Exit choices

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If you own a practice, have sufficient savings, want to retire, and know how you will spend your time when you do, you have six exit choices. Your options are: making a complete sale, hiring an associate with a later sale, establishing coownership, forming a solo group arrangement, merging your practice with another, or walking away.

MAKING A COMPLETE SALE

With the exception of walking away, a complete sale is relatively simple as compared to your other exit choices. Unlike 20-plus years ago, you should be fully paid in cash at closing. For large practices, the sale may include a component of seller financing of up to 20% of the selling price.

Depending upon the size of your practice, and as requested by the purchaser, your continued employment by the purchaser may be necessary to transfer your goodwill, finish cases, and provide treatment for an agreed time period — typically six months to one year and by mutual agreement thereafter. You should be paid the greater of a daily rate or half-day rate or an agreed percentage of production or collections, which is often 35% for a general dentist and higher for specialists. The daily rate accounts for greeting and administrative time and assures that, if you work, you will be paid irrespective of your treatment schedule. While laboratory costs should be paid by the purchaser's practice, your direct business expenses, insurances, and benefits not paid by the purchaser's practice would be reduced and offset from your compensation calculation. While you and the purchaser would like for you to be classified as an independent contractor for expense deduction purposes, you would be classified as an employee.[1,2]

In the past three years, corporate practices have become prevalent, despite most state laws prohibiting nondentist ownership. They are providing selling dentists with an additional choice as buyers. If you sell to a corporate buyer, do your best to be fully paid in cash at closing, without any holdback for one or two years, based upon practice performance. Do not accept stock in lieu of any portion of the purchase price, as there is a very limited market for selling it at a later time. While easier said than done, always attempt to ensure that you are not required to continue to work for the corporate practice postclosing should you not desire to do so.

HIRING AN ASSOCIATE WITH A LATER SALE

If you have a practice that requires strong mentorship due to high-level or unique services, or if you believe that you have located the right successor and your practice has sufficient production, but you are not ready to retire, this exit strategy has merit. Here, you and the associate sign the associate employment agreement, the purchase and sale agreements, and your postclosing employment agreement. The signed purchase and sale agreements close upon one to three years from the date of the associate's employment or upon your death,

disability, or election to retire — whichever is earlier. Since this exit strategy often involves a large practice that can support an associate, it is more likely with this option, than with a complete sale, that you will continue to work post-closing.

I have found this exit choice to be a very desirable alternative to coownership if you plan to work less than six years, as it usually takes seven years to pay for the first half of your practice. As an example, the associate works for you for three years, and then you work for the associate for three years and by mutual agreement thereafter. If the new owner fires you without cause, your restrictive covenant could become null and void. Similarly, if you do not sell your practice under the terms of the agreement, the associate's restrictive covenant may become null and void.

To justify that you are taking your practice off the market by this arrangement, I suggest an earnest money deposit in the form of a promissory note in an agreed-upon sum. If the associate does not purchase your practice, except for specified reasons, the promissory note becomes immediately due and payable. You may also be subject to a comparable promissory note that would become immediately due and payable should you decide not to sell your practice. This form of earnest money deposit is favorable to an associate because it does not require an up-front deposit. Depending upon your state laws, the court may limit damages for breach of contract to the sum of the earnest money deposit. Due to this concern, the sum of the promissory note(s) should be carefully considered.

As a failsafe, if 100% financing is not available in the future, despite the purchaser's best efforts, either the obligation to purchase your practice becomes null and void or the terms of your owner financing, to the extent that you are willing to provide it, are delineated in the agreements.

As to the determination of the purchase price, your practice is valued as of a date before the associate's employment begins. Your practice is again valued in one year after the associate period. The rationale is that in one year, the associate's production is attributable to your pent-up demand. Often, the associate is from the community where your practice is located. While we can exclude those patients directly attributable to the associate from the goodwill calculation, the reality is that the patients directly referred to your practice will be de minimis. New equipment and technology purchased during the associate period should be as mutually agreed over a threshold dollar amount, except for emergency purchases, and depreciated over a 10-year, straight-line method. For example, if you and the associate agree to purchase technology at the end of the first year of the associate period that will cost $40,000 and last for three years, the purchase price for the technology will be reduced by $4,000 in the second year and then by $4,000 in the third year, and the fair market value is $32,000.

What's beneficial about hiring the associate with a later complete sale is that there is one owner and an asset sale that consists mostly of capital gains to you and with assets deductible to the purchaser. An exception is for a son or daughter purchasing a parent's practice, which was formed prior to August 10, 1993, due to the harsh antichurning rules under the tax code.

ESTABLISHING CO-OWNERSHIP

Co-ownership is the most complex form of practice ownership because you need to deal with the buyin, operations (consisting of compensation allocations, decision-making control, and employment of family members as dentists/specialists and/or nondoctor staff), and most overlooked, an owner's buy-out for any reason. Added to this complexity, there are three business and tax structures for coownership, two of which do not work very well if the tax rules are followed.

