



Buying and Selling a Dental Practice – the legal process

Part 2: Business structures



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There are a number of business structure options which must be considered at the outset of a prospective purchase. These are dependant to a great extent on whether, for example, the purchaser is a sole practitioner or two or more practitioners, what their income tax position is, or shall be and

whether the target dental practice is a private, NHS or mixed practice.

There are five main arrangements or business vehicles that are commonly used. Here is a brief summary of the nature and the pros and cons of each as well as some of the circumstances where one option may be more preferable to another or simply not available.

The five arrangements are:

- 1) Sole practitioner
- 2) Two or more practitioners working under a Deed of Association or expense-sharing arrangement
- 3) Partnership
- 4) Limited Liability Partnership (LLP)
- 5) Limited Company

The Sole Practitioner

This is the most common method of owning a dental practice, especially for practices with NHS (GDS or PDS) contracts.

It is the practitioner himself that buys the practice, employs the staff and has contracts with all suppliers, the lab, the patients and notably, the insurance company.

As a result, liability for all of the practice's activities, whether arising from health and safety, patient matters, employee issues, rent for the leasehold premises etc etc, all rest with the practitioner himself.

This means that in times of dispute, the practitioner's own personal assets are at risk. As a result, adequate insurance is a must.

From a taxation point of view, the profits of the practice are taxed as the personal income of the practitioner. There are only limited opportunities for tax-planning.

The majority of GDS and PDS contracts are granted to sole practitioners and partnerships and, due to the restrictive wording of standard GDS and PDS contracts and the perceived unwillingness of PCTs to deal with any but the favoured few 'corporates', it remains the case that most NHS practices are, and must be, purchased by sole practitioners or partnerships.

Association and Expense-sharing

It is possible for two or more sole practitioners to work together in relation to certain matters whilst retaining their legal status as sole practitioners.

This is common where, for example, two dentists each have their own NHS contract, and therefore their own income, but wish to share overheads.

For example the two dentists may wish to share the rent on premises with two-surgeries, a reception and reception or dental nurse staff.

The dentists need to formally agree the parameters of the expense-sharing arrangement and care must be taken to ensure (for the benefit of both parties) that the arrangement does not amount to a partnership (see below). It is also possible, and common, for the dentists to agree options for each other to buy the other out in the event that one wishes to sell up or retire.

Partnership

A partnership is 'two or more persons working together with a view to making profit'. There is an essential difference between a partnership and two or more persons working individually but with an expense-sharing arrangement. The partners are liable to each other and for each other and are jointly liable to third parties. A partner contracting with a person (a patient, employee or supplier) in the name of the partnership makes all the partners liable under the contract, whether they are aware of the actions of the partner or not. If the partner or partnership reneges on such a contract, the third party can sue all or any of the partners individually for the whole liability.

So it is vitally important that the partners set ground rules, allocate roles and have organised systems and processes for agreeing important (and potentially risk-attracting) decisions – for example, hiring and firing of staff, bank borrowing and incurring substantial capital commitments (eg. expensive hire purchase dental equipment).



Whilst assets are 'partnership' assets, who would they belong to (how would they be distributed) if the partnership ended? How will profits and losses be shared?

This is why a written partnership agreement is so important. Without such an agreement the default provisions of the Partnership Act apply – and those provisions can be far from ideal and presume that all assets are owned equally by the partners (eg. with two partners – everything is owned 50/50).

Whilst the partners can indemnify each other for liabilities incurred by one partner in the name of the partnership, there is no protection for personal assets.

Partnerships are common and the traditional way in which dentists have operated together. As a result, the standard GDS contract allows for the coming and going (appointment and retirement) of partners from a partnership and statutory mechanisms exist to allow a GDS contract to be varied when such changes occur. It is just those statutory mechanisms that may be used to ensure the transfer of a GDS contract from a sole practitioner or partnership seller to a similar buyer of a dental practice. However, this process is not without its problems and pitfalls (to be examined in a forthcoming edition of this series of articles!)

Limited Liability Partnership (LLP)

It was only in the year 2000 that the LLP came into existence in English law and it is still quite alien to, and misunderstood by, many practitioners.

