SCHENKMAN JENNINGS LLC
ATTORNEYS AT LAW

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Physician Planning Series

BECOMING A PARTNER IN A PHYSICIAN PRACTICE

Physicians are traditionally given the opportunity to become a member or shareholder in to the medical practices in which they are employed. Significant issues are involved in this process, which will have both an economic and lifestyle effect on the physicians and their families. To avoid making mistakes in becoming a member or shareholder, it is imperative that physicians learn these issues and avoid unintended consequences.

Consult With Your Own Professionals

Since buying into a physician practice is one of the most important business decisions the physician makes, it is important that a physician hire his own professionals and not rely on the practice's attorney or accountant. Those professionals have a potential conflict of interest in that they represent the existing practice and not the physician buying in.

Negotiate the Terms and Conditions of Becoming a Partner at Commencement of Employment

At the time a physician joins a practice, he or she has a unique opportunity to negotiate all the terms of becoming an equity owner before joining the practice. The physician has the most leverage at this time and should take advantage of the opportunity. As with any employment situation, once a physician becomes an employee he will have less leverage and may be in a less favorable negotiation position.

The employment agreement should address the following:

- The terms of the becoming a Partner.
- The determination of the purchase price.
- The terms of paying the purchase price.
- The compensation and decision making authority after becoming a Partner.
- The retirement benefits to senior owners and the estimated time of their retirement.

Conduct Due Diligence Prior to Purchase

Due diligence should include, at a minimum, a review of: the practice documents (including its organizational documents); the practice's financial statements and tax returns; all material contracts to which the practice is a party; and information regarding any potential or pending litigation.

Type of Entity Affects Liability

Physicians need to review the structure of the practice to ensure that they are not creating additional unnecessary liability for themselves. If the entity is structured as a partnership (with unlimited liability), a physician should strongly recommend converting to a limited liability company or a professional corporation to the extent it is allowed under state law.

Although all physicians are personally liable for their own malpractice liability, depending on the structure of the entity they may be able to **insulate themselves from the medical malpractice of the other owners**, as well as from the practice's obligations. When the practice is structured as a partnership, there is **unlimited liability** to the individual physician with regard to the other owners' malpractice and the general liabilities of the practice. In other words, if the practice is a partnership, the physician is personally liable for another owner's malpractice. In general, limited liability companies and professional corporations insulate an owner's personal assets from malpractice liability of another owner.

Analyze the Tax Treatment of the Purchase Price

It is best to structure the purchase price to use pretax dollars to pay the purchase price.

> For example, if the purchase price is $100,000, the physician must earn about $167,000 to pay the practice $100,000, because he or she must pay taxes of about $67,000 in order to have $100,000 *after* taxes to pay for the purchase price.
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> If, however, a significant portion of the **purchase price is characterized as some type of seniority payment or deferred compensation for the more senior doctors, that amount would be paid by the practice as a professional payment to the senior doctors and as a reduction in the physician's salary**. The amount paid to the senior physicians will be pretax money.

Existing Accounts Receivable Should Not Be Paid For in the Purchase Price

Accounts receivable at the time a physician buys into a practice should not be calculated as part of the purchase price. Rather, a mechanism should be established whereby the existing physicians receive the value of the "good accounts receivable" over a reasonable period of time. Paying it over time will reduce any significant negative effect on cash flow and distribution.

If accounts receivable are included in the calculation of the purchase price, the physician will pay for the accounts receivable with after-tax money and when the accounts receivable are collected by the practice and distributed to the physician as compensation, the physician will be taxed on it as ordinary income.

Disclosure of Related-Party Transactions

It is important to understand the relationships that the practice has with related parties as this will have bearing on the practices profitability.

Termination Provisions Should Be Clearly Defined

A physician generally will be required to sell his or her ownership interest upon his or her death, disability (which should be clearly defined), and other termination of employment events. It is important that all “triggering” events be reviewed carefully to make sure that they are reasonable under the circumstances. For example, in typical termination provisions may include, at a minimum, material breach of the physician’s employment agreement, loss of license to practice medicine, loss of DEA licensure, and loss of privileges.

Physicians wear two hats in these situations: that of an owner who may want to terminate another owner and that of the physician who is being terminated. Therefore, physicians need to review termination provisions from both the employer’s and the individual owner’s perspective to make sure the provisions are fair and appropriate. It is important that the post-termination obligations appropriately fit the circumstances and have some relationship to the triggering event. Also, they should ensure that appropriate notice is given to allow a physician to attempt to remedy (cure) the breach before termination and the required sale of his or her ownership interests.

Scope of the Restrictive Covenant

Restrictive covenants in New Jersey are enforceable if they are reasonable. Many employment arrangements contain restrictive covenants that prohibit a physician from practicing medicine for a specified time after termination and within a certain geographic area. Restrictive covenants also prohibit a physician from soliciting patients, referral sources, and employees after his or her employment is terminated. Such covenants will result in the physician’s inability to continue to practice for a specific period of time within the local geographic area, which may include the community in which the physician lives. Each physician must understand the obligations (restrictions) that are imposed upon him or her at termination and make sure he or she can live with them.

Conclusion

Before entering into negotiations regarding a purchase of interests in a medical practice, a physician should have a clear understanding of the issues that need to be addressed and should obtain appropriate professional advice.

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