Partnerships—It Is Way Beyond Sharing Toothpaste: Part II

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1. Introduction

When we talk with veterinarians about their “perfect practice,” we frequently receive mixed messages. Especially with equine practitioners, balancing personal and practice time is a high priority. They do not want to be spending all of their time on the road. That said, mention the word “partner,” and many of them can tell one horror story after the other of people they knew who had partners in a business venture and the nightmare in which it became.

When you take a look at the main reasons why business “marriages” (i.e., partnerships) break up, it all revolves around four main areas: money, power, family, and sex. This is not very different from traditional marriages; the analogies can have far more similarities than differences.

The focus of our presentation is to help individuals understand the process of becoming partners and then help them create partnerships that will allow them to realize their dreams and not their nightmares.

Today, the word partner is in many ways overused. Our medical doctors want to partner with us in our medical care. Phone companies want to partner with us to take care of our communication needs. We are constantly told to partner with our clients, team members, vendors, and taken to extremes, even competitors. What does the word partner mean in the traditional sense? Basically, a business partnership means that two or more people have joined together, pooled money and talents, and assumed a risk to create or build something together.

We are not talking about partnerships in the highly regulated Internal Revenue Service (IRS) meaning of a partnership agreement, which is filing a form 1065 Partnership Tax Return and following IRS Code Section 721. We are talking about business partners without regard to their legal status as partners. They may be in a partnership limited liability company (LLC), or corporation. This means that these individuals own something together, generally a veterinary practice, and as such, they have a duty to one another. Additionally, the actions of one individual affect the other individual. Essentially, they sink or swim together.

Why do people want to take on a partner? Basically, it is because you are much more likely to succeed in business with a partner than going it alone. Successful businesses are much more likely to be found where individuals pool their strengths and move forward toward a common goal than where the lone romantic individual succeeds against all odds.
With the complexity of running a successful veterinary practice today and the demands that we all have on our time, energy, and skills, it is much more attractive to “share the wealth” than to try to do it all yourself. Having partners is often what makes ownership possible. Even the thought of providing extended hours in your practice becomes much more of a possibility if there are two or more owners available to provide coverage. With the high cost of opening and running a practice, sometimes the only way to have the financial strength is to share the burden.

Now, we have set the stage. Before we go any further, however, I am going to digress for a moment with some warnings that are somewhat “touchy and feely” but can give you good advice as you start down this path.

If you do not think that you are a team play, do not even try.
Exercise extreme caution when selecting a partner.
If you do not need a partner, do not get one.
Legal documents alone are not going to keep you out of trouble.
If things do not feel right, work to fix them.
If you see potential problems, work to fix them while you are still “in love.”

Some questions to ask before you start down the path. Why do you want to own a veterinary practice? I know the response is to “provide high-quality medicine for the horses and to create a good experience for all of your clients.” But there is more to it than that. If you want it “your way or the highway,” you might need to reconsider if partnership is the route for you. Why do you want to have a partner? Do you want to get the cream of the work and dump all the less desirable work onto your partner? Perhaps it is time to rethink your plans. Are there better alternatives available? Perhaps hiring a good technician or assistant would solve some of your needs. Perhaps someone to help with the office work or administrative duties would help. That way, you get some help, but you can keep the ownership entirely in your hands. And finally, are you choosing the best partner for you? There are many people who could be good partners. But just like choosing the spouse with whom you want to spend the rest of your life, your business partner is pretty much in the same category. Just like spouses, partners do not change after you tie the knot.

Now that we have covered some of the basics surrounding the partnership concepts, we are going to address some of the basics of putting together a successful partnership arrangement. As an aside, the documents do provide a good legal basis that will provide a measure of protection for the parties involved. Charlotte Lacroix has talked in her session about good legal documentation, but I want to reiterate that it is the process as much as the documents that help make for a good “financial marriage.”

