Common Transition Planning Myths

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There is still an abundance of bad advice in the marketplace. I hear enough of these things, that I thought it might be a good time to clear up some of the confusion and dispel some of the myths.

In order to maintain control over my practice, I should sell a maximum of 49% to my partner. False. A 51% ownership interest does not give the owner significantly more control. Control is governed by the Operating or Partnership Agreement and not by share of ownership. One could own only 5% of the entity and still be the Managing Member or Partner. Remember that Bill Gates and other CEOs have ran their corporations with impunity; while owning less than 5% of the company. This authority is given by contract and, where appropriate, we can do the same thing in your practice. If you are bringing aboard an equal partner, make that person truly equal; do it on a 50:50 basis.

I want my partner to buy into the practice; but I want to keep the facility to myself and rent the space to my partner. You have heard me use the metaphor of a partnership being a "business marriage". You wouldn't marry your spouse under the terms that you're only married Monday through Friday! When you're in, you're all in! Allow your partner to buy into the facility as an equal partner. There is nothing more awkward than being a partner in the business; but being a debtor/tenant in the building. Usually, the facility purchase can be accomplished at the same time as the practice buy-in. Banks like having real estate as part of the security.

Independent contractor vs. employee: I sent an article on this issue a few months ago. The bottom line is: that 90% of the time, the doctor is going to be an employee. Stay away from this trap! If you would like another copy of the June article, let me know.

My broker says that he can do the valuation and represent both sides fairly. The broker's commission is calculated as a percentage (typically 8-10%) of the practice value; so by definition, the broker cannot be objective. A proper fair market valuation should be done by an Accredited Senior Appraiser (ASA) and for a fixed fee. No ASA appraisal can be linked to the compensation of the appraiser. Also, the buying doctor will be rightly suspicious of the broker and so the deal will start off on the wrong foot. Do these deals with a purely fee-based consultant.

I am not ready to think about "transitioning" my practice because I am only in my fifties and not ready to retire. This is one of the saddest things that we hear; because it betrays a fundamental misunderstanding of the concept of transition planning. Transition planning is about building wealth within the practice; it is NOT about retiring. Proper transition planning greatly enhances the economic wealth of the owner doctor and thus accelerates his/her economic freedom; but it should be started as early as possible.

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We have clients in their thirties who are doing this planning and finding themselves economically free by 50 and able to practice dentistry on their own terms; because they *choose* to; not because they *have* to! This is because they are able to transition their practices two or three times before retiring. The beautiful thing is that these doctors are making more money and working less.

My lawyer says that we should sell the associate stock in my corporation, rather than assets. This advice is not uncommon when coming from the seller's counsel; because it is definitely to the advantage of the seller. When selling stock, the gain recognized will be taxed at favorable, capital gains rates. On the other hand, the buyer loses any ability to depreciate and, therefore, deduct, any of his/her purchase price. This is a very one-sided structure that is certainly likely to kill the deal. We believe in keeping the deal a "win-win" and thereby maximize the likelihood of success. This is why the vast majority of practice purchases are done as asset sales.

I heard about a "tax-free" way to bring a partner aboard. If you hear this, run, don't walk, to the phone and call me! There are some really dangerous "strategies" being floated out there. Suffice it to say, that there is *smart* tax planning and design and then there is sheer recklessness; which will certainly get you in trouble with the IRS. We don't want the latter.

My CPA tells me that I should elect "S Corporation" treatment for my LLC. The benefit of being an LLC (or PLLC) is that you have the liability protection of a corporation, without all of the restrictive regulations and hassles of a corporation. By making the S Election you, essentially, convert your LLC into a corporation. The purported rationale that is given for this, is that you will save money on Medicare taxes. This is a relatively esoteric loophole that allows S Corp owners to avoid Medicare tax on the net earnings of the corporation. This tax is currently 1.45% and it is applied to salary only; so the tax savings is only on earnings over and above the doctor's salary. The S Election definitely complicates your transition; but it is something that we can work around. If you have made an S Election, don't worry about it; but don't feel pressured to do it.

I have always said, that if you hear about a strategy that sounds interesting, call us; because if it makes sense, we want to know about it. If it doesn't make sense, we want to talk you "off the ledge".

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