

# The Dental Transition

NEWSLETTER

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## Top 5 Reasons to Hire a Practice Broker

*Selling a dental practice is a complicated process. Don't go at it alone.*

Selling a dental practice is a complicated process that involves numerous steps including determining the market value of your practice, finding the right buyer, negotiating the purchase price, drafting the purchase agreement and lease assignment, and facilitating the transition of ownership (just to name a few). Employing the services of a trusted professional can make a tremendous difference in the success of your transition. Here are the top 5 reasons to hire a practice broker when selling a dental practice:

### ***To formulate a transition strategy to meet your individual needs***

Not all practices and all doctors are the same. A good dental practice broker will listen to your specific needs and goals to develop an individually tailored transition strategy that fits your situation. There are many ways to structure a practice transition, including a walk away sale, associate to purchase, phased sale, and partnership arrangement. When selling a dental practice, choosing the right transition strategy for you and your practice is the first step towards a successful transition.

### ***To confidentially market your practice to find a buyer who is the right fit***

Utilizing the services of a practice broker will provide you with the opportunity to market your practice to a broader range of potential buyers, thereby increasing the likelihood of finding

a doctor who is an ideal fit for your office as well as shortening the timeframe required to complete the sale. The broker will handle practice showings and oversee all communication with potential buyers and their advisors, which can take a significant amount of time and effort. Delegating this responsibility to a seasoned professional will allow you to focus on the operation of your practice and enjoy your personal time rather than spinning your wheels talking to countless potential buyers. To protect the value of your practice during the marketing process, the broker should require each potential buyer to complete a confidentiality agreement prior to receiving any information regarding your practice and show your office only after business hours.

### ***To maximize the value you receive for your practice***

Your dental practice is one of your most valuable assets and the proceeds of the sale will likely be used to fund a significant portion of your retirement. Therefore, it's crucial that you maximize the value of your office at the time of sale. Determining the market value of your practice, articulating the practice value to potential buyers and their advisors, and maximizing the price you receive at closing are key responsibilities of a practice broker. Practice brokers are typically paid a commission based upon a percentage of the practice sales price. Therefore, it is in their best interest to get you the highest possible price for your practice.

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## Top 5 Reasons to Hire a Practice Broker

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### **To represent your best interest during the transition process**

While a dental practice broker's goal should be to structure a win-win transaction for both parties, the broker should solely represent the best interest of the seller during the transition process. The broker also serves as a buffer between the buyer and seller to preserve the goodwill of the practice and relationship between the parties during negotiations.

### **To provide a structured closing process to ensure a smooth and timely transition of ownership**

Navigating the closing process is often the most tedious and stressful part of selling a dental practice. Once you have identified a buyer for the practice, there are numerous

steps involved in completing the sale, including negotiating the practice purchase price, letter of intent, asset purchase agreement, assigning the lease, securing practice financing, announcing the sale to the staff and patients, etc. A dental practice broker will walk you through each step of the closing process to ensure a smooth and timely transition of ownership.

These are just a few of the reasons to employ the services of an experienced practice transition consultant when selling a dental practice. Planning in advance and building a strong team of advisors will ensure that your practice transition is a success.

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## Communication is the Key to a Successful Dental Practice Transition

As dental practice brokers, we are often asked "What is the most important factor in facilitating a successful dental practice transition?" The simple answer is: Communication. While it is imperative for the buying doctor to build a strong team of advisors, complete due diligence on the practice, secure financing, and navigate the closing process, all else could be lost if there is not effective communication between the buyer and seller during and following the transition of ownership.

As part of the due diligence process, the buying doctor should schedule a face-to-face meeting with the selling doctor well in advance of closing. We typically recommend this meeting be held at the seller's office after operating hours, with the practice broker attending if possible. The initial meeting is designed to allow both parties get to know one another, ask any questions they may have regarding the practice or each other, discuss practice philosophies, etc. During this meeting, the parties may also exchange contact information so they can reach out to each other directly to discuss any remaining questions or concerns leading up to closing (while also keeping the practice broker in the loop).

The buyer typically learns a great deal about the seller and practice during this interaction and leaves the meeting knowing if the opportunity is the right fit for them. Once the buyer and seller have met and established a personal connection, we also find that negotiations are more amicable and the closing process goes much smoother.

With a fee-for-service and/or personality-driven practice (where most of the patients are coming to the practice specifically because of the seller's personality), we have found that a second meeting between the buyer and seller in a more casual setting such as lunch, dinner, or happy hour can allow the parties to loosen up and gain additional insight into each other's personalities, interests, practice philosophies, etc. It is important to mention that we suggest the parties steer clear of discussing pricing, allocations, or any other negotiable items during any of these meetings.

Throughout the closing process, the buyer should clearly communicate his or her expectations of the seller leading up to and following the sale and the seller should notify the buyer if he or she is unwilling or unable to fulfill these obligations. Regardless of the seller's post-closing plans or obligations, the selling doctor should plan to serve as a resource to the buyer following the sale and be available for phone consultation to answer questions and offer advice.

By effectively communicating throughout the transition process, the buyer and seller will have established a solid foundation for a smooth and successful dental practice transition.



