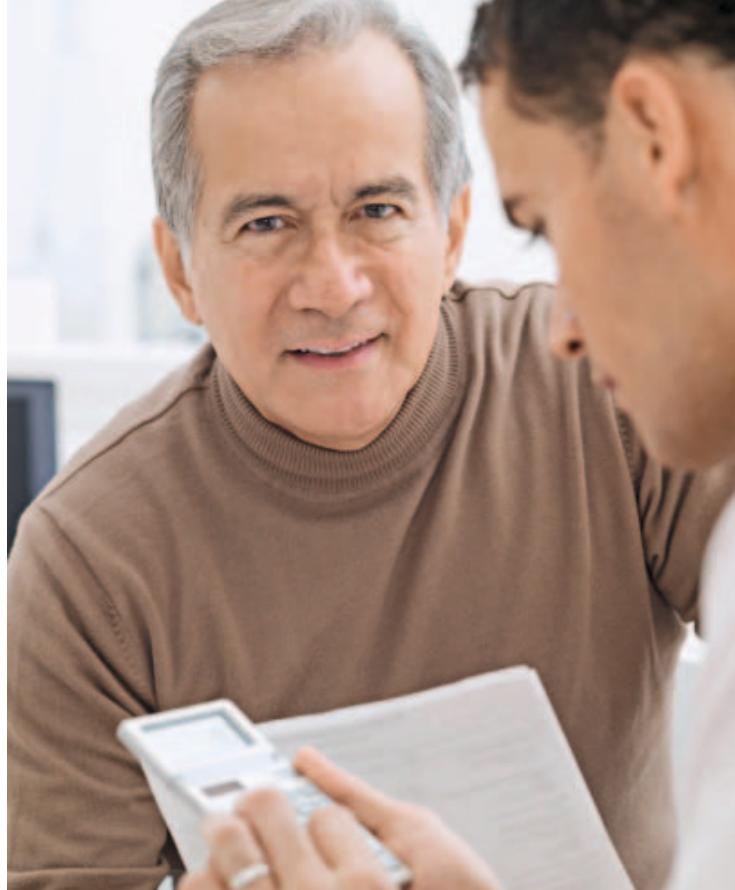


DENTAL TECHNOLOGY AND TAXES

Be clear on your options so you can maximize your returns.

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As we get closer to the end of the year, dentists often ask about how major technology purchases will impact their taxes. Applications such as lasers, CAD/CAM restoration systems, digital and cone beam radiology are large investments, and dentists who work closely with their CPAs can strategize to maximize the tax benefits of purchasing them.

Capitalizing on Section 179

First, let's look at Section 179, that magic amount of write-off we all want to understand. Section 179 of the Internal Revenue Code specifies the amount of equipment one may elect to expense in a given year. The number has changed a lot

TABLE 1. 2010 Section 179 Depreciation Example

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|---------------------|-----------|---|---|---|---|---|
| Equipment Purchased | \$134,000 | | | | | |
| Tax Bracket | 40.00% | | | | | |
| Tax Savings | \$53,600 | 0 | 0 | 0 | 0 | 0 |

with various economic stimulus packages. In 2010, we may expense up to \$134,000. In 2011, though, unless Congress makes a change, the amount will drop to \$25,000.

If a dentist spends exactly \$134,000 on equipment in 2010, he or she may expense the entire amount under Section 179 (see Table 1). Dentists making that same purchase in 2011 will be able to expense only \$25,000 under Section 179 with the remainder of \$109,000 spread over 5 years (it's actually 6 but who's counting?) (see Table 2). This might not be a bad thing, however, because tax rates are going up

in 2011 (see the March DPR article about tax changes).

Understanding depreciation

Depreciation is a non-cash expense that lowers one's income for tax purposes, theoretically helping save for the replacement of equipment as it becomes obsolete or wears out. We look at two methods of depreciation, called conventions; these are the Mid-Year and Mid-Quarter Conventions.

Suppose your dental specific CPA advises you to spread the depreciation over 5 years instead of electing Section 179. Why do this? If you finance the equipment, you

may want the 5-year deduction to offset the cost of paying back the loan, which is done with after-tax dollars. By aligning the depreciation deduction with the repayment of principal, you can avoid the pain of paying tax on income you don't really have. This is a significant problem dentists should consider very carefully with their tax advisors.

The typical scenario for depreciating equipment over time calls for the Mid-Year Convention. See Table 3 for an illustration of this method using different dollar amounts and the related tax savings. Often times, dentists learn that they are going to have a large tax bill

In-depth on depreciation

Some additional points on depreciating assets.

