Partnerships: Exploring One of Dentistry’s Fastest Growing Trends

Jonathan R. Martin, C.P.A.

Current Practice Trends

Competition level is higher
- Doctors retiring later
  - Avg. retirement age increased from 64.8 in 2001 to 68.8 in 2015
  - 15.3% of dentists are older than 65 yrs old, up from 8.7% in 2005
- Growing number of graduates
  - Enrollment increased by 19% since 2005, while the number of graduates has increased by 14%
- Competition from non-specialists
- Growth of DSOs

Supply & Demand
- Decrease in the number of practices available for sale
- Increased demand
- Increasing practice values

Buyer State of Mind
- Debt sensitivity (student loan debt)
- Shift in buyer priorities
  - Workload flexibility

Perception VS. Reality
- Negative Perception
  - Seller will take a pay-cut
  - You’re giving away part of your practice
  - You can’t sell your remaining interest
  - You’ll lose your “perks”
  - They just don’t work

Increase in Partnerships and Other Group Practices
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
       - Sellers don’t realize it at the time
       - Feel burnt out (temporary)
    2. Sell later than you should
       - Income declining
       - Overhead rising
       - Referring sources moving on

Selling Too Late:

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

**WHAT HAPPENED:**
- Bank unwilling to finance the sale
- 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
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
- Other terms may have larger financial impact
- Most emotional term
- Is my practice worth 70% of income?

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

Solving Financial Structure: Two Alternatives
- Modified Stock Sale (I)
- Asset Sale (II)
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
  - Can’t always write off interest

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

<table>
<thead>
<tr>
<th>Tangible Net Worth</th>
<th>Intangible(s) Component</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>Pre-Tax Income Shift</td>
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</tbody>
</table>

Components of Value

<table>
<thead>
<tr>
<th>Tax Differential</th>
<th>Imputed Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock Purchase</td>
<td>Tangible Net Worth</td>
</tr>
<tr>
<td>Intangibles</td>
<td>Pre-Tax Income Shift</td>
</tr>
</tbody>
</table>

Capital Gains Tax
Ordinary Income Tax

Fractional Sale: Structuring the Buy-In

Alternative Financial Structure II: Asset Sale
- Two Sellers
  - Practice Sells Tangible
  - Doctor Sells Intangible

ASSET SALE STRUCTURE

$ Income (Overhead)
$ Allocable Profit

Partnership or LLC

50.0% of Fixed Assets/Supplies/Receivables

Seller's Entity

50.0% of Intangibles

Purchaser's Entity

50.0% of Fixed Assets/Supplies/Receivables

50.0% of Intangibles

Seller (Individually)
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
  - Deduct interest payments on loan

Allocation of Purchase Price

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

*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

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

Which Structure is Better?
- Stock Sale with Earnings Shift
- Asset Sale with Three Entities

Other Considerations:
- Additional Costs of Asset Sales
- Related Party Transaction Rules
- What About My Personal Expenses?
- Buy-Out Considerations
  - Third Partner?
C) Income Distribution

Fractional Sale: Structuring the Buy-In

(C) Income Distribution Formulae: Basic Types

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

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

Proforma: Putting It All Together

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