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Obamacare And Entrepreneurs: What You Should Know; How To Prepare

As one of my ongoing roles, I am Chairman of Utah's Technology Association, the **Utah Technology Council (UTC)**. In a recent Trustee meeting, one of my associates, **Kelvyn Cullimore**, CEO of medical device company **Dynatronics (NASDAQ: DYNT)**, provided our assembled leaders with perspective on what the coming changes of Obamacare will mean. He spoke particularly about the impact for organizations such as his own, that will be impacted by the proposed and expected medical device excise tax.

Dynatronics Inc. is a manufacturer of advanced medical devices

For all organizations, while much is still unknown as we approach the start dates, the implications of the **Affordable Care Act (Obamacare)** will be immense. Regardless of political views, there are aspects of the changes entrepreneurs must take into account as they plan their business and employment strategies for 2013 and beyond.

As Cullimore notes, medical device companies will be hit especially hard. Dynatronics is a company that employs 160 people. Their own situation is an interesting case study; however the issues they face will apply to many other organizations as well.

Kelvyn Cullimore is CEO of Dynatronics, an officer of MDMA, a trustee of the Utah Technology Council, and also serves as the Mayor of Utah's Cottonwood

As a note – in addition to his role as CEO, Kelvyn Cullimore is active in the local political arena as he has also served for the past seven years as the Mayor of Utah's **Cottonwood Heights**. He is also an officer and board member of the **Medical Device Manufacturers Association (MDMA)** in Washington DC, and through that role is engaged in advocating for industry issues with the Federal Government.

I have taken the chance to talk to Kelvyn at further lengths about his thoughts and plans in relation to the coming changes. In Dynatronics'

Heights

case, the company acquired several of its distributors in 2007 as a means to protect its distribution channel. After the acquisitions, the company was thankfully able to survive the extremely adverse market from 2008-2010. Coming out of the recession, the company made the strategic decision to invest more than $2 million in research and development to allow the company to innovate new products and to create profits the company would be able to recognize for shareholders in 2013 and beyond. While those higher R&D costs did significantly impact their profitability for the last two fiscal years, it has positioned them well for improved profitability in the coming years. As every entrepreneur knows, innovation is not only critical to survival, it is essential to sustained profitability.

On the whole, while Cullimore notes that few people would argue with the benefits of eliminating limits on insurance due to pre-existing conditions and allowing children to remain on their parents' insurance to age 26, the cost of enacting Obamacare's changes is estimated to exceed $2 trillion over 10 years. The money to cover these costs is designed to come from two places:

1) Reducing the scheduled increases in future benefits in Medicare, and

2) Increased taxes. Forbes contributor **Kelly Phillips Erb** has written about the coming tax increases in detail here.

Of particular interest to companies such as Dynatronics is the coming excise tax on medical device companies. This 2.3 percent tax is particularly frightening because it is levied on *top-line sales*, even if the respective company doesn't earn a *bottom-line* profit in a given year.

The medical device industry comprises some 409,000 direct jobs and close to two million indirect jobs, according to the Medical Device Manufacturers Association (MDMA), 80% of these companies have fewer than 50 employees. Only 10% have 500 employees or more.

"In this sector, the profit threshold is not usually crossed until a company achieves $25-50M revenue," Cullimore stated. "For a complex device, a company may need to gross $100M before they are posting a profit. In either case, many of these companies must incur an operating loss for several years as they pioneer the next generation of life-improving devices. Now they must add to their working capital needs the resources to pay an excise tax which will have the effect of moving the goal line of profitability even further."

For those medical device companies who are making a profit, the 2.3% excise constitutes "a tax within a tax." For a company making an 7% pre-tax profit, for example, the 2.3% excise tax would comprise 33% of their entire net profit – and that price tag would be in addition to the regular income taxes they may owe on their earnings. Very literally, it amounts to a tax on top of a tax.

Dynatronics develops and manufactures SolarisPlus products to provide ultrasound and light therapy

Fox News agrees with Cullimore's assessment: "...this looming $20 billion tax is already causing small business job loss and cuts to research and development budgets.....When Congress taxes the sale of a specific product

through an excise tax, as the Affordable Care Act does with medical devices, it too often disproportionately impacts the small companies with the narrowest financial margins and the broadest innovative potential. It also pushes companies of all sizes to cut back on research and development for life-saving products."

