering of gain or "phantom income" upon distribution. However, the presence of deficit capital accounts can complicate this scenario if one partner or partner took distributions in excess of tax basis capital account capital contributions + - tax basis profit/loss allocations.
3. Tax effects of passive activity loss rules: rental activities are normally deemed "passive activities" whose losses are typically limited to the extent of passive income. Self-rental arrangements have additional limitations where net rental income is classified as nonpassive income to prevent these losses from offsetting other passive income (to prevent "gaming" passive activity loss rules under sec 469), while net rental losses are passive losses that cannot offset nonpassive sources of income.
4. Coordination with the QBID: self-rental activities qualify for the QBID. However, where the related party lessee is an SSTB, it "taints" the QBI of the rental activity to be SSTB as well, limiting the benefit of the QBID.
5. 1031 exchanges: upon liquidation of a rental activity and/or medical practice, the owners may desire to take advantage of a 1031 exchange where gain upon sale is deferred based on following the requirements of sec 1031 and investing sales proceeds into like-kind property (e.g. purchasing an interest in another commercial rental property to create a stream of rental income upon retirement). This option is more attractive with the expectation of future capital gain rate increases. These arrangements are at times structured with professional managers of syndicated real estate partnerships (e.g. trusts or operating partnerships in a diversified real estate portfolio, though there's usually a lock-up period of funds invested with management fees and transaction fees charged by the sponsor). In the context of a multimember LLC taxed as a partnership, the real estate interest could be retitled to tenants in common of the former LLC members for them to handle their own separate 1031 exchanges or alternatively take cash upon sale of the property and pay the tax ("drop and swap" transaction).

Retirement accounts

1. Retirement accounts deferring compensation and earnings generated by a medical or dental practice remains the best tax planning tool at the professional's disposal. Medical and dental professionals should consider this their primary tax reduction tool. If a professional operates their own practice, they should be maximizing their contributions to retirement plans.
2. Various plans available with benefits and costs
    a. SIMPLE IRA: contributions equal to 2% (nonelective, available for eligible employees) or 3% (matching contributions, up to 3% for eligible employees) of compensation. Arrangement allows for deferrals of employee wages up to $16,500 in year 2025.
        i. Pros:
            1. Ease to set up and run (easy annual reporting requirements to employees on IRS Form 5304-SIMPLE).
            2. Employees may contribute to their SIMPLE plan.
        ii. Cons:
            1. Low maximum contribution amount.
            2. Limited flexibility in contributions to employee accounts (2%-of-compensation nonelective contribution for all eligible employees or elective matching contributions by employer limited to 3% of compensation).
    b. SEP IRA: contributions up to 25% of compensation (20% for sole proprietors).
        i. Pros: allows for larger contributions to plan
        ii. Cons:
            1. All eligible employees must receive an equal contribution as a % of compensation (e.g. if owner contributes 25% of their compensation to the plan, other employees get 25%).
            2. No employee contributions to plan.
    c. 401k: an employer may set up a 401k for their sole practice or for other employees. For year 2025, employees made pretax contributions up to $23,500 from payroll. Employers can contribute up to $70,000 in addition to the employee deferral. Employers can contribute up to 25% of employee compensation towards the plan, limited to $350,000 of compensation for purposes of the 25% limit. For example, if the plan calls for a 5% employer contribution, it would be limited to 5% of $350,000 or $17,500.
        i. Pros:
            1. Large amounts can be contributed to the plan with a profit-sharing component with a level of discretion on the size of contributions in a given year.
            2. Owners age 50 or older may contribute additional amounts to the plan through employee contributions ($31,000 employee contribution limit for 2025).
            3. ROTH component: 401ks can integrate ROTH components, which can provide greater after-tax benefits if the retirement account has sufficient time to grow tax-free. Employee contributions to a ROTH are post-tax, but eventually distributed tax free which can reduce overall tax.
        ii. Cons:
            1. Comparatively expense to run with "top-heavy plan" compliance testing implying third-party administrator needed to ensure penalties are avoided for scenarios including benefits only accrue to owners and not other employees.
            2. Contributions for the benefit of eligible employees can be costly, especially if they don't meaningfully contribute towards revenue generations nor perform a critical function of the business.

