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Tax advantages and risks should be major issue when selling a practice

ACOs, other changes leading to more offers to buy your business

Selling your practice is a major decision with revenue and tax implications that can affect you far into retirement. More physician practices are being approached with buy offers as accountable care organizations (ACO) form across the nation, so it is important to know the key issues beforehand.

"Over the past several years there has been an acceleration of hospital acquisitions of medical practices," says **James B. Riley Jr., JD,** a partner with the law firm of McGuire Woods in Chicago. "ACOs are increasing the sales, and so are other drivers like physician practice management groups." Both buyers and sellers must understand the tax implications of different practice acquisition structures, Riley says.

The structure of the sale is one of the first decisions to make, he says. Will it be a sale of assets or stock? Each option comes with different advantages and disadvantages with regard to taxes, and the form of a transaction is often dependent upon the transferability of seller obligations as well as the corporate practice of medicine (CPM) laws and fee-splitting laws of a particular state.

TRENDSPOTTING

15%–23.8%

Federal capital gains rates affecting most physicians selling their practice.

1.2

The number of emails patients sent to their doctors per month at one hospital, contrary to fears of overuse.

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QUICK HITS

Doctors still accepting new Medicare patients, HHS reports

An HHS survey released recently indicates that the percentage of doctors willing to treat new Medicare patients has stayed relatively stable over the past two years.

The 2012 data from the National Ambulatory Medical Care Survey revealed that 90.7% of doctors admitted new Medicare patients, compared to only 87.9% in 2005.

The report also noted that the rates of new Medicare patient acceptance are similar to those of physicians accepting new privately insured patients for the same time period (2005–2012).

"Overall, Medicare beneficiary access to care has been consistently high over the last decade and continues to be high today," the issue brief said. There are 650,000 physicians who participate in and bill Medicare, and including non-physician providers like nurse practitioners, more than 1 million providers are active in the Medicare program.

Questions? Comments? Ideas?

Contact Editor **Greg Freeman** at *gafreeman@bellsouth.net* or 770-998-8455.

FROM THE FIELD

"The tax implications of [selling a business] are extremely important and one that I don't think physicians initially focus on when they think about this as an option for their practice."

James B. Riley Jr., JD

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Riley explains that the CPM doctrine generally prohibits a business corporation from practicing medicine or employing a physician to provide professional medical services. In some states corporate employers, such as hospitals, HMOs, and professional corporations, are exceptions to the CPM doctrine prohibition. Other states merely prohibit the practice of medicine without a license or the sharing of fees between licensed and unlicensed individuals. Still other states flatly prohibit the ownership of medical practices or employment of professionals by nonprofessionals.

The CPM issue must be addressed early in the consideration of a sale, in accordance with state law. Once that issue is settled, you can move on to the tax implications of an asset versus a stock sale, Riley says.

"The tax implications of the transaction are extremely important and one that I don't think physicians initially focus on when they think about this as an option for their practice," he notes. "How much you can dictate some of the decisions and steer the deal to your best tax advantage will depend on who is buying. If you are in a state that allows nonphysicians to own the practice, that gives physicians more flexibility to decide whether to structure the sale as an assets sale or a stock sale."

An asset sale is one in which a buyer purchases certain assets and liabilities of a physician practice but not others. A stock sale, on the other hand, is what most people think of when they imagine someone "buying a practice"—the buyer is acquiring the practice with the intention of replacing the seller as the doctor within the practice. The stock sale involves a buyer purchasing a seller owner's equity in a physician practice as well as its assets and liabilities. Additionally, most or all of the accounts on the physician practice's balance sheet are sold with the practice.

The incorporation of the practice—namely, whether it is a C corporation or an S corporation—becomes important during a sale, Riley says. With a C corporation, income is taxed once as earnings, and then shareholders are taxed again when corporate earnings are distributed. In contrast, S corporation earnings are generally taxed just once, with the shareholders. When evaluating an offer to purchase your practice, consider how the incorporation will affect the proposed price. The net purchase price after taxes can be substantially less for C-corporation shareholders than for S-corporation shareholders, Riley says. (See the story on p. 4 for more on the different sale options.)

