Transitions Roundtable

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

QUESTION:

I want to bring in an associate and sell the person some equity after a trial period. I won't be retiring for many years, so he or she would become a junior partner. How and when is that sale price determined?

BRANDON S. COLLIER, JD, LLM

There are two issues here: (1) the price, and (2) the timing of when the evaluation is to be made. Buyers don't want to have to pay for any growth that they bring to the practice. Sellers believe (usually correctly) that any growth the practice sees after the new doctor is hired is more the result of the seller making the business decision to hire another producer to meet the practice's pent-up demand for its services. As much as Dr. Seller may like Dr. Buyer, the truth is that the new doctor is often not bringing in many new patients or referral sources.

There's merit on both sides, and this drama plays out in debates over the practice's *goodwill* value; i.e., the value of the patient or referral base. The parties will usually agree that the practice's tangible assets and liabilities will be determined on the date of the future buy-in based on what exists at that time. As for valuing the goodwill, Dr. Buyer prefers the price to be set as of his or her arrival date in the practice, and Dr. Seller prefers it to be set on the future buy-in date.

Perhaps the fairest approach is to take the average of the two. This way both doctors agree that they're equally responsible for any growth during the interim period. The practice can be appraised up front with stipulations that the appraisal will be updated at the closing date for the future levels of tangible assets and liabilities, and to average in the practice's future goodwill value.

BRANDON S. COLLIER, JD, LLM, is a dental attorney. He provides tax and business planning services to the dental profession through Collier & Associates Inc., a law and consulting firm representing doctors in all phases of practice transitions and appraisals, retirement plan services, and tax-deductible CE seminars. He is the editor of the biweekly Collier & Associates Doctors' Newsletter. For more information, visit collieradvisors.com or call (216) 765-1199.

WILLIAM P. PRESCOTT, ESQ., EMBA, of Wickens Herzer Panza in Avon, Ohio, is a practice transition and tax attorney and former dental equipment and supply representative. His most recent book is titled *Joining and Leaving the Dental Practice, Third Edition*. Visit prescottdentallaw.com, or contact him at (440) 695-8067 or wprescott@wickenslaw.com.

WILLIAM P. PRESCOTT, ESQ., EMBA

The valuation date, with the exclusion of mutually agreed upon purchases of new or replacement equipment, for a future junior owner in a partial sale should be after the associate works one year on a full-time basis. The rationale is that during the first year, the associate is producing revenue from existing patients. Associates will not agree to a valuation date immediately prior to being admitted as a junior owner.

The practice valuation should be prepared by an appraiser with experience in appraising dental and dental specialty practices. While qualifications vary, experience is key. Partial sales values are a pro rata percentage of the entire practice value. Irrespective of the valuation method used, the economics need to be sound. The incoming owner should incur a slight compensation increase, pay his or her share of the practice's operating expenses, and pay the lender (third-party or existing owner) within a period of time not to exceed seven years.

Not only are the valuation date and appraisal important, so are the business and tax structures. The business and tax structure may increase or decrease the value to balance the tax effects to the existing and junior owner(s).

If an associate will not be expected to buy out the existing owner, the existing owner should include language that includes the right to sell the practice to any third party, provided any junior owner would share pro rata in the sales proceeds.

In addition to the buy-in, other considerations are compensation allocations, decision-making control, and owner buy-outs, all of which should be delineated before the associate employment begins. An associate buy-in usually works very well if the practice economics are sound and it is thoroughly planned in advance. DE