Thinking of Selling?

Check Yourself… Legally

Selling your dental practice now or in the next 5 years? Get yourself checked now – legally that is. Otherwise, it could cost you hundreds of thousands of dollars, plus delays and aggravation when you do go to sell.

Let's start your self-check: grab the following:

- Your professional corporation's ("PC") minute book (that's the big compendium of documents, usually including a seal, for your corporation)
- Your lease (if you are renting your space)
- The last 3 years of your practice's financial statements
- Your staff contracts

Got everything? Good. Let's get started.

PC's Minute Book

If your practice is not incorporated, you should be. Why? So you can sell the shares of your PC and take advantage of the lifetime capital gains exemption ("LCGE"). If your LCGE is maxed out, you can save close to $250,000 in taxes. And you can also multiply the LCGE among family members who sell their shares of your PC.

To qualify for the LCGE, you and your PC need to meet various tests. One of those tests requires you to own the right shares. Open up your PC's minute book and check your share certificates right

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now. They're usually at the end. The coloured certificate will have numbers, signatures, dates and say something along the lines of: "Dr. Mike Carabash owns 100 Common Shares of Dr. Carabash Dentistry Professional Corporation"

IMPORTANT: the ONLY shares that qualify for the LCGE are the so-called "common" shares that appreciate in value over time with the growth of the dental practice. These cannot be so-called income-splitting "preferred" or "special" shares that can be bought back for some nominal amount (like $1.00 per share).

Look at the share certificate and make a note of what CLASS of share you have (e.g. "common" or "Class A Common" or "Class B Preferred" or "Class C Special"). Now, flip to the front of the minute book and examine the Articles of Incorporation and try to find your class of shares and what attributes they have. Does it say that they can be bought back ("redeemed" or "retracted") for some small amount of money – like $1.00 per share? If so, that share may not qualify for the LCGE.

Perhaps it says something like that share can be bought back "for the net consideration paid on initial issuance" (i.e. for the money you first paid the corporation when you first subscribed for the shares)? In all likelihood you may have also paid $1.00 for each of those shares and thus, those shares can only be bought back for $1.00 per share. As such, those shares don't grow in value and won't qualify for the LCGE.

If you get intimidated reading all the legalese in your minute book, no problem: just have a dental lawyer review it and advise you accordingly.

Ideally, you and your family own the correct class of shares (i.e. common, equity, growth shares) that cannot be bought back for some nominal amount of money. If not, a dental lawyer can correct the share class structure through a manoeuvre called an estate freeze (i.e. freeze the value of your corporation now and introduce more shareholders with the correct class of shares) or a purification (i.e. move the dental practice assets from your dentistry professional corporation to another dentistry professional corporation with the correct share class structure and shareholders). Bear in mind that both manoeuvres require that the new shareholders own their shares for 24 months (yes, you read that right – this is the share holding test), so if you're thinking about selling in the near future, it's vital you prepare in advance!

Financials

To further qualify for the LCGE, check to make sure your PC's balance sheet doesn't have too many "non-active business assets" – like cash, investments, real estate, related party loans, and life insurance (in other words: assets OTHER THAN your "active" dental practice assets).

These "non-active" business assets can't be left in your PC when you go to sell. The buyer won't buy them. And if you have too much of them, you won't qualify for the LCGE because of the 24 month + 50% asset test: for the 24 months leading up to a sale, the fair market value of the "non-active" business assets cannot be worth more than 50% of the total fair market value of your PC's assets. So for those 24 months, if your PC owns a dental practice valued at $2-million, it cannot also have cash, investments, real estate, life insurance, etc. also worth at least $2-million.

And on the day of the share sale, your PC cannot have more than 10% of the fair market value of its total assets as "non-active" business assets. That's the day of sale + 90% asset test to qualify for the LCGE.

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To know if you meet these asset tests, first find out what your practice is worth today. You can give the author a call for a free over-the-phone assessment (since we prepare, market and sell practices, we'll give you a quick idea). Then compare that figure that we give you to the "non-active" business assets that have been sitting in your PC's balance sheet for the last 24 months. If you don't meet the asset tests above, then you either need to purify (i.e. move out) those "non-active" business assets and wait 24 more months OR you need to purify the "active" business assets (i.e. sell the dental practice) from your PC to another new PC you own and wait 24 months (so the shares of the new PC will qualify for the LCGE per the share-holding test discussed above).