The real benefit of the documents is that if they are thought through properly, they provide an opportunity for the partners to really discuss issues, put their viewpoints out on the table, and voice concerns and approaches to issues that will be faced. For example, the structure of the transaction will influence the power distribution between the parties, and this is generally an area that needs and should receive a great deal of thought and discussion up front.

In the discussions that are held about the various elements that should be covered in the contract, things will surface that should be dealt with before the knot is tied. Remember that definitions mean different things to different people. We all filter words through our life experiences. Fairness is simply in the eye of the beholder. Talking about what each person’s expectations are concerning the business relationship will help to cut down on the distrust that tends to develop when things do not play out exactly as planned. Do not put money, time, or effort into the equation, or this can be a recipe for disaster.

Another issue that needs to be covered is understanding all of the personalities involved. Some of the questions that help to get an understanding of how the interaction between the parties will evolve include:

Where do you prefer to focus your attention? Inward or outward?
How do you acquire information? Sensing or intuition?
How do you make decisions? Are they based on feeling or thinking about it?
How do you view the outer world? Judgment or perception?
How much time do you want to dedicate to the business versus personal life?
What are your financial beliefs regarding debt, retirement, and “fun” things?
What is your management style? Top down or collaboration of the team?
How do you treat team members? Is their hierarchy or equality?

2. Partnership Compatibility

Partnership agreements, financial understanding, and good advisors are all important, but the most critical aspect of the relationship is that the person you are going to be spending the rest of your business life with is someone with whom you are very compatible. If it is not the right match, now is the time to back out. You cannot change someone after the financial marriage anymore than you can change a spouse after a traditional marriage.

Every practice in which we work talks about the high quality of medicine that they practice. That said, high-quality medicine is very much in the eyes
of the beholder. Now is the time for discussions about standards of care. What are your feelings about technology, and is every “toy” a necessity? Will there be continuing education for the doctors? For the staff? In local or exotic places? Is there consistency in recommendations? Does every doctor have the same script or is the care recommended dependent on the doctor seen? Do we do everything possible in house or do we develop relationships with specialty hospitals for referrals? Do we refer to other practitioners who may have an expertise in a given area?

What about ethical issues? What are our beliefs about a request to euthanize a horse, because an owner no longer wants the expense of providing needed care? What are our beliefs regarding compounded drugs? What are our beliefs on providing drugs for show horses? Now is the time for these discussions. Although the animal-related ethical issues are part of the beliefs that need to be ironed out, this is a business we are discussing. That opens up another whole area of ethical concerns. These issues can center around tax as well as general business matters.

In addition to these heavy ethical matters, there are the practical concerns that revolve around the management of the practice. Who is going to deal with human resource issues? How are prices going to be set and adjusted? Will we use a big marketing budget or are we going to rely on word of mouth and client referrals? How are we going to be spending our work-related time? Are we going to do emergencies or refer? Are the weekends time for family except when on call, or do good clients’ needs come before our own personal needs? How do we use our flex time during the work week? Is it okay if one of us runs for office with the local or state Veterinary Medical Association? If that takes time away from the office, how is that going to be compensated? Are clients considered clients of the practice or clients of the individual doctor?

Having control over your practice, knowing where it is today, and envisioning where it will go tomorrow is part of the thrill of owning your own practice. If there is one of you, you can pretty much agree on these matters. When there is co-ownership of a company, you can have tremendous control on these matters if everyone agrees. If you cannot agree, disaster can occur.

Additionally, the contract should provide provisions for buy out, dissolution, forced mediation, and any number of other ways to deal with a problem. It is better to address some of the issues ahead of time. This way, when disagreements arise, there are guiding structures built into the agreements to assist with a resolution where each could benefit rather than taking the path of dissolution?

One of the major areas of stress in most partnerships is the sharing of power. In veterinary practices, this can take a path very dissimilar from many businesses. With most traditional businesses, the issue is how to share power or who is going to be “in control.” In veterinary practices, we often see the opposite, because no one wants to assume the role of CEO. Many times, the solution to this issue, as proposed by veterinarians, simply does not work. Sharing control and requiring a unanimous vote may not work during a disagreement.