d. IRAs (personal tax return): dental practitioners can contribute to traditional IRAs in any given year. Contributions are capped at $7,000 for year 2025. ROTH IRAs can be utilized as well, though they have income limits on contributions, with limited ability to engage in tax planning (e.g. “Back-door ROTHs”).
    i. Pros:
        1. Ease of administration
        2. Does not imply need to contribute to employee accounts.
        3. Individuals aged 50 or older may contribute additional amounts towards the IRA ($8,000 total contribution limit).
    ii. Cons:
        1. Low contribution limits
        2. Income limitations and coverage by other plan limitations reduce probability of deduction. While nondeductible contributions aren’t “lost” and create tax basis to reduce taxable IRA distribution later, the “basis recovery” to reduce taxable distributions is of limited benefit in a given year.

e. Other pension arrangements:
    i. Defined benefit plans (e.g. “Cash Balance Plans”): those medical professionals with existing practices and reaching retirement could consider a defined benefit plan. These plans imply larger amounts required to be set aside to meet benefit requirements, creating larger, front-loaded deductions. These plans should not be considered unless the owner has a large amount of cash that they can devote to retirement contributions.

Other benefit issues

1. Health insurance plans: owners may offer health insurance plans to their employees as well as themselves.
    a. Pros: tax deduction for employer and nontaxable benefit to employee
    b. Cons:
        i. Owner must be careful not to run afoul of Affordable Care Act rules. Cannot just offer reimbursement to employees for health insurance for their own individual plans as it could be construed as operating an employer plan imposing benefit limitation subject to penalties. However, the Qualified Small Employer Health Reimbursement Arrangement is available to avoid heavy penalties and offer a plan through reimbursement of employees for their personal health insurance plans.
        ii. Owner limitations on participation: more than 2% shareholders in an S corporation and more than 2% partners in a partnership *may* participate in plan. However, it is considered either taxable wages (S corporation shareholder) or guaranteed payments (partner in partnership). However, this is a deduction to the PTE and ultimately a deduction on the personal tax return of the owner as the Self-Employed Health Insurance Deduction (so treated as income once and offset by two deductions, netting to an overall deduction). Requires that the PTE pays the insurance premiums (reimbursement or direct payment) and reports correctly on owner W2 or K-1 or deduction will be denied. Health insurance premiums paid for an owner in a PSC are *not* subject to this rule.

3. Health Savings Accounts (HSAs): employers may establish HSAs on a stand-alone basis or through "cafeteria plans" allowing for various employee benefits at the "payroll level." HSAs allow for both employee contributions that reduce taxable wages for both income tax and FICA purposes (social security and Medicare) as well as nontaxable and deductible employer contributions.
    a. Pros:
        i. Tax benefits to both employer and employees. Employee contributions may be up to $4,300 for year 2025 for self-only coverage and $8,550 for family-coverage. Employers may make matching contributions, though the same overall limitation indicated above applies.
        ii. Allows for catch-up contributions of $1,000 for participants age 55 or older.
        ii. Easy to operate, though it requires a written plan (assume drafted by an attorney).
    b. Cons:
        i. Requires high-deductible health insurance plan (for 2025, self-only coverage annual deductible of +$1,650 and family coverage deductible of +$3,300 with self-only coverage annul maximum out-of-pocket expenses of $8,300 and family-coverage annual maximum out-of-pocket expenses of $16,600).
        ii. Owner limitations on participation: more than 2% shareholders in an S corporation and more than 2% partners in a partnership *may not participate* (most benefits have reduced availability to more than 2% owners in a PTE). PSCs do not have this limitation on owner participation. Any contributions by the PTE for the owners are instead distributions to contribute to their own separate plan (so there is a workaround)

4. Educational assistance programs (college tuition plans; not common for small employers): employer may offer a *written plan* for tuition assistance to employees. The benefit is limited to $5,250 in a given year.
    a. Pros: deduction to employer and nontaxable to employee
    b. Cons:
        i. Cannot be "discriminatory," providing benefits primarily to highly-compensated employees ($160,000 for year 2025) or its owners (for owners, no more than 5% of the benefit can go to more than +5% owners).
        ii. Employees only: can only benefit employees and not their children, spouses, etc. unless they are also employees of the business.