Essentially, just like a limited company (see below) the LLP is a legal 'person' in its own right. The members of the LLP are like the shareholders and directors of a company and they own and manage the LLP. This means that it is the LLP that enters contracts and employs staff etc, and the members do not have personal liability for the liabilities, risks and contracts of the LLP.

In the event that the LLP becomes insolvent and is wound up, the members risk losing the investment they made in the LLP.

Because many of the issues and potential disputes between partners also apply to members of an LLP and, because although it is a corporate entity there is no constitution or set of rules as there are with limited companies, a members agreement (like a partnership agreement) is necessary.

Members are taxed individually just as partners in a partnership are, and this is appropriate and suitable for many.

NHS legislation treats an LLP as a 'dental body corporate' just like a company. So the

majority of members must be dentists or dental care professionals and the statutory mechanism for the appointment and retirement of partners (mentioned previously) does not apply to an LLP.

Consequently, an LLP may find it very difficult, if not impossible, to secure the transfer of a GDS contract held by a sole practitioner or partnership into its name from the date of completion of purchase of the practice. It may be that the PCT will grant the LLP a new contract coincidental with the termination of the seller's contract. However this is dependent on the necessity to follow a competitive tendering process.

Limited Company

Limited companies have existed in many legal jurisdictions for hundreds of years. Just like an LLP, the limited company has a status and legal existence of its own. Directors manage and run the company. The shareholders own the company. These people are often the same people.

The liability of the shareholders is limited to the amount unpaid and paid on the shares they own. If the company were to be wound up, the investment the shareholders made in paying for their shares is lost. The amount outstanding and unpaid on the shares must be paid by the shareholder.

In reality however, shares may be issued for £1 and often that is all a shareholder stands to lose. The concept of limited liability means that the shareholder's and director's personal assets are protected from risks that arise due to the company's activities.

With new companies, banks will always require personal guarantees from the shareholders/directors for the loan that is required to fund the purchase of the practice. So not all liability can be avoided!

A company has a constitution – the Memorandum and Articles of Association. These contain rules for what the company, its shareholders and the directors may or may not do. However, the constitution is a public document (see below) and it is not the appropriate document to record certain agreements between the shareholders. Consequently, it is recommended that the shareholders enter a shareholders' agreement (like a partnership agreement).

Shareholders and directors have various tax planning opportunities. Whilst the company must pay corporation tax on its profits, the tax liability is calculated at a lower rate than the income tax a taxpayer in the higher rate band would pay. The remaining profits may then be extracted from the company by way of a director's salary or by dividends on the shares

held – once again, this at different tax rates. Every person's circumstances are different, but these opportunities make incorporation and using a company to buy and run a dental practice attractive for some.

A company also has an opportunity to raise funds that no other arrangement affords. Rather than debt borrowing – loans and mortgages from a financial institution, a company may issue different classes of shares for cash to investors. The issue of non-voting shares to investors raises cash for the practice (for example, to fund a diversification plan), whilst voting control of the company is retained by the original shareholders and the investor enjoys dividends declared from profits made and a slice of the sale proceeds if the company is ever sold. This method of raising funds is called equity finance.

Only since 31 July 2006 have new 'dental bodies corporate' been able to exist and hold GDS and PDS contracts. Consequently, whilst some larger 'corporates' exist and are growing, the majority of dental practices are still bought by individuals and partnerships rather than companies.

Increasingly PCTs are including 'change of control' clauses in NHS contracts, which prevent the transfer or issue of shares or changes amongst the directors without the PCT's consent. Such a clause is included in the new standard Warburton PDS Plus contract.

Both LLPs and limited companies are regulated by the Registrar of Companies (Companies House). Annual returns providing the details of the shareholders and directors and annual accounts must be filed and are made available to the public. Consequently, practitioners must be comfortable with the fact that, with a company, they give up a degree of privacy and confidentiality.

Summary

Early in the process, the potential purchaser(s) must consider the business structure and entity to be used to buy the practice. Whilst an LLP or company may seem attractive, dependent on the practice to be bought (i.e. the nature and clauses of any NHS contract), those options may not be appropriate.

If business partners are buying a practice together, consideration should be given to ensuring the agreement between them is recorded, to prevent disputes and settle them early, should they arise.

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