A better solution might be that before the knot is tied, the partners take a serious look at the practice needs and the experience that each of the partners brings. Practices need to differentiate roles to be efficient. Just like a technician should not primarily be doing a receptionist’s work, partners have different jobs to do. After it is determined the role of each person and the skills each brings to the table, it is then important to determine how each veterinarian will coordinate their efforts. After this is established, actually putting your conclusions onto paper (an organizational chart) with job descriptions and responsibilities clearly outlined can be of major benefit. It is also important to understand that although it is important to separate roles and responsibilities, partners need to continually reconnect and share information. Therefore, in addition to the regular well-run staff meetings and doctor meetings, all successful practices need to have very well-run partner meetings.

Accountability in a partnership arrangement rises to a whole new level. The buzz word in practice management today is getting your team to be accountable for the things that they say they are going to do. Discussing ahead of time the level of accountability they want to maintain between themselves can prevent major problems down the road. Frequently, if it is not spelled out ahead of time, then the partner who most needs to be held accountable may resist all efforts to do so.

Accountability obviously means that there is a consequence if performance is not up to some expected level. It is much easier to hold team members accountable than fellow equals. Without real accountability, the alternative can be disastrous. They can truly cost the practice money rather than helping to generate the profits that all practices need to survive. Lack of accountability among partners can and does destroy good businesses. Nobody wants that to happen, but avoiding performance problems among partners requires careful planning and generally, lots of discussions. It rarely takes care of itself, and therefore, talking through these issues while everyone is still best friends is a good idea.

3. Details of the Different Entity Choices

First, we will look at corporations. What we will be talking about here, for the most part, applies to C corporations and S corporations as well as professional corporations and professional associations. Remember, personal service corporations are not a separate set of initials behind your name; instead,
they are a type of C corporation, and the designation only applies to tax rate calculations.

When you decide that you want to be a corporation and receive the benefits of that type of entity, there are also certain responsibilities that you assume. You agree that you will have annual meetings of the shareholders and keep annual minutes of that meeting. Many people are derelict in doing this, but if you are ever audited by the IRS or sued by a third party, one of the things that your lawyers and accountants are going to insist on is that the corporate minute book be brought up to date. It actually is much easier if one time a year, at least, you sit down with your advisory team and commit to writing what you have accomplished during the year and what you have agreed to do in certain areas. For example, if you have a retirement plan for your employees and you have decided on a contribution to the plan, commit the amount to writing. If you have agreed to purchase an expensive piece of equipment, decided to move the location of the practice, chosen to open a satellite office, or made any major decisions affecting the practice, the shareholders, etc., these are the types of things that are put into the minutes. Talk to your advisors about what is appropriate for your practice.

Additionally, on forming the corporation, there should be stock certificates issued to the shareholders, and the money for those certificates should be paid to the corporation. Again, this is a step that is frequently overlooked. If the corporation has issued 100 shares of stock at a dollar value for each share, the shareholders need to write a check to the corporation for the amount of money represented by the number of shares that he or she own. Although this might seem silly, accomplishing each of these steps plays into the next topic.

One of the reasons that owners elect the corporate structure is for liability protection. Except for malpractice issues, being incorporated protects the shareholders' personal assets should a legal claim be won against the practice. That said, this protection exists if the “corporate veil” is intact. This means that if you have functioned as a corporation, kept your personal business separate from the business of the practice, played by the rules, and not intermingled personal and business assets, the corporate veil and therefore, the protection remains intact. Failure to do so in any of the components, and the corporate veil is pierced; this is one of the main reasons that incorporating disappears. Listen to your competent advisors in this area.