5. Dependent Care Assistance Plans: employer may off a written plan allowing for the employee to exclude from their income up to $5,000 for contributions to a childcare program.
    a. Pros: reduces employee taxation
    b. Cons:
        i. Routine accounting for child-care expenses imposed on business to be in compliance.
        ii. Nondiscrimination: plan cannot be discriminatory, benefiting primarily highly-compensated employees ($160,000 for year 2025 or its owners (for owners, no more than 5% of the benefit can go to more than +5% owners).

6. Life insurance:
    a. Group plans: employer may offer group plan for life insurance policy through a cafeteria plan (common and popular).
        i. Pros:
            1. May be paid by employee or employer (deductible by employer if paid by employer).
            2. Nontaxable benefit for first $50,000 of coverage if paid by employer. Taxable as compensation for coverage above $50,000.
            3. Potentially deductible coverage of shareholder-employee of PSC if in name of shareholder-employee.
            4. Life insurance benefit payout is nontaxable
        ii. Cons:
            1. Low coverage limit for nontaxability.
            2. Owner participation *does not* create deduction to business
            3. Nondiscrimination rules can apply
            4. Can generate Form 5500 tax filing requirements and be subject to ERISA regulations.
            5. *Willl* be part of taxable estate for estate tax purposes.

    b. Shareholder-employee plans: employer may offer larger policy on life of the shareholder-employee.
        i. Pros:
            1. Life insurance benefit payout is nontaxable.
            2. Allows for larger policy coverage.
        ii. Cons:
            1. Not deductible by company.
            2. Can create taxable wages to S corporation shareholder-employees.
            3. *Will* be part of taxable estate for estate tax purposes unless structured as a separate Irrevocable Life Insurance Trust (separate tax planning opportunity).

    c. Term policy vs. whole life insurance policy: accountants tend to prefer term policies over whole life insurance policies (some editorializing here). Whole life insurance policies are more expensive, the coverage can be lost if underpaid, and at best act like separate investments (better to just invest in marketable securities themselves without same risk of loss of policy).

Estate planning

1. Inter vivos trusts: “inter vivos” or living trusts are often created by taxpayers during their lifetime to provide asset protection from creditors, create comparative ease in the estate administration process following death of the taxpayer, and allow them control of the disposition of assets generated during life for the benefit of beneficiaries.
    a. Avoiding probate delay and expense: living trust for property held in trust helps reduce avoid the delay and expenses of probate as trust property passes outside of probate.
    b. Privacy of trust: probate assets with an estate become a matter of public record. Trust property avoids this disclosure.
    c. Tax treatment during life: inter vivos trusts are often “disregarded” as being separate from the taxpayer as they typically retain control over assets of the trust. Accordingly, income/expenses of the trust are just reported directly by the taxpayer without a separate tax return for the trust.
    d. Direction of assets for benefit of surviving spouse and children: taxpayer transferring property into trust can provide limits on the use of assets, ensure the surviving spouse has access to funds to pay living expenses, help ensure inheritance to their children (e.g. in the context of “blended families).
    e. Flexibility in assets placed in trust: taxpayer can direct specified assets to be placed in trust, a particular dollar amount to be placed in trust, or alternatively have a “pour over” provision in their trust document directing all assets in their asset to be placed in trust for the benefit of their family members or other parties.
    f. Common trust issues: be sure to retitle property and accounts in name of trust for those assets meant to fund the trust (e.g. real estate retitled to name of trust; change name of investment and bank accounts to name of trust)!

2. AB Trust planning: in spite of the historically high federal exemption on estate taxes at $13,990,000 for year 2025 ($27,980,000 for married couples; expected to "sunset" to around $7 million for $14 million for married couples after 2025), dental professionals in Washington must be wary of Washington estate taxes with a comparatively low exemption at $2,193,000. Because of that, estate planning to minimize estate often include AB trusts ("B" trust or "credit shelter trust" formed for the first spouse to die, and "A" trust for the surviving trusts). These trusts are formed from the deceased spouse's share of property that funds a trust for their surviving spouse and/or children up to the estate tax exemption, providing an income stream (e.g. investment accounts held in the trust of the deceased spouse). The surviving spouse keeps control of their share of marital property. Upon death of the surviving spouse, the first-spouse-to-die's trust escapes inclusion in the taxable estate of the second-spouse-to-die reducing overall estate taxes. The second-spouse-to-die's trust property then becomes irrevocable with beneficiaries as their children or other designated beneficiaries.