Asset valuation is another important area to consider. A buyer will record a practice's assets and liabilities at their fair market value, which could alter their carrying value and/or amount of annual depreciation, Riley explains. The selling physician practice will recognize a taxable gain or loss based on the difference between the allocated sale price and the tax basis of the assets and liabilities. C corporations usually end up with an increased tax burden, Riley says.

"If you are in a state that allows nonphysicians to own the practice, that gives physicians more flexibility to decide whether to structure the sale as an assets sale or a stock sale."

—James B. Riley Jr., JD

How much can the tax hit be? It can be pretty big. Federal long-term capital gains rates are between 15% and 23.8%, and federal ordinary income tax rates go as high as 39.6%. If the practice being sold is an S corporation but formerly was a C corporation within the 10-year built-in gain tax recognition period, additional taxes could be owed, Riley notes.

With a stock sale, the practice's assets and liabilities stay with the business. Sellers often favor this option because they want to simply sell the whole kit and caboodle and be done with it, Riley explains. It is typical, however, for purchase agreements to include indemnification clauses that make the seller responsible for some liability during the transition period, he adds.

Capital gains also can become an issue with a stock sale because the seller may have a gain or loss based on the difference between the price paid and the current basis in the stock, Riley explains. This loss or gain usually is treated as a capital gain, making it subject to lower federal capital gains rates—currently 15%–23.8% for most sellers.

Smaller physician practices, such as practices with only two or three physicians who are all retiring at once, may not have much leverage when it comes to structuring the sale, Riley notes. If a physician in such a practice wants to retire within a certain time frame, the buyer may have all the power to dictate terms. Being flexible and willing to postpone retirement can give the seller more power, he says.

The worst outcome from selling a practice would be a sale of assets by a C corporation without considering the tax implications, Riley says. The double taxation could be a ruinous surprise after the deal is done.

"We've seen practices in that situation. They didn't plan in advance for the potential sale of their practice, or there may have been certain components of the practice that were sold," Riley says. "If they had a cath lab in the practice under a C corp and sold that lab to a hospital, they could be subject to double taxation."

But as important as tax considerations are, they should not be the biggest driving force when negotiating a sale, says **Neil S. Maxwell, JD,** a partner with the law firm of Kurzman Eisenberg Corbin & Lever in White Plains, N.Y. The sale of a practice requires extensive planning and research, so you should plan to devote a full year to this preparation before signing a contract, he says. In addition to research and contract negotiations, you should spend that year getting the practice in the best shape possible so that you get a top-dollar offer.

"If you see that hospitals are buying out the physician practices in your area, don't wait until someone comes to you with an offer," Maxwell says. "Get started now with your assessment. Do your own valuation. Know your strengths and what kind of deal you want before they come to you and express an interest."

Besides, while an actual purchase of the practice might be what a hospital is looking for, it might not be the best choice for the physicians, he says.

"Hospitals are paying very, very little for assets and instead they are looking to employ the doctors," he explains. "The employment contract might take into account the value of the practice and assets, but the hospital doesn't want your old computers and desks. They don't need them."

An office lease also can become an issue. The hospital may want the physicians to move into the hospital's property, leaving the practice to make its own deal to get rid of its current office space. In some cases, the hospital will sublease the space or buy some of the practice's equipment as part of the employment deal. It is unlikely that the hospital really wants the office space or equipment; this kind of offer is probably just made to sweeten the deal, Maxwell says.

"Always work with an accountant on any deal like this, not just an attorney," he says. "Generally if one component of the deal is good for you, it's not good for the other side. This all becomes a negotiation and there is a lot of money at stake."

