

Five Reasons to Update Group Practice Buy-In/Buy-Out Documents

In today's competitive recruitment market, group medical practices (whether organized as PCs, LLCs, partnerships, or sole proprietorships) should review their buy-in/buy-out documents to make sure they meet current business realities and address the expectations of newer physicians joining the workforce.

Good collaboration with the practice's legal and financial advisors can help you create a cohesive set of documents that reflects the practice's operations and maximizes the tax and financial benefits for all parties involved.

Each practice's legal documents should be structured to address its specific needs. A comprehensive set of documents might include: (i) corporate documents; (ii) a stock purchase agreement; (iii) a shareholder, partnership, or operating agreement; and (iv) shareholder employment agreements.

Here are five reasons these documents should be reviewed for updating:

1. Overpriced Buy-Ins. Fixed buy-in values quickly become outdated and do not account for practices' current financial viability. To avoid recalculating a purchase price each time a new physician buys in, the financial terms are best based on an objective formula with two components: (i) the acquisition of stock for the adjusted book value of the corporation's hard assets (excluding goodwill, cash, and outstanding accounts receivable), and (ii) a post buy-in income shift from the new shareholder employee's pre-tax income, factored around the corporation's receivables. This type of buy-in can result in a more favorable tax impact for the buyer, and thus make the offer more competitive.

2. Goodwill. Goodwill is an intangible asset based on the practice's going concern value and future income stream. If a buy-in includes goodwill, the value should be based on an independent "fair market value" appraisal to be compliant with the Stark and anti-kickback laws.

More recently, however, market place dynamics and personal choices have pushed the calculus toward minimal or no payments for intangible asset value. Young physicians with multiple practice opportunities are increasingly unwilling to pay for significant amounts of goodwill in a buy-in. Additional market and legal pressures affecting medical practices in Massachusetts have also contributed to lower goodwill valuations.

3. Buy-Out Formulas. A practice's buy-out formula may best be aligned with its buy-in formula. Instead of separate formulas for each separation-triggering event (i.e., death, disability, retirement, voluntary or involuntary withdrawal), practices could pay a redeeming shareholder, regardless of the event, a stock redemption price based on a factor of the same formula from the buy-in: the value of the corporation's hard assets. The redeeming shareholder could also receive additional W-2 deferred buy-out compensation, which the practice could deduct as an ordinary expense for tax purposes.

Alternatively, the buy-out formula could be based on an average of the departing physician's most recent year's annual income, incentivizing the individual to sustain productivity as he or she transitions into retirement. Another common feature is a vesting schedule based on years of service; under this approach, early retirement would not result in a full buy-out.

4. Using Deferred Compensation. A departing owner could be paid for the value of his or her stock and for individually contributed goodwill. This taxes the departing physician for capital gains and requires the remaining physicians to redeem with after-tax dollars (stock redemptions are not deductible) or wait 15 years to fully deduct a goodwill payment. If the buy-out is mostly in the form of deferred compensation, the departing physician will pay ordinary income taxes (the payment will be subject to payroll taxes), but the net effect on the practice is lessened, and as such, payments can be deducted.



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continued on page 4



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Five Reasons

continued from page 3

5. Multiple Buy-Outs. As more physicians approach retirement, practices will become financially burdened if they are required to fund multiple buy-outs at the same time. As a result, they may wish to amend their documents to prevent this. Deferred compensation arrangements are subject to recently enacted federal tax rules, which require the buy-out documents to include a fixed period of time for the payments, potentially limiting the availability of caps on total buy-out payments.

To stay viable, group practices need to establish a flexible system for transferring ownership. Just as with personal estate plans, medical practices should periodically review and update their plans of succession.

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RESOURCE CORNER

There are a number of resources and tools available in the “Physician Practice Resources” section of the MMS website at www.massmed.org. The Practice Ownership & Operations and Information Technology links have a number of templates and guides for members.

Have a suggestion for a new tool or resource? Contact the PPRC at pprc@massmed.org and let us know. We’re constantly creating new resources, and we would love to hear your suggestions.

Look for the next issue of *Practice Management Review* this summer.

Contact us at (781) 434-7702
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