Lease

These days, buyers and their banks typically want at least 10 to 12 "clear" years on a lease to complete the transaction. So you cannot have any nasty clauses in your lease that could give the landlord the right to terminate the lease during that time.

A demolition clause is typically a few sentences long, put in by landlord's lawyers at the start of the lease or on renewal or assignment. This clause typically says that the landlord can terminate the lease on 6 to 12 months' written notice to the tenant if the Landlord needs to demolish or redevelop the building – e.g. tear down the space to make a condo. These clauses compromise deals (i.e. buyers insist on price discounts or walk away completely).

Demolition clauses have become more prevalent in major cities. Make sure that you do not have these clauses in your lease or do everything within your power to get them out or at least delayed for 10-12 years. You don't want to wait until the last minute (when you're trying to sell your practice for big bucks and the closing date is coming up) only to discover that the landlord, unbeknownst to you, slipped in a demolition clause 20 years ago (which happened on a recent deal we were involved with but still managed to close without issue). It doesn't matter if the landlord has no intention to demo or even recently upgraded the building. Buyers and bankers are not comfortable taking on the theoretical risk of a demo and the cost and disruption that comes with having to relocate the practice.

Check every line of your lease and all the renewal, extension, amending and assignment documents that came after it to make sure you do NOT have a demolition clause and plenty of years left on your term.

Bad news: even if you do not have a demo clause in your lease, you are not safe. Your landlord (however nice they are) will wait until you're trying to transfer the lease to a buyer (right when you're trying to close) before insisting that a demo clause be inserted. Now your entire deal is in jeopardy! You need to be pro-active NOW and find out your landlord's plans. To protect yourself, you should ask for enough years on your term (with no demo or relocation) to satisfy a buyer and their bank. It goes without saying: don't talk to your landlord or sign anything without involving a dental lawyer.

Employee Contracts

If your employees have not signed proper contracts within the last year, you need to speak with a dental lawyer ASAP.

If a buyer of your practice ever wants to terminate an employee, they'll have to give them a cheque roughly equivalent to 1 month of their pay for every year of service (with you and them), for up to 24 to 30 months maximum! That's the Common Law (i.e. judge made rule) that can only be avoided through a proper written employment agreement.

But why would a buyer terminate anyone after the closing? Normally, they wouldn't since team members are some of the practice's best assets. But buyers don't know your team members, their performance, and / or how they'll get along. And a buyer's lawyer and accountant will scare the buyer by pointing out the potentially huge Common Law liability (i.e. 2 years of pay to terminate someone). So the buyer will naturally ask for a big price discount and / or have the seller agree to cover termination costs should the buyer ever need to terminate anyone.

To prevent all of this, the seller needs to introduce proper team contracts that replace the Common Law with a more manageable termination clause formula. For example, the contract could replace the Common Law with the *Employment Standards Act, 2000* minimum standards (i.e. typically 1 week of pay or notice in lieu of pay per year of service for up to 8 weeks maximum). Or the employer could offer a little more than *Employment Standards Act, 2000* but much less than Common Law. You get the idea: the liability of the seller and the buyer has now been mitigated, so the seller doesn't need to accept a price discount or sharing of termination costs after the closing.

Now for some bad news: if the have contracts that are more than a year old, there's a good chance the termination clauses won't be valid and enforceable. That's because of a brutal series of recent Ontario court cases that involved judges invalidating *all* termination clauses because of a technicality: *one* of the termination clauses was offside so they are ALL offside, which reverts everything back to the Common Law! What should you do? Check your employment contracts and see if it has a "termination for just cause" or "termination for cause" section. If so, chances are those clauses are invalid and, because of those court cases, so too are the "termination without cause" or "termination with notice" section. Back to the Common Law! Yikes!

Use a dental lawyer to introduce proper and up-to-date employment contracts; if it's not introduced and drafted properly, they won't be worth the paper they're written on. Also make sure your associates have signed restrictive covenants (i.e. non-solicitation).

Conclusion

Save yourself time, money and headaches tomorrow. Check your PC's share class structure, financials, lease and team contract situation today. ✧