The Financial Benefits of Partnership:

Proposed Federal Changes Significantly Increase Capital Gains Tax Burden

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Tax ramifications should be considered when making any major financial decision. With the current administration's proposed tax plan, this consideration takes on an even greater importance. Judging these changes is not our goal here, but rather to inform you as to how the proposed plan affects future decision making.

If the proposed plan is passed, long-term capital gains, personal income of high-wage earners, and business income will all be taxed at much higher levels. Depending on company structure, both a physician's personal and practice bottom lines could be negatively impacted. Further, physicians who are evaluating partnership opportunities should keep a close eye on how this tax increase plan progresses through Congress and the timing with which it may be enacted.

Rising Rates on Income & Capital Gains

To fund multi-trillion dollar government spending initiatives, an aggressive and wide-reaching federal tax increase has been proposed.

High-income earners and business owners will be hit with increases on both personal income and long-term capital gains, among others. Taxes on income above $400,000 will increase from today's current rate of 37% to 39.6%, while the corporate tax rate would jump from 21% to 28%.

According to the Tax Foundation, a non-partisan tax policy research organization, on a conventional basis, the top 1% of U.S. taxpayers – those earning $538,926 or more – would face an after-tax income reduction of approximately 10%. Taxpayers who earn just over $300,000 would have an approximate 1.3% reduction in after-tax income. The proposed plan also includes several other changes to the tax code that will further reduce individuals' and business owners' income. These changes are highlighted in the sidebar to the right.

Under the proposed plan, the advantages realized from selling long-held assets, such as a medical practice, will be diminished due to higher taxes. As proposed, there will be an increase in the average tax rate on long-term capital gains from 19.1% to 27.7%, and the marginal tax rate on capital gains from 22.4% to 33.4%. On income above $1 million, long-term capital gains and qualified dividends will be taxed at the ordinary income tax rate of 39.6%.

State Taxes Add to the Load

The federal tax burden is only part of the story. States also tax corporate income at rates varying from 0 to 11.5%. Currently, the average combined top tax corporate tax rate is 25.8%.

Some lawmakers are voicing concern over the proposed federal increase to 28% for corporate taxes, suggesting to bump the rate to 25% instead. Even then, the combined average top corporate tax rate would be 29.53%; 6% higher than the average tax rate among industrialized countries who are

How the Proposed Tax Plan Negatively Impacts Income for Individuals and Business Owners

- **Raises individual federal income tax rate for taxable incomes above $400,000 from 37% to 39.6%.**
- **Increases the federal corporate income tax rate from 21% to 28%.**
- **Taxes long-term capital gains and qualified dividends at the ordinary income tax rate of 39.6% on income (excluding state income taxes) above $1 million and eliminates step-up in basis for capital gains taxation.**
- **Increases the federal average tax rate on capital gains from 19.1% to 27.7%, and the marginal tax rate on capital gains from 22.4% to 33.4%.**
- **Caps the tax benefit of itemized deductions to 28% of value for those earning more than $400,000; taxpayers earning above that income threshold with tax rates higher than 28% would face limited itemized deduction.**
- **Phases out the qualified business income deduction for filers with taxable income above $400,000.**
- **Applies a Social Security payroll tax of 12.4% to earnings above $400,000.**

members of the Organization for Economic Co-operations and Development (OECD). Depending on which state a business is located in, its combined top corporate tax rate could be higher than in any other country in the industrialized world. Fortunately, at least today, we do not compete for patients on an international basis.

Most states also tax capital gains and dividends at the individual income tax rates. When combined with the proposed federal increase, capital gains could be taxed at up to 56.7%, with thirteen states' and the District of Columbia's residents taking a hit of more than 50%. On average, this plan will raise combined rates on capital gains to 48.4%, significantly higher than the current average of 29%.

Snapshot of Top Marginal Capital Gains Tax Rates
Current vs. Proposed

	Top Capital Gains Rate CURRENT	Top Capital Gains Rate PROPOSED
Delaware	30.4%	50.0%
Florida	23.8%	43.4%
Georgia	29.6%	49.2%
Kentucky	28.8%	48.4%
Michigan	28.1%	47.7%
New Jersey	34.6%	54.2%
North Carolina	29.1%	48.7%
Ohio	28.6%	48.2%
Pennsylvania	26.9%	46.5%
South Carolina	27.7%	47.3%
Tennessee	23.8%	43.4%
Virginia	29.6%	49.2%

Source: Tax Foundation

Minimizing the Tax Burden

The call to raise taxes on large corporations and high-income individuals has gained momentum. However, as written, the proposed tax plan will vastly impact small businesses owners, such as physicians. While 25% of medical practices are classified as C corporations, most others are typically structured as pass-through entities and taxed at individual income rates, rather than corporate rates. Not only will physicians see a reduction in their personal after-tax income, the ability to realize an optimal profit on the practices they've spent years building will also shrink.

The financial benefits of a QualDerm partnership are significant, and taking advantage of current tax laws can be extremely beneficial. Right now, most of the proceeds from physician practice acquisitions can be taxed as long-term capital gains. However, that may change soon, causing the proceeds to be taxed at the much higher rate of up to 39.6%, rather than today's average of 23.8%. Under current circumstances, the timing on when to realize long-term capital gains is important.

Historically, once a physician owner and QualDerm begin the process to partner, the deal can close within 2-3 months. Although there is no definite timeline on when the proposed tax increases may be enacted, nor what a finalized plan will look like, it is prudent for physician owners to proactively seek ways to mitigate potential tax burdens on their long-term capital gains.

Examples of Tax Impact on Practice Acquisition Capital Gains
Current vs. Proposed

CURRENT

		Purchase Price (Cash Portion)	$1,922,400	**Tax Rate**	
$1,000,000	75.0%	Personal Goodwill Allocation ($1.0M or less)	$1,000,000	23.8%	$238,000
		Personal Goodwill Allocation (> $1.0M)	$441,800	23.8%	$105,148
	25.0%	Ordinary Income	$480,600	36.5%	$175,344
		Federal Tax only; excludes impact of any state taxes		**Total Taxes Paid**	**$518,492**

FUTURE

		Purchase Price	$1,922,400	**Tax Rate**	
$1,000,000	75.0%	Personal Goodwill Allocation ($1.0M or less)	$1,000,000	43.4%	$434,000
		Personal Goodwill Allocation (> $1.0M)	$441,800	43.4%	$191,741
	25.0%	Ordinary Income	$480,600	38.1%	$183,197
		Federal Tax only; excludes impact of any state taxes		**Total Taxes Paid**	**$808,938**
				Delta	($290,446)

About QualDerm Partners

QualDerm Partners helps top-tier dermatologists position their practices for sustainable growth and profitability. The company creates market-leading practice partnerships through affiliations and de novo development. QualDerm provides the management support, capital, and guidance for growth. Under QualDerm's True Partnership℠ model, physicians are partners, not employees, and retain their own practice brand. This doctor-driven model is designed to maintain physicians' clinical autonomy and ensure the highest-quality patient care. QualDerm offers physicians tailored partnership structures to meet their needs, as well as the option to sell their practices.

QUALDERM PARTNERS
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QualDerm currently has affiliated practices in North Carolina, South Carolina, Ohio, Tennessee, Virginia, Georgia, Pennsylvania, New Jersey and Delaware, with plans to expand further. For more information, visit www.QualDerm.com.

Find out more about how a QualDerm partnership can help you mitigate tax burdens. To learn more about partnership opportunities or to discuss selling your practice, contact Ashley Johnson, Chief Development & Integration Officer at ashley.johnson@qualderm.com or 615.250.6736.