

## **SAVING PENNIES WILL COST YOU DOLLARS**

### **How using a single attorney for transactions will negatively affect you**

Exhausted from another long day slaving away working for someone else, you slowly sink onto your couch. An unexpected, but welcomed, sense of joy, bordering on giddiness, envelops you as you think, “Only a few more weeks and then I will be my own boss!” You finally found a practice that met all of your qualifications and the selling doctor seems to be an authentic person who cares deeply for his patients. The phone rings, pulling you out of your reverie, and you see that it is the selling doctor. “Hey doctor, its Dr. Smith. I know you have been concerned about the costs involved with purchasing my dental practice but I think I found a solution. I found an attorney who has agreed to represent both of us in drafting a purchase agreement for the sale of my practice. We can split the cost 50/50. What do you think?” And STOP.

If you agree to do this you have just jeopardized your future career. While you may have chosen this practice and this doctor from a long list of “potentials”, you are diametrically opposed to each other when you go to sign on the dotted line. The same also applies for the selling dentist. There are fundamental issues related to the business, patient care/treatment, tax issues, restrictive covenants, timelines, etc. which cannot be split down the middle. If they were split evenly, one side would end up being hurt more than the other (sorry Solomon). While not every transaction you will deal with during your professional life requires an attorney to represent only one side, the acquisition or sale of a dental practice requires you to have your own counsel, lest you be left unprotected on certain matters. Even some lawyers fail to recognize the inherent conflicts that can arise in what appear to be simple transactions. The following list is an insight into how issues found inside a purchase agreement can harm either the buying dentist or the selling dentist, or both, if an attorney represents both sides of a dental practice acquisition.

1. Purchase Price. At least half of all dental practice sales involve no broker, often being sales by the owner to his or her associate. In many of these instances, the parties will not have the benefit of a detailed broker appraisal and will contact an attorney to do the paperwork. If the attorney has a substantial background in dental practice sales and knows that the purchase price is significantly above or below the market rate, the attorney should disclose this even though the disclosure is directly adverse to one of the clients. If representing both sides, how does an attorney divulge this information without harming one of his/her clients?
2. Tax Issues. The amount that is paid for a dental practice is required to be reported to IRS,<sup>1</sup> and IRS regulations allow the parties to select from a variety of reporting categories that may benefit either the buyer or the seller.<sup>2</sup> Generally speaking, the seller will want most of the purchase price allocated into goodwill, a category that allows the seller to pay the lower federal capital gains rate on the amount allocated to goodwill.<sup>3</sup> However, the buyer may only write off this amount over 15 years.<sup>4</sup> By contrast, the buyer would like a significant amount of the purchase price allocated to supplies, a consulting agreement, and even to accounts

receivable, as they can be written off in the first year.<sup>5</sup> In addition, IRS rules can allow the ability to make a first year write off on equipment,<sup>6</sup> and any additional amounts allocated to equipment can be written off over 5 years.<sup>7</sup> However, these latter categories subject the seller to ordinary income tax and significantly increase the seller's tax liability.<sup>8</sup> At a minimum, the attorney should advise the clients of the significance of these allocation elections, and should try to get the clients to retain qualified CPAs to separately advise them.

3. Redo Work. Often, a retiring dentist may be moving out of the area and won't want to be saddled with having to redo bad or defective work. At times, the seller simply wants to narrow the window during which he or she will be responsible for redoing such work. By contrast, the buyer has paid a significant price for the dental practice's goodwill, and wants the selling dentist to redo the work or to pay the buyer to redo it, in order to retain a satisfied patient. However, most insurance companies will pay for certain procedures no more than once every five years. How does the lawyer representing both the buyer and seller properly counsel them in this situation?
4. Covenant Not to Compete. A properly drafted purchase agreement will contain a covenant prohibiting the seller from competing with the buyer post-closing. Most states require that the radius and the length of the covenant must be reasonable. The selling dentist may plan on opening another practice in a nearby area and the buyer may feel threatened and insist on a wide covenant radius. What should the attorney advise his clients, who have conflicting goals? Frequently, the buyer will seek monetary penalties for violating the covenants, but who should advise the clients on what is reasonable? Furthermore, if a violation does occur and the buyer seeks a restraining order, one of the prerequisites is that the buyer must show "irreparable injury to . . . personal property." A properly drafted covenant would contain a stipulation of irreparable injury, but drafting such a stipulation would be adverse to the seller's interests.
5. Covenant Not To Treat. In urban areas (rather than rural areas), most purchase agreements will have a much smaller covenant area (typically 10-15 miles) in which the seller cannot practice. The seller may be opening a practice just outside of this covenant area and will expect that some of the patients will either seek the seller out or will see the seller's yellow page or other advertisement and transfer to the new office. Any loss of patients will be harmful to the buyer and the buyer should want to greatly limit the seller's ability to treat former patients at another location. While an absolute ban on treating the patients at another location is not enforceable, a prohibition on treating them within certain areas (larger than the covenant not to compete area) is generally permissible. How should the attorney advise the respective clients on the subject, particularly if the seller hasn't even raised it as a possibility? The attorney has a duty to anticipate situations which in his or her experience may become a problem for one of the clients, and advise them appropriately. However, this attorney representing both sides is sure to offend the seller, whether or not the seller plans on opening another practice.

6. Contingencies. Most sellers want a simple transaction that will close quickly. Most buyers want to have ample opportunity to review books and records, charts, obtain a satisfactory lease, process and obtain a favorable loan, and have sufficient time in which to do so. There would typically be a security deposit which would be forfeited to the seller at the end of a contingency period so that the seller “knows” that the deal is likely to close. The buyer will try to push the contingency dates out as far as possible. What should the attorney representing both sides of the transaction advise?
  
7. Confidential Information. Assume you are the seller for a minute and you divulge to your attorney that you have a sick mother in New York that you desperately need to care for and you will accept any reasonable price for your dental practice. The attorney has agreed to represent both you and the buyer on the proposed transaction and the buyer is ready to sign a letter of intent for your full asking price for your practice. Does the attorney now have a duty to inform the buyer that you will accept any reasonable price for your practice? If you are the buyer, wouldn't you like to know that and possibly save tens of thousands of dollars? How does an ethical attorney deal with this situation? The answer is, the attorney cannot continue to represent both sides. Unfortunately, scenarios like this happen all the time in dental practice sales and while the confidential information might not be as immense as a purchase price reduction, attorneys are privy to confidential communications which the client may not even know are harmful to their transaction. For instance: the seller is retiring and will not be in Texas following the sale because the seller is going to travel the world. Seems innocent, but what a knowledgeable attorney understands is that the seller won't be available to perform redo work and can thus have the buyer charge the seller more to work on former patients.

Many dentists see dual representation of the buyer and seller as a way of saving money. Since the interests of the buyer and seller in many instances are diametrically opposed, how can an ethical attorney truly represent both sides of a deal when their best interests may be in direct conflict? Furthermore, as shown above, any amount saved in legal costs as a result of such dual representation is offset by the tax ramifications alone for both the buyer and the seller. It may seem attractive to a buyer and seller to hire just one attorney in a dental practice sale, particularly when they usually think it's just a “simple transaction”, or because they are getting along very well during this “courtship”. However, like so many courtships, differences later develop, and if the purchase document was drafted by one attorney trying to serve two masters, one or both of the masters would likely resent such dual representation when a real problem arises.

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1. IRS Form 8594

2. IRC §1060

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3. IRC §1(h)
  4. IRC §197
  5. IRC §197
  6. IRC §179
  7. IRC §168; IRS Revenue Procedure 87-56
  8. IRS Revenue Procedure 87-56