Overall, the sale process can be challenging; even financially savvy physicians and their advisors can make mistakes, Maxwell notes. That's why he advises always including an "unwind" provision in the sale contract. "Let's make sure that if it doesn't work out in a year or two, we can get back to where we were," he says. "Not everyone is going to agree to it, but if they argue that, you can tell them to give you a five-year guarantee instead. It's a negotiation."

Consider Stark Law, options when selling practice

The sale of a physician practice must always be viewed in light of the regulatory requirements and prohibitions of the federal anti-kickback statute and Stark Law, including the need to confirm that the purchase price is consistent with fair market value, explains **Ed Brown, JD,** partner at the law firm of Burr & Forman in Atlanta.

If the purchaser is a tax-exempt facility, IRS regulations must also be considered, including rules regarding private inurement and excess benefits. As tax rates increase, the tax sensitivity to these types of transactions will likewise increase, Brown says.

There are numerous tax issues that can arise in connection with the sale of a practice, both from

the perspective of the buyer as well as the seller. Because of the differences between C corporations and S corporations, and the two types of sale options (stock and asset), planning for the transition of the practice well in advance of the actual event is crucial.

Each type of sale has its advantages and disadvantages for both the buyer and the seller. Brown offers this summary of the two options.

Sale of stock

Advantages

- If the practice is structured as a C corporation, the sale of stock will create a capital gain for its physicians. Unlike a sale of assets, a stock sale will create two levels of tax: a tax to the practice with respect to the sale of the assets themselves, and a second tax to the physicians upon distribution of the cash to the shareholders.
- If the practice is structured as an S corporation, the tax benefit compared to the sale of assets is generally less, but a sale of stock is still less expensive and possibly tax prudent.
- For the physicians, the sale of stock transfers all assets and liabilities—and thus all ongoing obligations—to the buyer.
- For both parties, a stock sale is generally less expensive and easier to consummate, as it avoids the need to transfer title to assets as well as obtaining some of the consents that would be required in connection with an asset sale.

Disadvantages

- The buyer in a stock sale is likely to be at a tax disadvantage for several reasons. First, to the extent that the assets owned by the practice have already depreciated, the buyer steps into the shoes of the practice and will only be entitled to any remaining depreciation. Second, the purchase of the stock does not create any "goodwill" that would otherwise be amortizable in an asset transaction.
- The physicians will likely have greater risk to the buyer with respect to breaches of representations and warranties and liabilities connected to outstanding claims. Although they might retain these same risks in an asset sale, they would also retain the right to manage the risks and any claims, whereas they might give up that control in a stock sale.
- The buyer may not want to take the risk of assuming known, as well as unknown, liabilities that may come with the purchase of the shares.

Asset sale

Advantages

- An asset sale provides greater flexibility. Certain liabilities and assets can be purchased, while others can be left behind with what remains of the practice.
- The buyer is able to have a new tax basis in the assets acquired based upon their fair market value at the time of the purchase, and the buyer will then be able to realize a tax benefit from the assets' depreciation over time. In addition, the excess purchase price over the fair market value of the tangible assets can be treated as "goodwill" and be amortizable by the buyer, although many valuation firms will not value goodwill in a medical practice due to regulatory compliance rules.

Disadvantages

- The physicians will generally have a greater tax burden in an asset sale, although this might not be so in the case of the sale of stock in an S corporation. With a C corporation, however, the physician seller can count on double taxation on the sale of the assets. The owners need to remember that in negotiating a sale, the buyer would likely obtain tax benefits from purchasing the assets as opposed to the stock and thus might also be willing to pay more for the assets. This might help to narrow the tax difference between a stock and an asset sale.
- An asset sale is often more cumbersome for both parties. The need to obtain consents and document the transfer of specific assets can be more expensive and time-consuming than simply acquiring the stock.
- There is a general rule in the sale of businesses that "buyers want to buy assets and sellers want to sell stock." This rule applies to medical practices

as well as other businesses. Nevertheless, there are a variety of factors that may push the parties to a particular sale type:

