

Partnerships: Examining a Polarizing Business Model

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Current Practice Trends

Competition level is higher

- Doctors retiring later
- Growing number of dental school graduates

Current Practice Trends

Dental School Graduates

- 12,210 applied; 4,871 were enrolled in 2010
- 4,873 graduates in 2010 compared to 3,778 in 1993
- 12 New Schools Coming Online
- Should top 5,000 in coming years

Current Practice Trends

Actively Licensed Dentists

- From 166,383 in 2000 to 184,578 in 2010
- Increase of 18,195 or 10.94% in this decade



Current Practice Trends

Competition level is higher

- Doctors retiring later
- Growing number of dental school graduates
- Increased corporate presence
- Reduced demand from patients



Current Practice Trends

Increase in Group Practices



Perception VS. Reality

- **Negative Perception**
 - Seller will take a pay-cut
 - You can't sell your remaining interest
 - They just don't work

Perception VS. Reality

- **Real Benefits**
 - Reduce admin./mgmt. responsibilities
 - Additional time off (Take a 2 week vacation)
 - Lock in transition plan early
 - Work as long as you like

Most Common Transition Plan

- **Full Sale (100%)**
 - Most doctors don't want to quit "cold turkey"
 - Despite this, doctors typically choose 1 of 2 paths:
 1. Sell earlier than you would like
 - Income up/consistent
 - Feel burnt out (temporary)
 2. Sell later than you should
 - Income declining
 - Overhead rising
 - Referring sources moving on

Selling the Cow & Keeping the Milk

- SITUATION:** Immediate Buy-Out w/ Post-Sale Employment
- o Annual income of approx. \$1M
 - o Overhead rate < 45% (well below avg)
 - o Purchase price well above avg
 - o Seller wanted guaranteed post-sale employment for 10 yrs.
 - o Seller wanted \$1,500 per diem with minimum 100 days per year (\$150,000 per year minimum)

PROBLEM:

- o Practice isn't large enough for two full-time docs
- o Buyer paying higher price for additional profitability that he/she isn't getting

Expecting someone to buy the cow when they can get the milk for free!

- SITUATION:** Delayed Buy-Out Preceded by Associateship
- o Seller was 78 years old
 - o Income decreased each of last 10+ years
 - o A once efficient overhead rate now > 80%
 - o Few remaining referring sources
 - o Resulting low fair market value
 - o Buyer wanted to "test drive" practice prior to acquisition

WHAT HAPPENED:

- o Bank unwilling to finance the sale
- o Unable to sell the practice

Alternative Transition Plan

- **Well Planned Partnership**
 - Sell a fractional interest in your practice 3 to 10 years prior to your desired retirement
 - Purchaser agrees to buy remaining interest at later date
 - "Golden Handcuffs" (Security)
 - Work as long as you choose

Prelude to a Partnership

- **Pre-Planning**
 - Facility/Capacity Considerations
 - Scheduling
 - Are you Partnership Material?
 - Sharing Management Responsibilities
 - Percentage to be Sold
 - Decision Making When Unequal ownership %

Relationship Failures

Why Do They Happen?

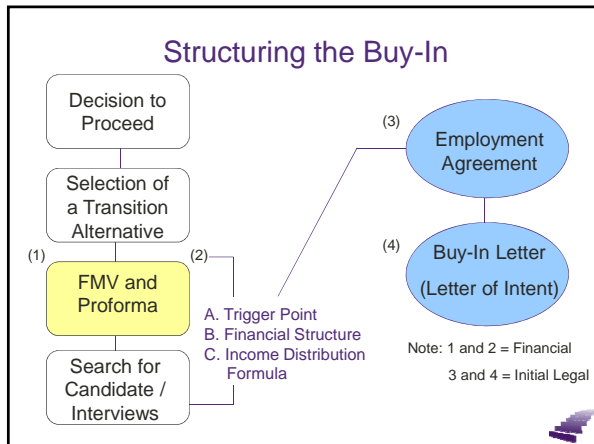
- (1) **Personality**
 - Acid Test
 - Professional Assessment



Associateships

Relationship Failures (continued)

- (2) **Unforeseen**
- (3) **Unfulfilled Expectations**
 - Financial Outcomes
 - Legal Arrangements
 - Process



Fractional Sale: Structuring the Buy-In

Fair Market Value (FMV)

- Most buyers/sellers feel this is the most important term
- Most emotional term
- Is my practice worth 70% of income?
- Other terms may have larger financial impact

Fractional Sale: Structuring the Buy-In

(A) Trigger Point

- Sufficient Collections
- No Decrease in Earnings

Fractional Sale: Structuring the Buy-In

(B) Financial Structure

- Simultaneous Objectives
 - Affordable for Associate/Purchaser
 - Fair/Tax-Efficient for Owner/Seller
- Push / Pull in Tax Code

Fractional Sale: Structuring the Buy-In

Solving Financial Structure: Two Alternatives

- Stock Sale (I)
- Asset Sale (II)



Fractional Sale: Structuring the Buy-In

Alternative Financial Structure I: Stock Sale

- Ownership Conveyed by Stock Purchase
- Inherent Conflict
 - Taxed at Capital Gains Rate (20.0%)
 - Inefficient for Purchaser

Fractional Sale: Structuring the Buy-In

Alternative Financial Structure I: Stock Sale

- Best Scenario for Seller
 - Capital Gain (15% to 20%)
- Worst Scenario for Buyer
 - Can't write-off stock
 - Exposure to existing liabilities (e.g. taxes, personal injury, creditor and other claims)

Fractional Sale: Structuring the Buy-In

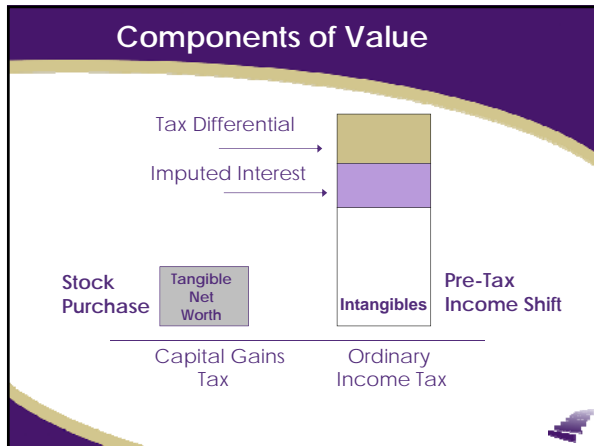
Can We Make This More Affordable?

