Medical LEGAL INFORMATION

Selling Your Practice?
Consider These Issues First

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There has been a resurgence of practice acquisitions of late. If you are an owner in your practice, chances are you are considering selling your practice or soon will be. Other than purchase price, which is the bait on the hook, what else should you consider?

Who's Your Buyer?

In general, there are three types of buyers. First, there are hospital buyers. With few exceptions, our recent experience has been that hospitals pay practices the fair market value of tangible assets. Often, the "value" is achieved by more lucrative employment agreements as a result of the hospital system's reimbursement rates that are more favorable than what a private practice might negotiate. There is not a lot of money transferred at closing.

The second types of buyers are other practices. Often, acquirers have built an efficient practice, and believe that they can squeeze inefficiencies out of smaller practices and make them more profitable. These acquirers usually have methods and processes that, when shared, make the acquired practice more profitable and thus more valuable.

These acquirers may have a long-range plan of building a bigger practice, which would make them more valuable to the third type of buyer, private equity-backed management service organizations, or "MSOs". While some MSOs are not backed by private equity, we will assume for the purposes of this discussion, that they are. This type of transaction involves the MSO purchasing the non-clinical assets of a practice, including goodwill. The practice owners often sell their ownership in the practice to a physician who may be "friendly" with the MSO. The friendly physician, simultaneous with the closing, causes to enter into a long-term management services agreement (MSA) with the MSO.

These types of transactions have become popular among practices because, well, adult money changes hands at closing. The MSO receives a return on its investment through the fees paid under the MSA. Often, these fees are paid from the reduced compensation of the providers in the practice. Further, in many of these transactions, owners in the practice are required to "roll over" purchase price into the MSO as an investment.

What Is Your Timing?

Often, timing can dictate the type of purchaser whom you pursue. We have helped smaller practices whose founder has experienced health issues and must transition his or her practice on a short time frame. Founders often do this to transition loyal employees and to address the nightmarish administrative burden of administering patient charts of a closed practice. In those cases, hospitals or other practices may be a better fit because there is often a prior working relationship between the buyer and seller.

Donating Your Practice

Another exit strategy is for the founding physician to donate his or her practice to a non-profit hospital. With some significant caveats, a physician may be able to deduct as a charitable contribution the appraised value of his or her practice. This allows the physician to meet his or her transition goals with respect to employees and patient charts, while at the same time giving him or her significant tax advantages that may outweigh mere liquidation value of the practice.

What Are Your Goals?

If you have plenty of time to search for a buyer, then your goal is to obtain the most value for your practice. This is not only a function of purchase price, but also depends on the tax treatment of the consideration you receive. For example, if your practice is a C corporation and you sell assets, the corporation will pay tax on the gain resulting from the sale, and the C corporation's shareholders will pay tax on the dividend they receive as a result of the sale. C corporation dividends are not deductible by the C corporation. As a result, this phenomenon is often referred to as a "double tax" since the C corporation pays tax on the gain and the shareholders pay tax on the resulting dividend.

The goal should be to structure the transaction so that there is no double tax, that the proceeds received by the owners are taxed at what have been lower capital gains rates, and that the tax on any roll-over equity be deferred until that roll-over equity is liquidated. This is often easier said than done.

Second Bites of the Apple

As a general rule, if practices sell to private equity, they are often valued based on a multiple of "EBITDA," which is "earnings before interest, taxes, depreciation, and amortization." Also, as a general rule, larger practices can often command a higher multiple of EBITDA than a comparably run smaller practice. One way to think of this is that one practice with 100 providers would be more valuable than the sum of the value of 50 practices with two providers each.

This matters because, with practice and MSO acquirers, the selling physicians may be asked to roll over equity into the new enterprise. The goal of course is that the new enterprise will grow and prosper, and the rolled-over equity will create another liquidity event for the physicians.

Not as Easy as It Looks

The complexity of a sale is often dictated by the type of buyer. In a hospital transaction, there is usually an asset purchase agreement and employment agreements for the providers. Since hospitals are exempt from the prohibition on the corporate practice of medicine, they can either directly employ the acquired physician, or own an operating LLC that does so. Further, an acquiring practice can directly employ the acquired physicians. The rub comes when lay companies like MSOs are purchasing non-clinical assets. Because MSOs cannot own medical practices, the transactions involving their relationships with medical practices are often fraught with peril. In short, don't try this at home.