- While most sales are asset sales, a stock purchase is sometimes used even though the buyer picks up additional potential liabilities. It is important, however, to pay attention to prohibitions on the corporate practice of medicine as well as fee splitting arrangements.
- Asset sales are more common, particularly when a practice is being closed and the physicians are not planning on continuing to practice but wish to retain the accounts receivable. In these instances, however, the practice needs to be careful not only to avoid violations of the corporate practice of medicine and fee splitting rules, but also to obtain fair market appraisals for the assets being sold in order to protect against any claim that the purchase price includes referrals.

CMS might pay for telehealth, chronic care without visit

It might be a move in the right direction, or it could be a significant change in how the physician fee schedule encourages certain types of care—we won't know until later—but right now it's encouraging that CMS is considering paying primary care physicians for chronic care management services without an in-person visit, and also for telehealth services.

If CMS follows through with the proposal in the Medicare Physician Fee Schedule for 2014, the change would start in 2015. Physician groups have long advocated for chronic care payments, but under the CMS proposal patients would need to have an annual, in-person wellness visit and consent to a doctor's management plan for a year. For the telehealth payment, the proposal redefines the definition of "rural" to avoid disruption of services if an area's geographic designation is changed. CMS said in the proposal that it is looking for evidence that "the service furnished by telehealth to a Medicare beneficiary improves the diagnosis or treatment of an illness or injury" or that it improves patient functioning.

"If you look at some of these hurdles you have to climb, telehealth is still something we're not going to see reimbursed often."

—Rene Y. Quashie, JD

Even with these changes opening up coverage to more patients, the telehealth benefit under Medicare is still very restrictive, says **Rene Y. Quashie, JD,** senior counsel with the law firm of Epstein Becker Green in Washington, D.C.

"If you look at some of these hurdles you have to climb, telehealth is still something we're not going to see reimbursed often," Quashie says. "It won't happen unless your patient presents in the most rural counties in the United States. The next hurdle is that you have to present at one of eight types of facilities, including a physician's office." Similarly, telehealth can only be provided by one of eight kinds of healthcare professionals, and in addition, only certain kinds of codes are eligible, mostly involving screening and

CPT codes for telehealth

Here are the CPT codes for telephonic and email care. Note the nonphysician provider codes that are listed. Just like telephone calls, trained support staff can screen emails and escalate issues that require a primary care physician.

	Telephonic care	Email care
Physicians	99441, 2, 3	99444
Nonphysician providers	98966, 7, 8	98969

mental healthcare.

"This is an opening and it's important," Quashie says. "It will increase the number of people who might benefit from telehealth, but doctors still have a long way to go see how it works out, whether they are fairly compensated for the time spent on telehealth."

Improved reimbursement for telehealth is long overdue, says **Tom Doerr, MD,** a physician in Boston who specializes in geriatrics and regularly communicates with patients by email.

"By and large it's not been embraced, and this is a terrific opportunity to expand our work in light of the shortage of physicians," Doerr says. "We can increase our capacity and still do it well."

He notes that Group Health Cooperative in Seattle used emails for six years and found that 30% of outpatient encounters are now done by email. (For more details on telehealth usage, see the story on p. 7.)

"I think primary care physicians are going to see a tsunami of patients wanting care and newly insured in 2014, and this is one of the easier ways to expand capacity," Doerr says. "You don't have to take on the hiring of a new midlevel clinician. There is a lot less stress involved with just sending an email and getting reimbursed for it."

Email telehealth popular among patients, data show

Research demonstrates that telehealth is popular among both patients and clinicians, says **Tom Doerr, MD,** a physician in Boston who specializes in geriatrics and regularly communicates with patients by email.