- Assign Portion of Value to Stock (Tangible)
 - Tangible Component Typically Much Smaller
- Remainder Paid with Pre-Tax Earnings Shift (Intangible)

Stock Sale: Affordable and Fair

Fair Market Value

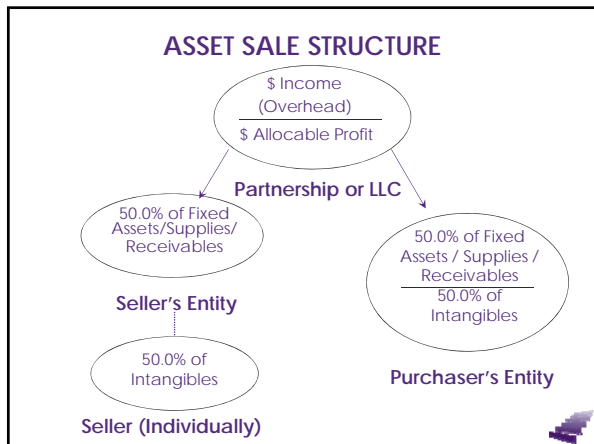




Fractional Sale: Structuring the Buy-In

**Alternative Financial Structure II:
Asset Sale**

- Two Sellers
 - Practice Sells Tangible
 - Doctor Sells Intangible



Fractional Sale: Structuring the Buy-In

Asset Sale

- Majority of sale proceeds to seller taxed as capital gain (15% to 20%)
- Buyer Can:
 - Depreciate/Amortize (write-off) assets

Fractional Sale: Structuring the Buy-In

- Allocation of Purchase Price
 - Order of Allocation:
 - Receivables
 - Consumable Supplies
 - Fixed Assets
 - Patient Records
 - Covenant Not to Compete
 - Personal Goodwill
- } Corporation Sells

} Doctor Sells

Allocation of Purchase Price

Asset Category	Tax Effects to Seller	Tax Effects to Buyer
Supplies	Ordinary	Expensed Immediately
Furniture & Equipment	Ordinary	Section 179; Balance over 5 to 7 Years
Accounts Receivable	Ordinary	Collected Tax-Free up to Amount Allocated
Orthodontic Contracts	Capital Gain*	Amortizable Over 15 Years
Patient Files & Records	Capital Gain*	Amortizable Over 15 Years
Leasehold Improvements	Ordinary	Amortizable Over 39 Years
Corporate Goodwill	Capital Gain*	Amortizable Over 15 Years
Personal Goodwill	Capital Gain	Amortizable Over 15 Years

*Although these items are capital assets, if retained in a C Corporation, they will be taxed at the corporation's ordinary rate, and again when distributed to the shareholder(s).

Fractional Sale: Structuring the Buy-In

Which Structure is Better?

- Stock Sale with Management Fee
- Asset Sale with Three Entities



Fractional Sale: Structuring the Buy-In

Other Considerations:

- Additional Costs of Asset Sales
- Related Party Transaction Rules
- What About My Personal Expenses?
- Buy-Out Considerations
 - Third Partner?

Fractional Sale: Structuring the Buy-In

Which Structure is Better?

- Must Evaluate Both Options
 - Choose the Most Mutually Beneficial Option

C) Income Distribution

Fractional Sale: Structuring the Buy-In

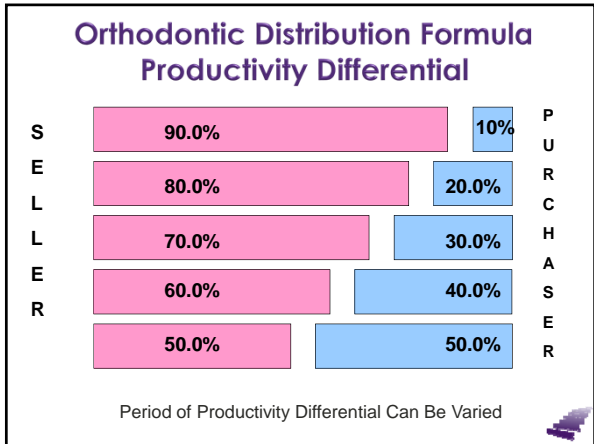
(C) Income Distribution Formulae: Basic Types

- (1) Equity (Ownership)
- (2) Days Worked
- (3) Multi-Tiered



Orthodontic Distribution Formula Multi-Tier





Fractional Sale: Structuring the Buy-In (Will This Dog Hunt?)

Proforma: Putting It All Together

- Tests Financial Outcome
- Sets Target for Associate
- Illustrates Financial Structure
- Pre-Defines Distribution Formula

Stepping over dollars to pick up pennies!

SITUATION: Buy-in Following an Associateship

- 2 year associateship leading to buy-in
- To avoid the cost of professional services, the seller offered a "hand-shake deal"
- After 2 years, the seller proposed terms to the associate

PROBLEM:

- Neither seller or buyer knew what to expect
- The associate was shocked by the price and terms and backed out of the deal
- Seller back at square one