   ABC trust variation: A variation of the AB trust is the ABC trust, that utilizes the "A" trust for the surviving spouse's, the "B" trust for the deceased spouse's property up to the estate tax exemption as to remain nontaxable on the net, and a "C" trust/qualified terminable interest property trust for the benefit of the surviving spouse for any residual property of the deceased spouse over and above the estate tax exemption. The "C" trust qualifies for the martial deduction allowing for the deferral of estate tax as it escapes the taxable estate of the first-spouse-to-die with the residual C trust eventually being included in the taxable estate of the surviving spouse once they die. The ABC trust is sometimes seen among blended families where the deceased spouse wishes to provide for their surviving spouse while imposing limitations on the trust to help ensure an inheritance to their children (often stepchildren of the surviving spouse). This structure is less common with larger federal estate tax exemption, but can still be utilized if non-tax concerns control (e.g. blended family concerns of assets available to various beneficiaries).

3. Irrevocable trusts: establishing an irrevocable trust during life can "fix" estate and gift tax regime values through gifting property to an irrevocable trust. This gifting removes the asset from the taxable estate of the decedent, though lifetime gifts are includible in the taxable estate of a decedent at a presumably lower value. For example, if an investment account value at $1 million is transferred to an irrevocable trust during life and it subsequently appreciates to $2 million upon death, the lower $1 million figure it what is captured in the federal taxable estate for federal estate taxes under the unified estate and gift tax regime. As Washinton does not impose gift taxes, it is fully removed from the Washington taxable estate.
   a. Pros:
      i. Effective planning can result in lower federal and/or state estate taxes.
      ii. Avoiding probate for assets placed into trust
      iii. Trust document upon funding can provide for flexibility in accumulation of income vs. distributions among designed beneficiaries.
   b. Cons:
      i. Loss of control over assets placed in irrevocable trust as the trust cannot be revoked and is subject to trust document provisions.
      ii. Separate tax identity implies separate trust income tax returns on Form 1041.
      iii. Higher marginal tax rates on accumulated income not distributed by trust to beneficiaries (e.g. realized capital gain typically retained and not distributed by trust reaches maximum 20% long-term capital gain rate + 3.8% net investment income tax rate quickly).

4. Irrevocable Life Insurance Trust (ILIT): larger life insurance policies can be structured as separate irrevocable trusts holding the life insurance policy as its sole asset. Policy is created for benefit by the trust with individual on whose life the policy exists paying policy premiums over time or at once. These premium payments are gifts to the trust by the individual.
    a. Pros:
        i. Policy benefit is not taxable for income tax purposes.
        ii. Policy benefit can escape estate taxation if structured correctly.
        iii. Policy benefit historically meant to cover estate taxes, but it can be used for distribution to beneficiary for other purposes.
        iv. Nontaxable benefit of policy payout for income tax purposes (though any interest income earned between death and payout is taxable).
    b. Cons:
        i. Irrevocable nature removes control over policy.
        ii. Last minute death planning difficult (3-year lookback for inclusion in estate where *existing* policy is transferred to an ILIT). 3-year lookback problem does not exist for new policies originally owned by the ILIT.
        iii. Potential gift tax effects if large enough, though offset by unified estate and gift tax regime credit.
        iv. Potential trust tax return filing requirements.
5. College savings (e.g. 529 plans): investing in state 529 college savings plans allows for the taxpayer to make nondeductible contributions into a tax-advantaged college savings plan. The earnings grow tax free and are nontaxable if eventually distributed for qualified education expenses.
6. Gifting to children to reduce estate: gifts are other parties are subject to the federal unified estate and gift tax regime, which can have a large effect on the net amount available to the beneficiaries of an estate. Taxpayers may gift up to $19,000 annually to a party without being subject to the gift tax regime. Taxpayers may elect to “gift split” with their spouse, increasing the annual exemption to $38,000 per recipient. Additionally, gifts in excess of $19,000 generating taxable gifts for gift tax purposes apply a “unified” estate and gift” credit to reduce any current tax effect. These gifts can also be in the form of setting up “UGMA” or “UTMA” accounts where the parent retains control of investment accounts set up for their children. The children are potentially subject to tax on this income, though of low impact for lower investment income (higher investment income figures of children *can* trigger the “kiddie tax” though where the child is taxed on their parent’s higher marginal tax rate on their investment income). Washington does not have a gift tax regime (“just” estate taxes), so gifting easier to remove assets from taxable estate of decedent. Gifts must be complete gifts to have an effect (e.g. death-bed gifting does not work).
7. Intrafamily loans: when rates are low, use of loans to family members to provide cash to children are common. Provided the taxpayer does not show an intent at the time to forgive the loan and treats the loan as bona fide debt (e.g. existence of a promissory note, regular loan payment, adequate interest being charged, considering borrower’s ability to repay, collateralizing the debt with asset security, etc.), it’s possible to later forgive the debt over time to transfer assets to children.