As a case study, in Dynatronic's case, had this excise tax been in effect during 2012, the company that had only broken even would have had to come up with an additional $400,000 to pay in excise tax to comply. Where would that money have come from? Says Cullimore, the company would have had to raise the price of its products (in a market that would likely not tolerate more than the smallest of increases). It likely would have had to limit investment in R&D as well as consider other cost reductions including layoffs.

Decreasing the amount of research and development would have decreased the amount of innovation the organization could bring to the fore. And as previously stated, innovation is a critical fuel to sustainability and producing the technologies that will ultimately make health care more affordable.

Another functional outcome Cullimore predicts: the excise tax will force an increasing number of organizations "on the bubble" under these additional expenses to consider offshore manufacturing. Yes, they will still be subject to the excise tax for products sold in the United States—but in desperation they will hope that the cost savings of taking the labor offshore will at least to some degree offset the additional cost of the tax.

"This is an outcome that will cost American jobs," he observes. "While strategies like offshore manufacturing, reducing R&D and reductions in force will help the medical device companies offset the impact of this egregious tax, it will simultaneously reduce the number of U.S. jobs and significantly stifle innovation – and it is innovation that will help ultimately bring down the cost of healthcare."

Why the particular "punishment" on medical device companies? According to Cullimore, the theory is that the enactment of the Act will result in more devices being needed and purchased, therefore producing a "windfall" for manufacturers that would offset the new tax.

However, for companies such as Dynatronics—who sell primarily capital equipment—there may be less of a windfall. Doctors will not buy more capital equipment, he notes. Instead, they will use the capital equipment they own to serve a larger number of patients than before. Providers such as Dynatronics can attempt to re-coup their loss by increasing prices; but Cullimore notes that capital equipment is a sector that is highly price sensitive and is already at or close to the cap the market will likely allow.

Cullimore also notes that the excise tax may possibly be postponed from its scheduled January 1, 2013 start date, since 30 days out there is still no final rule published by the IRS directing how the tax is to be collected and regulated – yet companies need to do their best to anticipate and prepare for the possibility the law will roll forward as scheduled on January 1.

Will there be layoffs? At 160 employees, Cullimore's company has no layoffs planned as the result of the tax currently, but he acknowledges that when details arrive, it is highly possible that many companies may have to make rapid changes in direction on the fly. Presently, the House of Representatives has repealed the excise tax, but the Senate has been unwilling to consider

repeal. Yet the industry continues to inform congressional leaders of the severe consequences the excise taxes will have on jobs and innovation in hopes of some relief before the tax is enacted.

Another aspect of Healthcare Reform mandates that all employers with more than 50 employees provide health insurance to their employees or face a tax of $2000 per employee. The health insurance must meet the federally mandated "essential benefits" which will dictate the minimum coverage required to avoid the tax. This aspect of Healthcare Reform will go into effect January 2014.

His advice to companies nearing 50 employees in size: "Fifty employees is a critical barrier where the coming change is concerned. My advice to companies nearing the 50 employee barrier in 2013 is that they must either stay below the barrier through various strategies such as outsourcing or part-time employees, or they must be very sure they are able to 'burst' past it—if headcount is allowed to creep above 50, the incremental burdened cost of those employees will be extraordinarily high."

Clearly, as written, the impacts of healthcare reform present some significant challenges for companies such as Kelvyn's. He is actively involved in lobbying for more lenient and realistic means to cover the Act's high additional costs.

Of most concern to Cullimore is the lack of concrete instruction that would allow his organization and others to make appropriate plans to prepare for the impacts of healthcare reform and specifically the medical device excise tax. He agrees with Erb's conclusion: "How can individuals and businesses plan without direction…It's simply not fair to taxpayers, to tax professionals, to IRS (yes, I'm sticking up for them, too) and for financial advisors to constantly be in the position of having to shift gears and hedge bets (no, not that kind of hedging). We need clear direction."

I would agree with this position as well. While medical device companies look to be one of the sectors most severely affected by the coming changes, all organizations will need to be nimble, will need to be observant, and will need to do all in their power to appropriately plan and prepare.

Entrepreneurial employees and organizations will be more vital to our economy than ever before. Do you have additional thoughts and comments? Feel free to leave them here – and both Kelvyn Cullimore and I will do our best to respond. As always, I'd love to hear what's on your mind, either here or via @AskAlanEHall or www.AlanEHall.com.

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