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Attorneys at Law

FALL 2019



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## Private Equity: An additional option to exit your professional practice

In the past when a dentist or medical doctor wanted to retire, his options included selling his practice to his partner, or if he was a sole practitioner, selling to another unaffiliated professional or a hospital system.

Another option has presented itself: Selling to a private equity firm.

A private equity firm raises funds from

investors and seeks to purchase privately owned businesses. Historically private equity has shied away from investing in professional practices in New York State due to its strict regulations preventing non-professionals from owning professional practices and its strict fee-splitting laws. Private equity has now cracked the code on how to properly structure the purchase

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## Succession Planning for Business Owners

Anyone who has started a business has typically devoted significant time, energy and resources to the endeavor while sacrificing other aspects of his or her personal and professional life, with the focus initially on growth of revenue and stock value. As the business matures, the prudent owner should devote some of his or her focus to consider who will take over so that future generations can continue to benefit from the profits while having all family members treated fairly with regards to management and equally with regards to equity.

There are a few goals which the business owner would like to achieve when planning for the future. First, after the death of the owner, the surviving spouse must receive sufficient income from the business. The surviving spouse should be

able to live in the same manner to which he or she was accustomed without any significant change in lifestyle. Income to a surviving spouse is the equivalent to a tangible asset whereas principal is akin to an intangible asset and of lesser concern. The fact that the company is valued at \$5,000,000 or \$50,000,000 is less important to the surviving spouse than is the fact that he or she is able to draw a salary or receive dividends and be able to take the same vacations and drive the same car as he or she did when the spouse was alive.

In effect, income is how the surviving spouse measures the success of the estate plan. To do so, there are a number of assets which can be used to solve this problem if they are planned for correctly and concurrently. For example, sources

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of income for the surviving spouse are the profits of the company, a triple net lease between the operating business and the real estate company, an employment contract which continues to pay salary to the surviving spouse and adopting a retirement account for the company, the benefits of which would be payable to the surviving spouse. Keep in mind that there is a delicate balancing act here because, simultaneously, the actively employed child (or children) are handling the day-to-day operations of the business and wish to be compensated for their efforts, which can reduce the surviving spouse's income.

The second goal of the business owner is to plan in such a way as to minimize estate taxes. The business is obviously an illiquid asset and will consist of a significant portion of the estate. While the Internal Revenue Code allows for a deferral of estate taxes over 14 years when certain requirements are met, it would be best to minimize and/or eliminate the estate tax through the use of the annual gift tax exclusion and the lifetime estate and gift tax exemption. Ideally, the business owner would consult with an insurance professional and purchase life insurance to be owned by an irrevocable trust as a source of liquidity to pay the estate taxes.

The third goal would be for the children to be treated in a fair and equitable manner. Furthermore, the

child or children who will continue to run the business must have incentives to do so or else the entire succession plan will fail. The starting point of discussion is identifying which family member or members will head the organization. Few discussions with business owners are as fraught with emotion as is the decision to choose a leader or leaders for the next generation of a closely held family business. Oftentimes this choice is made by the Darwinian theory of survival of the fittest: whoever has demonstrated ability, sound judgment, leadership, interest and business acumen, among many other traits, while employed in the business will likely win the golden ticket to steward the family for the foreseeable future. While it is human nature for every family member involved with the company to think that he or she is the most significant contributor to the company's success and that any bad decisions or adverse results are the fault of everyone else, reality says otherwise. In the family business context, for better or worse, this decision is often made by the senior generation owners.

As may seem evident, there are many contingencies to take into account when developing a business succession plan. Each party at each generational level has his or her own opinion and needs which must be considered in the design. Also, the solutions cannot be arrived at in a vacuum by just the client and

attorney. All estate plans, especially those involving succession planning, are a team effort among the attorney, accountant, financial advisor and, if applicable, a trust company. Since succession planning involves knowledge of the tax law, corporate law and trusts and estates law, each advisor's input is critical to ensure for a smooth transition of management and ownership. Lastly, once the clients and advisors are satisfied with the plan, it is important that the family meet (including the sons-in-laws and daughters-in-laws) so that the parents can present the results and everyone can air their pleasure or objections. It is preferable to have the children (and their spouses, who occasionally wield the power) understand the decisions made by the parents while they are both alive and able to articulate their thoughts instead of having this plan thrust upon them by the executor without any knowledge of the background of the succession plan. The intent is that this will hopefully avoid any fights between or among the children and allow the business to flourish under the capable leadership of the child (or children) who have been chosen to lead the next generation.

*If you would like to discuss developing a succession plan for your business, please contact Harris Markhoff, Michael Markhoff or Christopher Miehle at 914.948.1556*

## CASH BALANCE PLANS: THE SMART WAY TO INCREASE YOUR TAX-DEDUCTIBLE PLAN CONTRIBUTIONS

A "Cash Balance Plan" is an integral component of retirement plan design which allows you to make substantially larger tax-deductible contributions than those permitted under profit-sharing and similar defined contribution plans (DC Plans). Cash Balance Plans use easily understandable individual account balances not available under a traditional defined benefit pension plan. Each plan participant has his or her own account balance that is credited annually with a contribution and a specified rate of return.