Miscellaneous tax planning issues:

1. Tax avoidance schemes and investments: watch out for investment vehicles that sell themselves primarily on tax benefits! When wealth is high enough, salespeople will approach you with investment opportunities (e.g. exotic partnership interests in conversation easements, captive microinsurance companies, questionable ERC claims, etc.) that sell you on tax benefits as the primary source of return! These often involve a large, real cash outlay (e.g. your tax reduction may merely come from real losses)! Be sure to approach your financial advisor and accountant to comment investments that "seem too good to be true!" Any investment return should be based on the returns provided by the investment, considering the risks involved, not merely purported tax benefits.
2. Selling business into private equity: some level of editorializing, but be careful if approached by non-dental professionals as potential buyers of dental practice who are not dentists. The dental professional/private equity partnership arrangement may growing in prevalence, but the professional should make careful consideration of whether the partnership would involve partners with aligned values in the practice of dentistry (e.g. billing practices, issues of corporate practices of medicine).
3. Approach a financial planner and attorney early on: do not leave your estate without a written estate plan. A template found online likely does not cut it! The financial planner will help you determine if your investment allocation makes sense, whether you have enough assets to sustain you throughout your retirement years, whether assets will pass to your beneficiaries, and the adequacy of providing for your loved ones!
4. Consider municipal bonds later in life: interest income from municipal bonds are generally nontaxable and should be considered by older taxpayers trying to reduce their income taxes while ensuring their investments are not mismatched with their investment horizon and ability to recover from market losses.
5. Employing family members in your practice: employing family members to legitimately work in your practice can provide a means of providing tax free or comparatively low-taxed income to your children based on their lower marginal tax rates (e.g. deduction to dental practice while escaping income tax based on the standard deduction on individual income tax returns).
6. Business sales:
    a. Installment sale: consider splitting the sale into receiving proceeds over multiple years (e.g. 50% towards year-end, and residual 50% on January 1st of the following year) under the installment method to reduce overall income in a given year and potentially reduce applicable marginal tax rates.
    b. Allocation issues: in an asset sale (most common approach, as opposed to stock or LLC member unit sale), allocate more of the proceeds towards long-term capital gain assets (e.g. internally generated goodwill) that are subject to preferential tax rates (e.g. up to 20%; net investment tax rate of 3.8% likely N/A due to being nonpassive income). For sales involving PSCs, consider whether the sale includes the transfer of personal goodwill that would be the sale of a personal asset and not a corporate asset subject to corporate (double) taxation (requires a good fact pattern in that the shareholder must not have transferred personal goodwill to PSC though a noncompete agreement or similarly structured employment agreement).
7. Deduction timing: consider paying bills early as to reduce taxable income in a given year (e.g. prepay insurance premiums). Consider buying and placing into service early fixed asset acquisitions for depreciation deductions. Set up retirement plans for the business in a timely manner to ensure retirement plan deductions.