Legal and Practical Issues for Buyers and Sellers

Presented by:
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Resume
- Amherst College, 1979
- U. of Pittsburgh Dental, 1983
- Fairleigh Dickenson U., Ortho., 1985
- Pace Law, 1990
- Clinical Associate Professor, NYU Dept. of Orthodontics, 1989 – present
- Private practice of orthodontics, Brooklyn
- Private practice of law, Manhattan

Why am I Speaking to You Today?
- To explore legal issues in a transition from both the buyer’s and seller’s perspective
- To answer some of your questions about the legal issues of a practice transition
- To join my distinguished colleagues in a forum on practice transitions

Objective
This presentation is designed to give both buyers and sellers a brief overview of some of the legal issues to consider when transitioning into or out of an orthodontic practice.

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We will review the legal documents your transition might require.
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We will review what your attorney should do for you and what you should expect from your attorney.

Life Cycle of a Transition

Why would you be offered a job by a senior doctor?

- Excessive patient load
- Desire to reduce workload
- Transition imminent

What should you be careful of when evaluating an offer?

- Professional companionship
- Expectation of growth
- Desire to keep all procedures "in house"
- Locked-in buyer
- Better utilization of overhead

Associates, you have two functions in the office:

- Make your employer’s life easier
- Make money for your employer

Seller’s Transition Team
- Accountant
- Attorney
- Financial Planner
- Practice Broker
- Transition Consultant
- Spouse

Buyer’s Transition Team
- Accountant
- Attorney
- Finance Source
- Practice Broker
- Transition Consultant
- Insurance Broker
- Spouse
Attorney’s Role

- Evaluates: legal issues, employment issues, legal structure of practice, documents
- advisor
- negotiator
- document drafter
- document reviewer

Choosing an Attorney

- Attorney is your advocate and can represent only you.
- Probe for possible conflicts of interest.
- Attorney can be hired by both parties to mediate and draft a mutually agreeable contract, but...
- Each party must then hire a personal attorney to review contracts.
- Call an attorney before you have a problem

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Working with an Attorney:

Legal Costs

Written agreement outlining fees:
- Employment Agreement: 2 – 5 hours
- Practice transition: (15 – 30 hours)
  - initial retainer (refundable if unearned)
  - hourly: $300 - $400/hr
  - flat fee
    - seller: $7,500 - $15,000
    - buyer: $5,500 - $10,000

Legal Considerations

Things to consider and have in place when contemplating a transition...

Seller’s Entity Status

- “C” or “S’ corporation?
- If a “C” corp, consider switching to “S” status 5 years prior to transition. (was 10)
- “C” corp makes a transition more difficult due to tax consequences for both parties

Seller’s Employment by Corporation

- If you are a C corp and have an employment contract with your corporation, “resign” from corporation at least a year prior to sale.
- This will help ensure the goodwill value is personal to you and not a corporate asset.
Buyer’s Entity Status

In conjunction with your accountant, choose the appropriate entity:

- Sole Proprietor
- Professional Corporation (s-corp election)
- (Professional) Limited Liability Company

Lease Issues: Buyer and Seller

- Pay careful attention to your lease years in advance. Negotiate hard.
- Put your lease where you can find it.
- READ THE LEASE
- You must have at least five to seven years left on your lease when you are ready to sell. Buyer cannot get financing without a lease of this duration.

Lease Issues

- Never assume the landlord will cooperate even if he is your patient, friend or brother
- Make absolutely sure you can assign and sublet to your buyer. Key words in lease are “such consent shall not be unreasonably withheld, conditioned or delayed.”
- Practice purchase agreement must have a lease contingency

Lease Issues

- Seller: do not assign your lease unless you close
- If you own your space, consider a 1031 (like-kind) exchange when you sell.
- Buyer: do not close unless the lease is assigned to you.
- Buyer: if office is owned by seller, get an exclusive even if you vacate the space

Lease Zingers

- right of landlord to recapture space
- large assignment commission to landlord
- unobtainable standards for assignment
- “time is of the essence” clauses
- costly holdover rates
- failure to get an exclusive for ortho office
- failure of landlord to release seller
- relocation clause

Lease to Own

- fair market value rent
- fair market value purchase price
- right of first refusal vs. option to purchase
**Seller: Restrictive Covenants**

- Make sure all associates have employment contracts with restrictive covenants.
- Never hire an associate with the idea you will prepare a contract later.
- Lack of restrictive covenant will hurt practice marketability.

**Buyer: Restrictive Covenants**

- Restrictive covenants are enforceable: don’t sign one if you don’t intend to adhere to it.
- Be careful about a “bait and switch” restrictive covenant.
- You will be asked to sign a restrictive covenant: look for creative solutions to difficult issues.

**Financial Policy, Accounts Receivable**

- Tighten up your financial policies at least a year in advance.
- Make an effort to collect your accounts receivable at least six months in advance. This may be money left on the table after the transition.
- Buyer does not want to collect your a/r. Once you sell, you will not be in a strong position to collect them yourself.

**Practice Liens and Loans**

- Review and begin to pay off any outstanding debt on practice.
- Do not enter into any long-term leases or contracts. The buyer may not want to assume these and you may have to absorb them.
  - Examples include: yellow page ad, digital x-ray/cbct, postage meter, water cooler, laundry service, sharps pick-up, alarm system, software maintenance.