Ideal candidates for Cash Balance Plans are successful businesses with two or more owners. In a Cash Balance Plan, similar or varying contributions can be made on behalf of each owner, and each owner will know the exact amount of the contribution attributable to him. Naturally,

Cash Balance Plans can be successfully implemented for a sole proprietorship that produces substantial profits.

When a Cash Balance Plan is combined with a DC Plan, the combination of the two plans gives the business both an increased tax deduction and substantial flexibility for each year's contributions.

The Table below illustrates how you can make an additional tax-deductible plan contribution to a Cash Balance Plan (see Row D) even after contributing the maximum \$56,000 to a DC Plan (Row A plus Row B equals the maximum \$56,000).

The Table shows one example of an allocation maximized for the owner; the assumption is that the staff contribution will be as low as IRS rules permit, and the owner's

compensation is at least \$280,000. The most important factor is to ensure that the cost for covering the staff does not outweigh the benefit of the plan to the business owners. A thorough analysis of employee data, combined with creative planning concepts, often result in a successful outcome for the business owners. Obviously, it would be imprudent for a business owner to think of proceeding without the benefit of such an in-depth analysis.

If you want to make a plan contribution for yourself in excess of \$56,000, a Cash Balance Plan is the answer.

*To learn more about Cash Balance Plans, please contact Andrew E. Roth, Esq. at 914-948-1556 ext. 8033 or by email at [aroth@dmlawyers.com](mailto:aroth@dmlawyers.com)*

Type of Plan or Plan Feature		2019 Contribution Amount for Owner
A.	Profit-Sharing Plan – Employer Discretionary Contribution	\$ 37,000
B.	401 (k) Salary Reduction Plan - Employee Discretionary Contribution	\$ 19,000
C.	Additional "Catch-Up": Owner Age 50 or older	\$ 6,000
D.	Cash Balance "Add-on" Plan [On top of Employer's DC Plan]	\$ 49,800*
E.	Total Contribution: Owner under Age 50 [A+B+D]	\$ 105,800
F.	Total Contribution: Owner Age 50 or older [A+B+C+D]	\$ 111,800

\*Note also that depending upon the level of staff compensation, and the age of the owner, the amount that can be contributed for the owner may be substantially larger.

of a professional practice in NYS and private equity firms are investing heavily in this area.

In order to adhere to the strict NYS laws referred to above, a private equity firm will form two separate entities to purchase the assets from a dentist or medical doctor. A professional entity (i.e. a PLLC or P.C.) owned by a dentist or medical doctor affiliated with the private equity firm, will purchase the professional assets (i.e. patient list, goodwill of the seller) and a separate business entity (an LLC or corporation) will purchase the non-professional assets (furniture, fixtures, equipment, supplies, etc.). A management agreement will then be established between the business entity and new professional entity whereby the business entity will be paid a fee for providing management services to the professional entity.\*

Selling to private equity has many attractive features: (1) often the pur-

chase price is higher than that offered by another buyer (typically based on a multiple of EBITDA), and is not constrained by the anti-kickback provisions which may be applicable to a hospital transaction; (2) the purchase price is typically allocated to capital assets being sold so that the seller will pay tax at the lower capital gains tax rates; (3) a portion of the purchase price is offered as equity of the buyer (so the seller can participate in the growth of the private equity entity); (4) the seller is typically offered an employment contract with the buyer so he can continue to work for a few years (typically a guaranty up to 5 years) before fully retiring.

Some of the items that the seller needs to be concerned with when selling to private equity: (1) the seller will typically be offered less compensation than what he was earning prior to selling his practice (the advantage to the seller is that he receives cash upfront at capital gains rates in exchange for a

reduced income from his practice taxed at ordinary income tax rates); (2) the seller will typically not be guaranteed employment with the buyer for more than 5 years; (3) the seller will not be paid all cash for his practice at closing (the buyer will require a large portion of the purchase price be paid in equity in the buyer [i.e. "roll-over" equity]) which will have limitations on when and how that "roll-over" equity can be converted to cash.

Our office has been involved with representing sellers of professional practices to private equity firms as well as representing private equity firms in acquiring professional practices.

***Please contact Robert B. Danziger or Joshua Levine to discuss this exciting possibility at 914.948.1556***

*\*The details of properly structuring a management services agreement is the topic for a separate article.*

## IN OUR FIRM

We want to share with you that our firm has recently received the following honors. We thank our clients and colleagues for their continued loyalty and for helping us achieve these honors.

### ***Best Law Firm:***

Danziger & Markhoff LLP has been included in the **2020 U.S. News – Best Lawyers® “Best Law Firms”** list for the **ninth** consecutive year. The firm received a Metropolitan Tier 1 ranking in the area of Trusts & Estates Law.

### ***The Best Lawyers in America:***

Harris Markhoff, Michael Markhoff and Joshua S. Levine have been selected for inclusion in ***The Best Lawyers® in America 2019***. Harris was selected in the areas of Corporate Law and Trusts & Estates, Michael was selected in the area of Trusts & Estates and Josh was selected in the area of Health Care Law.

### ***New York Super Lawyers:***

Michael Markhoff has been selected for inclusion in **2019 New York Metro Super Lawyers**. Michael was selected in the area of Estate Planning and Probate. Each year, only 5% of the attorneys practicing in New York received this honor.