## Practice Transitions and Taxes

While the sales price of your practice is of great importance, what truly matters is how much of the sales proceeds you are able to take home at the end of day. Taxes are a fact of life and can have a tremendous impact on the sale of your practice. With that said, let's explore the tax implications associated with a practice sale and a few potential tax mitigation strategies:

**Price Allocation.** The IRS requires the total price of a practice be allocated to the various types of assets being sold and that the allocation be made according to the fair market value of the assets. As a general rule, the tangible assets are taxed as ordinary income "above basis", and the intangible assets are taxed as capital gains. ("above basis" means the difference between the sales price of the tangible assets and your book value or depreciated value which often is Zero.) Any consideration for a covenant not to compete will also be taxed as ordinary income. Since fair market value is somewhat subjective, there is some room for negotiating the overall allocation of the purchase price. As a seller, you will save taxes if you can negotiate with a buyer for a lower allocation to tangible assets (viz., equipment, furniture, fixtures, supplies, etc.) and a higher allocation to intangible assets (viz., goodwill and patient records). Unfortunately, it will benefit the buyer to have just the opposite allocation, so consideration must be given to making the allocation fair to both parties and some negotiation should be expected. Along with the price for your practice, the allocation of it is an area where a practice broker can add value to the process.

**Stock Sale.** If you are incorporated, a sale of the stock in your corporation to the buyer of your practice will usually produce the greatest tax savings because the sale of stock is almost exclusively taxed at the lower fixed capital gains rate as compared to the higher, tiered ordinary income rates. However, and this is a BIG however, stock is a non-depreciable asset to the buyer. As such, the buyer is not able to write off the sales price and essentially ends up buying your practice with after-tax dollars. Consequently, a buyer is likely only to agree to buy your stock if you are willing to discount your sales price by 30 percent or more to offset the loss of tax benefits for the buyer. For this reason (plus the assumption by the buyer of all of the associated legal and liability complications associated with a stock purchase), almost all dental and dental specialty practices are sold as "asset sales." In other words, the seller retains his/her corporation and all of its stock and instead sells specific tangible and intangible assets of the corporation (i.e., the practice) to a buyer since a buyer is then able to depreciate and amortize (write off) the entire purchase price as provided by current tax laws.

**Seller Notes.** Sellers ask us frequently, "Won't I save on taxes if I self-finance part or all of the sales price (i.e., carry back a promissory note from the buyer)?" The simple and safe answer is, "No, but maybe . . ." As mentioned above, the portion of the price in an asset sale that will be taxed as ordinary income will be due in the year of the sale, viz. the recapture over basis. That recapture will be taxed regardless of the receipt of any actual cash at closing, which means you owe the ordinary income tax associated with the recapture even if you do not receive a cent at closing. So if you are going to hold a note, you should require enough of a cash down payment to cover the tax liability you will incur from the recapture.

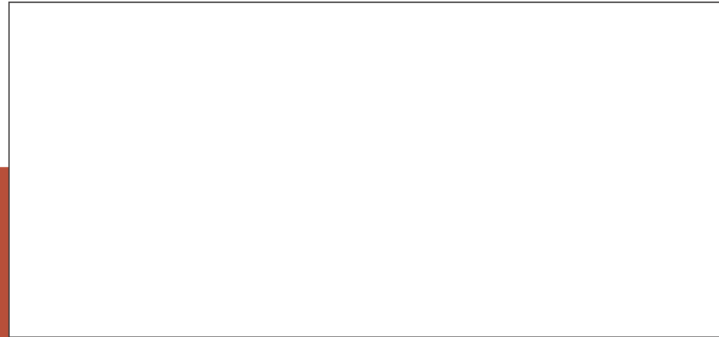
Since most of the remainder of the sales price will be taxes as capital gains and since the capital gain tax rate is a fixed rate unrelated to ordinary income or ordinary income tax rates, the same tax will be applied and the same tax amount will be owed whether you receive that portion of the price now or paid to you over time; unless . . . there is a change in the capital gains tax rate before the note you are carrying is paid off. If the rates go up, you would be taxed at that higher rate on that income as it is received- this just happened in 2013 when the Federal Rate on capital gains increased to 20% from 15%. Otherwise, self-financing a portion of the price serves only to defer capital gains tax, but it will not lower the total tax. (Also note that the interest portion of any promissory note payments will be taxed as ordinary income to the holder, while the principal portion subject to capital gains will be taxed at the capital gains rate.)

**Sale Timing.** As discussed above, the tax associated with recapture over basis on the sale of tangible assets will be determined by your ordinary income tax bracket in the year of the sale. If you are planning to retire after the sale of your practice and, consequently, will have a drop in your ordinary income level, it may be smart to time the sale of your practice until after the start of the next tax year depending on what is likely to happen to tax rates.. Also, if you have owned your practice for less than one year, you should, if possible, wait at least one full year before selling it since the sale of goodwill within a year of ownership will result in the higher short-term capital gains rate being applied instead of the long-term capital gains rate.

**"C" Corporation Consideration.** If you are currently incorporated and being taxed as a regular "C" Corporation, the sale of goodwill by your corporation will likely

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## Practice Transitions and Taxes

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be subject to double taxation once as capital gains inside your corporation and then again as ordinary income when paid as a distribution to the shareholder(s). There is some case precedence that allows for the shareholder(s) of "C" Corporations in closely held and professional businesses to sell goodwill individually, outside of the corporation, thus avoiding that double taxation. If this applies to you, consult with your CPA and/or tax attorney regarding the details of such a tax strategy and its application to your particular situation.

**1031 Exchanges.** . If you are selling a practice now and are planning to buy another practice within six months, a 1031 or "Like Kind" Exchange may be a tax deferral strategy to consider. It allows you to defer the taxes associated with recapture over basis you would otherwise incur with the sale of your tangible assets. A 1031 Exchange has very specific and rigid requirements

to accomplish correctly. The specific details and mechanics of this tax strategy are beyond the scope of this article. As such, consult with your CPA and/or tax attorney regarding the details of such a tax strategy and its execution.

As you can see, there are very important tax considerations to be dealt with as part of the sale of your dental practice. Doing this on your own or without competent and experienced advisors can end up being very costly.

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**Contact us TODAY to schedule a free consultation!**

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