Diving into the Details

Draw up an agreement on these issues before buying in to any dental practice

by Philip A. Bogart

Philip A. Bogart, a frequent online Townie contributor and a partner at Whiteford, Taylor and Preston LLP, represents dentists in business transactions and situations encountered during the life of their practices. Services include structuring and documenting employee arrangements, partnerships, acquisitions and other exit strategies. He can be reached via e-mail at pbogart@wtplaw.com

Senior dentists and dental specialists planning their retirement often see their exit strategy in bringing on younger dentists. As a result, when hiring the next generation of dentists, they discuss potential "buy-in" opportunities.

Typically, discussions start before an associate has even joined the practice, but an actual purchase doesn't begin in earnest until the "junior" dentist has been in the practice for a few years. During this gap period, the senior dentist may change his mind, or propose terms that are, perhaps unintentionally, unfair or unrealistic. For example, it's common for an owner to overestimate the market value of a practice.

The point? Rather than signing and hoping for the best, a younger dentist should recognize the critical importance of agreeing on the transition details up front. Working with a dental CPA and a trusted legal advisor who understands the unique challenges of a new partnership can help ensure that both parties understand and take advantage of all available options to pave a clear way to a fair and successful transition. That way, if everything goes well during the initial employment phase, the transition to partnership will be smooth and not encumbered by the potentially high costs of transition consultants, accountants or lawyers brought in to negotiate deal terms after the fact.

While the following checklist is not intended to be exhaustive, it's a good outline of issues that can become controversial if not dealt with clearly at the outset. (It shouldn't be considered legal advice and does not create a client-lawyer relationship.)

Economics. Determine whether the numbers justify the buy-in. Can the practice support another owner? The senior partner may be willing to take a slight cut in salary to pave the way for her exit strategy. On the other hand, one plus one may equal three if the new dentist is able to expand the practice's range of services, or can appeal to a difficult age group or demographic.

Running through some projections to know what to expect can help the dentists make their respective decisions with confidence. Again, an accountant with a focus on dentistry can be invaluable as the dentists determine whether the bottom line will justify the proposed partnership for both parties.

Timing. Typically, the buy-in begins at least 18 months to two years after the start of the associateship. The younger dentist will want a date that is certain, and the parties can agree upon a deadline at which either can withdraw without further penalty, after which is a "point of no return."

Until that time, each dentist has the chance to get to know the other—and sometimes just as importantly, each other's spouses!—on a personal and professional level, and decide whether they're compatible.

Percentage. How much of the practice will be purchased? Eventually, will the junior dentist become an equal owner, or will the senior partner retain 51 percent or more? There's a multitude of ways to handle this. Of course, this question is intertwined with the payment terms, which we'll discuss in a bit: 50 percent up front? 10 percent per year?

Valuation. When will the practice be valued—based upon the value at the beginning of employment, or when the buy-in begins? While all goodwill belongs to the practice until the buy-in, the younger dentist may expect some "sweat equity" credit for contributing to the growth of the practice.

Frequently, the parties split the difference by averaging the beginning practice value with the value immediately before the buy-in. In addition, the dentists can identify the valuation company in advance—or at least a mechanism for establishing value, such as a percentage of gross collections.

Payment. Will the younger dentist pay the price in cash? Unless the buyer is independently wealthy, he'll rely upon a bank loan, and the bank may require the owner to guarantee the debt and to pledge the practice assets as collateral. Alternatively, the parties can agree upon a portion of the buyer's salary to be used to purchase the equity (a salary deferral). This can be structured by a tax and legal advisor.

Properties. If the practice (or the owner) owns the building, the buying dentist may want a piece of that asset as well. Alternatively, the buying dentist may ask for an option and a right of first refusal to purchase a percentage of the property.

While all goodwill belongs to the practice until the buy-in, the younger dentist may expect some "sweat equity" credit for contributing to the growth of the practice. Frequently, the parties split the difference by averaging the beginning practice value with the value immediately before the buy-in.

Taxes. Agree upon the tax aspects of the buy-in. The buyer can purchase equity, which is primarily "tax-friendly" to the seller, or the purchase may be structured as an asset purchase, which may be tax-friendly for both parties. Tax and legal advisors will be invaluable in structuring the nature of the acquisition. The importance of this point cannot be overstated.

Compensation. As partners, how will profits be split—50/50? Eat what you kill? Something in the middle? If the production of the partners is identical, the resolution is easy. If the new dentist outperforms the senior dentist, this question is more complex.

Power. How will decisions be made? Certainly, when the new partner is a 50 percent owner, she will want a "say" in the practice. Then again, the senior dentist may not be ready to let go of the reins.

Handoff. Don't underestimate the need to develop a road map to guide the senior dentist into riding off into the sunset. Consider the mandatory retirement age and payment terms. Don't allow the senior dentist to overstay his welcome. The practice could also be authorized to buy back equity if a partner is terminated for failing to abide by the agreed-upon employment terms.

Disasters. Life happens. Upon the death or disability of either partner, the practice should be obligated to buy out the practice of the deceased/disabled.

Competition. After the retirement or termination, the former partner should have a restriction on competing with the current practice. It is helpful to agree upon those parameters up front.

Ideally, all terms will be memorialized in definitive documents at the beginning of the associateship—or, at least, in a binding written letter of intent. That way, the parties will have a clear set of shared expectations.

A buy-in will be one of the most significant milestones in the careers of both the buying and selling dentists. Instead of kicking this can down the road, it's crucial to craft the buy-in road map at the outset of the relationship. Ensuring a fair and stable financial transition will make a difference not only to the dentists, but also to their families, the practice's staff and the patients. Ultimately, the attention to detail given now can help provide the practice with a better future. ■

Questions for the author? Comment after this article at dentaltown.com/magazine.