As mentioned in an earlier session, C corporations require special planning and insight by you and your advisors to be sure that you are getting the benefit of the C corporation structure if it applies to you. If you are nearing retirement or thinking about transitioning 100% of your ownership of the practice to a third party, talk to your competent advisors very early in the process. The taxation of a sale of a C corporation can be devastating if not prepared for properly.

S corporations present their own challenges. As mentioned previously, C corporations pay taxes on their earnings, but S corporations are considered pass-through entities. The profit an S corporation experiences flows through to the shareholders according to their ownership interest and is reported on the shareholders’ individual income tax returns. It takes vigilant tax planning to be sure that there are no nasty surprises on April 15th because of this flow through of profits but not necessarily flow through of money from the corporation. This is something that shareholders frequently do not understand, and if their advisors do not prepare them properly, there can be very nasty conversations when tax time rolls around.

S corporation taxation and accounting is much easier to understand and has a longer history than LLC and partnership accounting and tax issues. In an S corporation, the shareholders are generally employees of the corporation, and they receive a salary and for the most part, benefits; however, there are some exceptions. Except for the taxation of the end of the year profits, taxes are handled through withholding from a paycheck. When selling an S corporation, the taxation of any gain is handled much more beneficially, which means you pay less in taxes, than you would selling your C corporation stock.

Using the corporate structure, “silent owners” or equity owners can play a role in helping veterinarians realize their dream of owning their own practice. In this scenario, individuals can purchase stock in the corporation (i.e., they are capital investors versus sweat-equity partners) and play a minimal role in making management decisions, but they can share in the increasing value of the practice over time. If you go this route, make sure you have competent legal and accounting advice. Do not think that you can skip the whole discussion process of really getting to know the person you are taking on as an equity partner. Minority or equity shareholders are shareholders nonetheless, and they have rights just like majority shareholders.

Co-owner agreements are sometimes what causes two people to wind up in a partnership even though they do not think this is what they are doing. As far as the IRS is concerned, when two or more people enter into a business arrangement even without all the formalities of partnership agreements and the “paperwork,” they are still in a partnership. “We’ll cross that bridge when we come to it” does not work very well when issues arise in these types of arrangements. In a time of crisis, bridges are more likely to be burned than crossed. The liability issues associated with partnerships, especially general partnerships where you are grouped if you have not elected a more restrictive kind of arrangement, can be devastating.
Co-ownership arrangements can arise without paperwork or employment agreements that would not rise to the level of partnership agreements, but nonetheless, it puts you into the partnership arena. If you are going to operate in the partnership arena, having formal partnership agreements at the very least put you into an arena that provides for a spelled out governance policy. Hopefully, this provides for a predictable transfer of ownership interests.

Partnerships, S corporations, and C Corporations have very different provisions for distribution of money and certain other allocations of profits, losses, and benefits. Again, this is not a course in taxation and accounting, but be aware that each of these is not created equal. You can inadvertently terminate your S election if you are not aware of or do not pay attention to the rules governing the distribution of profits. Distribution of profits in a partnership is generally governed by the partnership agreement. In the absence of a formal agreement, anything goes. Unfortunately, this method of handling money can give rise to major dissention among the partners.

With an LLC, many of the rules and regulations are still being hashed out by the court system and the IRS. That said, whether or not you choose to be taxed as a corporation or a partnership generally determines if you follow corporate or partnership rules. Just the mere thought that you can be taxed as a partnership or corporation by checking a box on a form is more than most veterinarians want to know. What many owners of LLCs fail to understand is that the entire profit realized in an LLC (assuming that it is taxed as a partnership) is subject to payroll taxes in addition to income taxes for the member/owners. Make sure that you have an advisor who really understands the rules and that you take the time to understand the system and the regulations in which you are a part.

4. Transfer of Partnership Interests

One of the key issues to be addressed in any arrangement with two or more people involved is transfer of ownership interests. Transfer of ownership interests can occur voluntarily when one of the existing shareholders decides to retire or when the shareholders decide to admit a new person to the mix; it can also occur involuntarily. Involuntary transfer of ownership interests occurs when someone is forced to sell their interest. This could occur from some triggering event such as loss of a license to practice veterinary medicine, death, or disability.

