OF THE approximately 27,000,000 privately owned businesses in the United States, only 6,000,000 have employees. An interesting segment of those businesses are certain professional practices with value that can be sold and transferred. Dental and dental specialty practices continue to maintain the highest values, well ahead of veterinary, optometry, and many medical practices. As such, this article discusses the exit choices for dental and dental specialty practices in light of determining their value.

EXIT CHOICES • If a dentist (including dental specialists) has sufficient savings, knows how he or she will spend time after retirement and wants to retire, there are six ways to do it. They are a complete sale, hiring an associate with a later sale, co-ownership, a solo group arrangement, merger, and walk away.

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Succession Planning for Dental and Dental Specialty Practices
Complete Sale

A complete sale is relatively simple as compared to other exit choices, with the exception of closing the doors. Unlike 20-plus years ago, the dentist should be fully paid in cash at closing. For large practices, there may be a component of seller financing of up to 20% of the selling price.

Depending upon the size of the practice, the continued employment of the seller by the purchaser may be necessary to transfer the seller’s goodwill, finish cases and provide treatment as requested by the purchaser for an agreed time period, typically six months to one year and by mutual agreement thereafter. The dentist should be paid the greater of a daily rate or half-day rate or an agreed percentage of production or collections, often 35% for a general dentist and higher for specialists. The daily rate accounts for greeting and administrative time and assures that if the selling dentist works, he or she will be paid irrespective of the treatment schedule. While laboratory costs should be paid by the purchaser’s practice, the selling dentist’s direct business expenses, insurances, and benefits not paid by the purchaser’s practice would be reduced and offset from the selling dentist’s compensation calculation. While the seller and purchaser would like the seller to be classified as an independent contractor for expense deduction purposes, the retired dentist who continues to work is probably an employee.²

In the past three or four years, corporate practices have become prevalent purchasers, despite many state laws prohibiting non-dentist ownership. They are providing selling dentists with an additional choice as buyers. If the dentist sells to a corporate buyer, the dentist should be fully paid at closing, without any hold back for one or two years based upon practice performance. The dentist should not accept stock in lieu of any portion of the purchase price as there is a very limited market to later sell it. While easier said than done, always attempt to ensure that the selling dentist is not required to continue to work for the corporate practice post-closing should he or she not desire to do so.

Hiring an Associate With a Later Sale

To the extent that the practice owner has a practice that requires strong mentorship due to high-level or “unique” services or the practice owner believes that he or she has located the right successor and the practice has sufficient production, but the owner is not ready to retire, this exit strategy has merit. Here, the practice owner and the associate sign the associate employment agreement, the purchase and sale agreements and the practice owner’s post-closing employment agreement. The signed purchase and sale agreements close one to three years from the date of the associate’s employment or the earlier of the practice owner’s death, disability or election to retire. Because this exit strategy often involves a large practice that can support an associate, it is more likely here, than with a complete sale, that the former owner will continue to work post-closing.

This exit choice is a very desirable alternative to co-ownership if the practice owner plans to work less than six years, as it usually takes seven years to pay for the first half of the practice in co-ownership. As an example, the associate works for the practice for three years, then the former owner works for the associate for three years and by mutual agreement thereafter. If the new owner fires the former owner without cause, the former owner’s restrictive covenant could become null and void. Similarly, if the practice owner does not sell the practice under the terms of the agreement, the associate’s restrictive covenant may become null and void.

To justify that the practice owner is taking the practice off the market by this arrangement, we suggest an earnest money deposit in the form of a promissory note in an agreed upon sum. If the associate does not purchase the practice, except for specified reasons, the promissory note becomes immediately due and payable. The practice owner may also be subject to a comparable promissory note that would become immediately due and payable should the practice owner decide not to sell the practice. This form of earnest money deposit is favorable to an associate because it does not require an up-front deposit. Depending upon the state, the court may limit damages for breach of contract to the sum of the earnest money deposit. Because of this concern, the sum of the promissory note(s) should be carefully considered.

As a fail-safe, if 100% financing is not available in the future, despite the purchaser’s best efforts, either the obligation to purchase the practice becomes null and void or the terms of any owner financing, to the extent that the practice owner is willing to provide it, are delineated in the agreements.

As to the determination of the purchase price, the practice is valued as of a date before the associate’s employment begins. The practice is again valued in one year after the associate period. The rationale is that in one year, the associate’s production is attributable to the pent-up demand of the practice. Often, the associate is from the community where the practice is located. While those patients directly attributable to the associate can be excluded from the goodwill calculation, the reality is that the patients directly referred to the practice will be de minimis. New equipment and technology purchased during the associate period should be as mutually agreed over a threshold dollar amount, except for emergency purchases, and depreciated over a 10-year straight-line method. For example, if the practice owner and the associate agree to purchase technology which costs $40,000 at the end of year one of the associate period that will last three years, the purchase price for the technology will be reduced by $4,000 in year two and $4,000 in year three, and the fair market value is $32,000.

What’s beneficial about hiring the associate with a later complete sale is that there is one owner and an asset sale that is mostly capital gains to the practice owner with the assets being deductible by the purchaser. An exception is for a son or daughter purchasing a parent’s practice which was formed prior to August 10, 1993 due to the harsh anti-churning rules under the tax code.

**Co-Ownership**

Co-Ownership is the most complex form of practice ownership because the parties need to deal with the buy-in, operations (consisting of compensation allocations, decision-making, control and employment of family members as dentists/specialists and/or non-doctor staff), and, most overlooked, an owner’s buy-out for any reason. Added to this complexity, there are three business and tax structures for co-ownership, two of which do not work very well if the tax rules are followed. Those business and tax structures are as follows: (1) the purchase and sale of stock in a corporation or a membership interest in a limited liability company, excluding goodwill and a compensation shift for the buy-in and deferred compensation for an owner’s buy-out, adjusted upward to reflect the differential of Dr. Senior receiving ordinary income and again for an interest component; (2) the three-entity method, consisting of a limited liability company or partnership of corporations to achieve favorable asset treatment for those practices formed after August 10, 1993 due to the anti-churning rules; or (3) purchase and sale of stock in after-tax dollars and adjust downward to reflect that the purchaser is purchasing stock in after-tax dollars while Dr. Senior receives all capital gains, which is the only business and tax structure always without tax