**Practice Statistics: Charts and Computer Entries**

- Be diligent about entering computer stats.
- Inaccurate stats present an incomplete picture of the practice.
- Improve your charting. Take progress records.
- Buyer will do a chart audit. Do not be offended or defensive. Neat charts improve value and buyer confidence.

**Pre-Sale Patient Management and Care**

- Start treatment on any patient who is ready to begin.
- Increase your initial fee and make sure patients adhere to your fee schedule.
- Avoid excessive prepayments and excessive use of third-party financing.
- Avoid a last minute “fire sale” on treatment. Buyer’s can spot that and will look unfavorably on it.
**Tax Returns/Financial Data**
- Clean up your books.
- Slow down on the personal deductions to show more income.
- Report all cash in the unlikely event you haven’t been.
- Have tax returns and P&L ready for buyer.
- Work with your accountant to have all the financial data ready for buyer.

**Personal and Financial Issues/ Seller**
- Can I afford to retire?
- Can I roll a portion of the sale price into a tax-deferred retirement plan?
- Look into a 1031 exchange if you plan to practice somewhere else.
- Am I burned out?
- Do I have something else I would rather be doing?
- Is my spouse on-board with the sale? (For better or worse, but not for lunch.)

**Post-Transition Employment**
- Does seller want to work for buyer?
- Does buyer want to employ seller?
- If yes, how much and in what capacity? As an independent contractor or an employee?
- Will Seller close P.C. or have P.C. work for buyer?
- Seller: how you treat buyer will be how buyer will treat you.

**Personal and Financial Issues/ Buyer**
Know seller’s answers to the previous questions and ask yourself:
- Can I afford this practice?
- Do I need to work somewhere else?
- Am I ready to run a practice?
- Is my spouse as excited as I am?

**Tax Issues in a Transition**
There are three parties to every transition:
- Seller
- Buyer
- IRS

**Tax Issues in a Transition**
- goodwill
- accounts receivable, contracts receivable
- restrictive covenants
- fixed (tangible) assets
- supplies and instruments
- leasehold improvements
- stock transfer
**Goodwill**
- best for seller
  - buyer: straight-line 15 year amortization
  - seller:
    - capital gain for unincorporated, S-corp, LLC
    - double tax if C corp
    - 35% corp tax plus personal income tax rate

**Restrictive Covenants**
- allocation unfavorable to both parties
  - buyer: straight-line 15 year amortization
  - seller: ordinary income
  (If restrictive covenants are merged into goodwill, capital gains treatment is possible.)

**Fixed (Tangible) Assets**
- dental and office equipment, furniture, fixtures
- good for buyer
  - buyer: depreciates annually according to schedule, 5 – 7 years
    - (Section 179) $500,000 yr
  - buyer may pay sales tax on value of assets
- seller: ordinary income

**Supplies and Instruments**
- great for buyer
  - buyer:
    - immediately deductible
    - no sales tax
  - seller: ordinary income

**Leasehold Improvements**
- so-so for buyer
- up to 39 years to depreciate

**Allocation of Purchase Price**
- Make sure you can support the allocations in your agreements
- Get your accountant involved
- Consider a 1031 exchange if you plan to buy a practice somewhere else
Stock Sale
- Great for seller, terrible for buyer.
- Buyer: no deduction, becomes "basis"
- Buyer: inherits all of corporation's liabilities
- Seller: capital gain above basis

Fractional (Stock) Buy-In
- Limited value assigned to stock in a fractional buy-in to reduce unfavorable tax outcome to purchaser (depreciated value of assets)
- Income shift, buyer to seller
  - offset (increase) in purchase price
- Personal goodwill of seller
- May be the only way to buy in to a group practice

Psychological Issues
- Seller's Concerns
- Buyer's Concerns

Seller
- Your practice is probably not worth 1x gross despite how great you feel it is
- You probably aren't worth $2,000/day despite how great you think you are
- Don't stay too long, sell while your practice still has real value
- Even though you just "hung out a shingle" and did well, it is a different environment today.
- Are you sure you can live on what you have left?

Buyer
- Seller's practice is worth more than 25% of gross despite how antiquated you feel the physical plant is
- Somehow, seller managed to make a great living with that dowdy old office
- You probably aren't worth $1,500/day despite how great you think you are
- It will take you a year or two to realize you don't know everything
- Are you sure you can live on what you have left?

Seller, you have three functions in the office:
- Make your buyer's life easier
- Make money for your buyer
- Make your buyer a success
Inter-family Transitions
- every parent’s dream
- fraught with emotion
- dependent upon having a large practice
- challenging with divorced families
- complex tax issues

You are ready to move ahead.

What documents will you need?

Formal Document Drafting
- letter of intent/term sheet
- parties negotiate issues
- formal documents are drawn up, usually by seller’s attorney
- documents can be drawn up by broker, consultant or buyer’s attorney
- other attorney reviews and comments

Formal Document Drafting
- asset, stock, or interest purchase agreement
- new lease or lease assignment and assumption
- employment agreement for seller
- consulting agreement for seller
- deferred compensation agreement for seller
- stock purchase agreement
- stock pledge agreement
- goodwill assignment agreement
- restrictive covenants
- partnership agreements/ partnership dissolution agreements
- promissory note
- bill of sale
- security agreement
- escrow agreement
- lien search/title search

Sailing to Iceland

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Make an Investment

Thank You

See you in San Diego

Disclaimer

This information is not intended as a substitute for legal advice. You should familiarize yourself with the laws of your local jurisdiction and seek legal advice from a local attorney who specializes in such matters.
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