This is an area that you want to give a lot of thought to before forming the business arrangement or committing to a partnership, corporation, or LLC. One area that you want to contemplate is giving first right of refusal to existing shareholders/partners. This essentially means that before any of the ownership is given to someone new to the equation, the existing people have a right to purchase the shares or interest. Alternatively, the practice can have the right to purchase the shares as treasury stock. There should be some provision that shares can only be sold to qualified buyers.

Discussion needs to be given to how retirement of shareholders is handled. Also, what if a partner decides he or she is simply tired of the rat race and wants out? Is it handled the same as an older veterinarian retiring?

Another area of concern that is frequently overlooked is the case of death or disability. Not all definitions of disability are the same. How do you want it defined in your agreement? This is an area that needs to be fully discussed before the pen is put to the paper. Partners must discuss how the practice will deal with divorce or bankruptcy of one of the shareholders. I know that many think that this will never happen in their practice, but the time to discuss the possibility is when the occurrence is remote. Do you want to have a mandatory retirement age? If you or your partner can practice until they carry you out with your stethoscope on, are you entitled to the full privileges, including compensation and benefits, that you were entitled to when you were a fully contributing member of the practice?

When the whole process of buy outs or transfer of interests is discussed, a key determining issue is “how much is the departing person’s interest worth?” There are many ways to value a practice: book value, fair market value, and investment value. It is important to spell out in the paperwork, either the shareholder agreement and/or the cross buy-out agreement(s), how this is to be determined; this precludes problems developing at the time that this is needed. This is an area that, again, you need competent advice from individuals who not only understand the veterinary profession but also understand the legal, accounting, tax, and valuation issues that are at stake.

Assuming that you can reach some kind of agreement on how the shares will be valued (a formula, a full evaluation by a competent appraiser, or something in between), how is the buy out going to be funded? There are many variations to how this can be handled. Depending on the circumstances and the amount of money required, this can range from life-insurance proceeds to commercial lenders to promissory notes to sophisticated deferred compensation plans. There is no “one size fits all” when it comes to this area of your discussions. You may have different funding patterns for voluntary withdrawals for the departing shareholder to move to Key West versus the sudden death of your key managing partner. Again, before the pen hits the paper, it is important to have these discussions.

Non-competition agreements are another area that is frequently overlooked in dealing with partnership issues. Agreements that are pulled from journal articles that are read or agreements that other people are using can be equally troublesome, because they do not fit the specific needs of the
practice. Non-competition agreements are generally a good thing. Their purpose is to prevent departing owners from directly or indirectly competing with the practice. They keep owners focused, preserve the goodwill of the practice, and reduce conflict of interests. They also have different enforceable components dependent on the state in which you practice, if you are an owner or an employee, how they are worded, etc. This is one more area where seeking competent advice is critically important.

What does it take to make your partnership work successfully? In our discussion, we have mentioned frequently that partners need to meet on a regular, meaningful schedule. To be meaningful to the attendees, these meetings must have communication as the utmost importance. The attendees need to respect each other and to be open to agendas that might be setting the stage for problems to develop. Sometimes it is not what is necessarily said but what is going on behind the scenes or in someone’s head that needs to be addressed. Being in a partnership with other people requires a sense of humor. There is enough stress involved with running businesses today without taking seriously the dictum that you have to have fun at what you are doing. Yes, it is possible to have fun and to be in a partnership with other people. This is also a time when you do not want to sweat the small stuff. Keep your focus on what you are trying to accomplish—the mission statement for your practice. Put a good team in place, including outside advisors to help you on your journey. If you stick to doing the tasks that are appropriately yours and have a good team in place, you can have fun on your journey and actually achieve the goals that you set out to achieve.