- If you are purchasing technology of some sort and are able to separate the software component from the hardware, you may depreciate that software over 3 years instead of 5.
- The county in which you practice may tax the assets in your practice much like a home or dental building. For this reason, you should review your depreciation schedule with your CPA annually to make sure you are not being taxed on any assets that you no longer possess.
- Be sure to notify your property & casualty insurance carrier of any new equipment purchases so you are properly covered. It is quite common for dentists to be over or under insured.
- Assets may be depreciated once they are placed into service. When they are paid for has no bearing on when the depreciation starts. So, all that digital radiography equipment you buy in December must be fully functional and in service before you take any depreciation.

TABLE 2. 2011 Section 179 Depreciation Example

| Year | 1 | 2 | 3 | 4 | 5 | 6 |
|-----------------------------|-----------|----------|---------|---------|---------|---------|
| Equipment Purchased | \$134,000 | | | | | |
| Less: Section 179 Deduction | 25,000 | | | | | |
| Remaining Basis | 109,000 | | | | | |
| Regular Depreciation | 21,800 | | | | | |
| Add: Section 179 Deduction | 25,000 | | | | | |
| Total Depreciation | 46,800 | 34,880 | 20,928 | 12,557 | 12,557 | 6,278 |
| Tax Bracket | 40.00% | 40.00% | 40.00% | 40.00% | 40.00% | 40.00% |
| Tax Savings | \$18,720 | \$13,952 | \$8,371 | \$5,023 | \$5,023 | \$2,511 |

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and make significant equipment purchases toward the end of the year to offset it. Be careful! If you purchase more than 40% of your total equipment for the year in the 4th quarter, you must use the Mid-Quarter Convention, which renders a much smaller first year deduction (see Table 4). Of course, you can elect Section 179 to increase your first year deduction. As you can see from Tables 3 and 4, the depreciation amounts are different each year. Dentists may make an election on their tax returns to use the Straight Line method

of depreciation, which renders the same deduction each year, making budgeting a little easier.

If you sell or trade-in an asset that has been depreciated, you likely will have a taxable event. Let's say you want to upgrade your CAD/CAM restoration system's milling unit. Before you begin depreciating the new unit, you are required to recapture the depreciation taken on the old one. Simply stated, that prior depreciation now becomes ordinary income taxed at your highest rate. The proper technique is to do an

TABLE 4. Mid-quarter convention (40% of Purchases in 4th quarter)

| 2010 Purchases | Depreciation by Year | | | | | |
|----------------------|----------------------|--------|--------|--------|--------|--------|
| | 1 | 2 | 3 | 4 | 5 | 6 |
| \$50,000 | 2,500 | 19,000 | 11,400 | 6,840 | 5,470 | 4,790 |
| \$100,000 | 5,000 | 38,000 | 22,800 | 13,680 | 10,940 | 9,580 |
| \$200,000 | 10,000 | 76,000 | 45,600 | 27,360 | 21,880 | 19,160 |
| Depreciation Formula | 5.00% | 38.00% | 22.80% | 13.68% | 10.94% | 9.58% |

exchange for tax purposes, whereby the old milling unit is replaced with the new one and only the difference in cost between the two is depreciated.

Whether dentists use Section 179, Mid-Year, Mid-Quarter or

Straight Line depreciation, the total deduction is the same. The only difference is timing. Dentists should plan carefully with their CPA to ensure they receive the maximum benefit from their depreciation deductions based on anticipated income, tax rates and future purchases. ●

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CPAs and Capital Performance Advisors provide wealth management, accounting and tax services to successful dental practitioners. Haden regularly lectures and provides seminars on tax, financial planning, practice management and practice evaluations. His firm has partnered with the Pride Institute to bring a full circle of service to dentists. Together, they assist dentists in aligning personal financial goals with sound business practices. For more information, please contact Haden at 877-939-2500 or haden@cpas4docs.com.

TABLE 3. Mid-year Convention (Purchases throughout the year)

| 2010 Purchases | Depreciation by Year | | | | | |
|----------------------|----------------------|--------|--------|--------|--------|--------|
| | 1 | 2 | 3 | 4 | 5 | 6 |
| \$50,000 | 10,000 | 16,000 | 9,600 | 5,760 | 5,760 | 2,880 |
| \$100,000 | 20,000 | 32,000 | 19,200 | 11,520 | 11,520 | 5,760 |
| \$200,000 | 40,000 | 64,000 | 38,400 | 23,040 | 23,040 | 11,520 |
| Depreciation Formula | 20.00% | 32.00% | 19.20% | 11.52% | 11.52% | 5.76% |