He notes these findings:

- A 2002 Harris survey found that many patients wanted email care; moreover, they would pay for it, and it would influence their choice of doctors and health plans.[1]
- In 2005 Charles Kilo, MD, demonstrated that 80% of care in the five-doctor Greenfield Clinic in Portland, Ore., could be delivered through the Web—most of it via email.[2] In a subsequent interview, he stated, "Doctors hate to admit this … but a very large percentage of what we do does not have to happen in the office. Fifty percent of office visits don't need to occur."[3]
- At Harvard-Beth Israel Deaconess Medical Center, John Halamka found that the average patient sent 1.2 emails to his or her provider every month. Ninety percent of these emails could be triaged to extenders such as nurse practitioners.[4]
- Kaiser implemented email care and found that between 2004 and 2007, the total office visit rate decreased 26.2%; meanwhile, secure email messaging, which began in late 2005, increased nearly sixfold by 2007.[5] Kaiser also found statistically significant improvements in numerous Healthcare Effectiveness Data and Information Set metrics among patients who were email users, compared to non-users.
- In 2013, Patrick Courneya and colleagues at Minnesota's HealthPartners found that online visits for simple conditions delivered savings of $88 per visit, and 98% of the patients would recommend the service to a friend.[6]

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Maximize revenue with attention to detail

Even with all the changes in healthcare that seem to be out of your control and squeeze your revenue stream tighter every day, there still are ways to improve your bottom line, says **Dixon Davis,** vice president of AAPC in Salt Lake City, which provides training and credentialing in medical coding.

"There is still a lot of money being wasted through claim denials and information not being sent to payers right the first time," Davis says. "You have to maintain productivity, and that comes down to how many patients you're seeing and working as effectively as you can. And then you have to capture the data and relay that accurately for payment. That's still under your control."

Physician offices can get so busy that charges are not captured, Davis says. There must be a solid process for capturing all the data generated by clinical care, and then that information must be submitted accurately for payment the first time.

Davis suggests using an audit sheet, which can be posted at the front desk or the intake area, to remind staff of the data they must collect on each patient. In addition, codes should be double-checked before sending a claim to the insurer.

"These key steps can be overlooked because we're so busy. We're trying to run such a lean physician practice and that can have consequences," Davis says. "Formal checklists and audit sheets can help you avoid the mistakes, even when you hire a new front desk person who has no experience with this data collection."

A practice also should have a process in place to collect patients' copays up front before they see the doctor. Any decision about delaying payment or waiving the copay should be made at this stage, not when the patient is with the doctor, Davis says.

"Studies have shown that it costs about $20 or $25 for you to collect the payment at some later date, and that may be all the copay is," he says. "If you collect it up front, that's money in your pocket instead of having to spend money to collect money."

Buying a practice just as challenging as selling

The trend may be for hospitals and other entities to buy physician practices, but physician groups are also making such acquisitions, notes **Bradford Hall, JD, CPA,** managing director at Hall & Company CPAs in Irvine, Calif.

Of additional note, Hall is seeing far more asset purchases than stock purchases among these transactions.

"I don't know if it's because of liability concerns or something else, but most acquiring physicians are not willing to take on any liability related to the seller," Hall says. "They're almost always purchasing assets instead."

When buying, one concern to keep in mind is how long the selling physician is willing to stay on to assist in the transition. A minimum of one year is preferred, Hall says.

"That doesn't have to mean that the selling doctor is there every day of the week, but there frequently to make introductions, answer questions, and generally praise the new doctor for being the greatest thing since sliced bread," Hall says. "The selling doctor sometimes wants to just quit and walk out the door with guarantees of income for two years or so, but I advise against that. There should be an installment payout that includes the selling doctor helping with the transition."

The biggest mistake with acquiring a practice is not performing adequate research before buying, Hall notes.

"Doctors typically have horrible records and can't tell you what's coming in from insurance companies or any other financial issues," he says. "They just don't have a good handle on their own practices, so when the new buyer looks at the tax returns they can be very misleading."