Transitions Roundtable

We ask two experts the same question on a complex issue.

Question: Under what circumstances, if any, would a minority interest discount be appropriate in the purchase of less than an equal interest in a partnership?

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Under no circumstance is a minority interest discount appropriate in the purchase of less than an equal interest in a private dental partnership. If the incoming partner's advisors determine that the appraised value for the interest being purchased is not fair, that the business and tax structure of the partnership is untenable, or that the terms of the partnership, such as a mandatory buy-out of the existing owners, are unacceptable, then the incoming partner should seek an alternate opportunity.

Bottom line is, to the extent that the incoming partner believes that there is a high degree of risk in entering the partnership, the partner candidate should seek another opportunity. This should be done only after consultation with an attorney and CPA who understand dental and dental specialty partnership buy-ins and buy-outs.

In a corporate partnership, the new partner needs the ability to be bought out and depart unscathed should the partnership become unacceptable. The partnership agreement should provide that the corporate practice cannot revise the terms of a minority partner's interest under any circumstances. It should allow for a full buy-out if there is a change of ownership control, or if an event, such as a recapitalization, adversely affects the minority partner.

In private practices, partnership candidates often believe that unless control is equal, a minority interest discount is appropriate.[1] What the candidates usually miss is that the existing owners can and should mentor the new partner from both a clinical and management perspective. The benefit of mentorship offsets any minority interest discount. As long as new partner compensation cannot be changed and additional dentists or specialists cannot be hired without unanimous consent, the control issue is minimal, and the minority interest discount should be irrelevant. Many dentists and specialists have walked away from otherwise tremendous opportunities because they did not perceive that the mentorship had any value.

REFERENCE

1. Fishman JE, Pratt SP, Morrison WJ. *Standards of Value, Theory and Applications.* Ebook. 2007. ISBN: 978-0-470-07431-2.

ALLEN M. SCHIFF, CPA, CFE

In order to understand the concept of "minority interest" along with "minority interest discount," we have to define these concepts. Once we have an understanding, we can then apply them to acquiring an equity interest in a dental partnership.

What is minority interest? It is exactly what it says. When you buy into a dental partnership, and if the equity you are purchasing is less than 50%, you in effect are purchasing a minority interest in the dental partnership because your equity position is noncontrolling. What is noncontrolling? Noncontrolling means you cannot control a major decision because you lack the equity interest to control it.

What are major decisions in a dental partnership? They vary, but they're often things like hiring an associate, moving the practice to a new location, or purchasing a major piece of equipment. As you can readily see, these are major decisions that you will not have control over. So, you should prepare yourself from the beginning to lack control over these decisions because you are not a simple majority.

Now ask yourself, if I have an opportunity to purchase a minority interest in the dental partnership, how will that impact me buying into the dental partnership? This is where the concept of minority interest discount comes in. The minority interest discount applies when you buy into the dental partnership and you own less than the controlling interest (50%).

I demonstrate how the minority interest would apply in figure 1. The assumption is that both parties (you

Figure 1: How minority interest would apply

Total practice value @ 25%	
Total dental practice value @ 100%	$1,000,000
Equity interest offered at 25%	25%
Total dental practice value @ 25%	$250,000
Application of minority interest discount	
Total dental practice value @ 25%	$250,000
Application of minority interest discount	10%
= Minority interest discount	$25,000
Total dental practice value @ 25% after applying the minority interest discount	$225,000

and the seller) have agreed to the overall enterprise value of the dental practice. I will place a value of $1 million on the entire practice. Let's further assume you have an opportunity to purchase 25% of the overall equity of the practice ($250,000). Now, I will apply the concept of minority interest on your buy-in.

Based on the example, the concept of minority interest has been applied to you buying into a practice valued at $1 million for a 25% equity interest. As you can see, the 25% equity you are purchasing has been reduced due to the fact that you lack the controlling interest.

Furthermore, the discount I applied in the example (10%) is very subjective, which means the dental CPA has the ability to increase the discount based on his or her understanding of the partnership and what exactly you are purchasing. The minority interest discount could be as high as 30% or 40%, but your dental CPA would have to provide justification for a minority interest discount that approaches these levels.

> In a corporate partnership, the new partner needs the **ability to be bought out** and depart unscathed should the partnership become unacceptable.

In conclusion, when you are purchasing less than a controlling interest, a minority interest, you need to be careful with the economics associated with the buy-in. Be sure to take all of these variables into consideration in arriving at your conclusion. There are many concepts and decisions that ultimately get you to what is fair to you as the buyer and what is fair to the seller. That is what is most important in arriving at a fair partnership buy-in for all involved. Good luck! DE

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