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THOSE BUSINESS AND TAX STRUCTURES ARE AS FOLLOWS:

1. The purchase and sale of stock in a corporation or a membership interest in a limited liability company, excluding goodwill and a compensation shift for the buy-in and deferred compensation for an owner's buyout, adjusted upward to reflect the differential of you receiving ordinary income and again for an interest component.
2. The three-entity method, consisting of a limited liability company or partnership of corporations to achieve favorable asset treatment for those practices formed after August 10, 1993, due to the antichurning rules.
3. The purchase and sale of stock in after-tax dollars, adjusted downward to reflect that the purchaser is purchasing stock in after-tax dollars, while you receive all capital gains, which is the only business and tax structure always without tax risks.[3,4]

Remember, your third partner is the IRS. Notwithstanding IRS scrutiny in these complex transactions, coownership is becoming more and more common due to large general and specialty practices that cannot be sold in complete sales due to their sizes. Unfortunately, the tax laws are not friendly to coownership. Make sure that you engage advisors who follow the tax rules, however, and you will be fine.

The buyin will be internally financed unless you are willing to provide the lender with a guaranty through your practice entity and/or you personally. If the new owner leaves, you will be required to repay the loan. As such, the buyin should be internally financed. As to the buyout in a two-owner practice (by far the most common), you should be paid in cash, and your buyout should be mandatory by the associate. Unfortunately, the associate may not desire to buy the second half of your practice and complete the buy-out unless it is mandatory. In my view, this is a big problem in coownership — second only to production disparity due to insufficient patient demand.

In a practice with more than two owners, the second owner admitted, Dr. Two, does not want to be affected by Dr. Senior's departure. Because Dr. Two does not want to be affected by Dr. Senior's departure, Dr. Three pays the buy-out over time.

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FORMING A SOLO GROUP ARRANGEMENT

Solo group arrangements are a good alternative to coownership because the associate who purchases the first half of the practice is not obligated to purchase the second half. Because you and the associate, who is now an owner, have separate practices, you sell your practice to a third dentist upon your retirement. This works well because the third dentist is not a co-owner with the other solo group member. In a solo group arrangement, you sell one half or an undivided interest in your equipment, technology, and goodwill. Thereafter, you and the new owner, your former associate, operate your practices under an office-sharing agreement. Common expenses to both practices are either equally allocated or allocated on the basis of respective productivity. This exit choice resolves the antichurning rule problem, in contrast to the three-entity method, to achieve favorable asset treatment for the seller and purchaser because they are unrelated for practices formed prior to August 10, 1993. An exception is for family members.

MERGING YOUR PRACTICE WITH ANOTHER

For those practices that are relatively small or unsalable for any reason, you can merge into a larger practice with adequate space. You continue to work, and when you're ready to retire, the purchaser's practice purchases your patients under an agreement over 12 months. The selling price is often 35% of the purchasing practice's collections attributable to your goodwill or revenue generated from your patients. The purchasing practice pays only for your goodwill actually transferred. There may be an initial payment upon your retirement – often half of the anticipated or calculated goodwill value – with the second half "trued-up" after 12 months from the sale. Usually the purchasing owner does not need your equipment, except for specified items. Mergers are becoming more common because new dentists and specialists cannot earn a reasonable living, cover their living expenses, and service school debt by purchasing a small practice. As a result, these dentists, and now specialists, are joining corporate practices rather than buying a smaller practice and then developing it.

WALKING AWAY

Assuming that you can afford to retire, you can elect to work one or two years longer than anticipated, and then you can close the doors. As an example, let's say that your practice collects $800,000 in a year. Your earnings are $320,000 or 40% of collections. By working two more years, you earn $640,000 — or maybe $500,000 if you take more time off. If your practice sells for 65% of one year's collections or $520,000, you haven't lost anything. If a successor is available when you are ready to leave, you sell. If not, you walk away.

Some specialists and general dentists in certain geographical areas have no choice other than to close the doors should a successor not be available. While you aren't paid for your practice, you are not faced with the complexity of selling it.

SUMMARY

A complete purchase and sale is the least complex. You get fair market value for your practice and goodwill, and you are paid in cash with maybe a small percentage of seller financing. If you have identified your successor and are sufficiently busy, admitting an associate with a complete sale in one to three years is workable, although more complex than a complete purchase and sale. If you plan to practice full-time for seven-plus additional years, coownership can work, as long as Dr. Junior is willing to purchase the second half of your practice. A solo group arrangement often works better than coownership, though, because Dr. Junior probably does not want the obligation to purchase the second half of your practice. For an otherwise unsalable practice, a merger can work well. Finally, you can work an additional one or two more years and walk away. You only have to pick one! **DE**

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