WHITE PAPER

Thinking of Buying or Selling a Medical Practice? Read This First

Medical practice acquisitions represent a challenging and risky strategic decision. There are three main legal structures for acquiring a medical practice: asset purchase, stock purchase, or merger. All three of these structures are different types of acquisitions. A merger is a type of acquisition that has a particular legal meaning.

The decision to buy, sell, or merge a medical practice is more complicated than ever, and physician owners must have a clear understanding of the legal structure of the potential transaction. Here are some of the advantages, disadvantages, and considerations for these legal structures.

Asset purchase

In an asset purchase, the buyer purchases specific assets of the target practice that are listed within the transaction documents. Buyers may prefer an asset purchase because they can avoid buying unneeded or unwanted assets and liabilities. Generally, no liabilities are assumed unless specifically transferred under the transaction documents. Because the liabilities remain within the selling practice, buyers can eliminate or reduce the risk of assuming unknown liabilities.

Further, buyers typically receive better tax treatment when purchasing assets as opposed to stock. Buyers may also be able to reduce their taxable gain or increase their loss when they later sell or dispose of the assets.

The main risk to buyers in an asset purchase transaction is that a buyer may fail to purchase all of the assets it needs to effectively run the practice. There are also various aspects of an asset sale that can be time-consuming and drive up transaction costs, such as listing specific assets and determining their value.

For some assets, third-party consent may be required before the assets can be transferred to the buyer. The manner in which title of an asset is passed to the buyer will vary depending on each kind of asset. Finally, there is always the risk that the seller could retain sufficient assets to continue as a competing going concern. This risk is usually mitigated by requiring that the seller enters into a covenant not to compete with the buyer.

Sellers generally disfavor asset transactions because the seller is left with potential liabilities without significant assets it could otherwise use to satisfy those liabilities. Also, the tax treatment of an asset sale is generally less favorable to sellers than a stock sale. The practice and its shareholders can each potentially incur taxable income, which could result in double-taxation of the sale proceeds. Entities that have pass-through taxation such as partnerships, LLCs and S corporations can avoid the problem of double taxation and thus may be more likely to accept an asset purchase structure.

Stock purchase

In a stock purchase, the buyer purchases the stock of the target practice directly from the target's shareholders. The practice remains an existing going concern after the purchase, and its business, assets, and liabilities are all unaffected by the transaction. A stock purchase may be preferred if the buyer wishes to continue operating the target practice after the purchase. Further, absent unusual circumstances, consent from third parties is not needed to approve the transaction.

However, the buyer may be exposed to unknown risks by buying the entire practice, assets, and liabilities. Buyers can reduce their risk by holding back some of the purchase price in escrow to satisfy any liabilities that arise after closing.

Obtaining approval for a stock purchase can be problematic if the target has a large number of shareholders. Unless there are agreements in place before finalizing a deal, buyers cannot force shareholders to sell. Thus, a holdout shareholder could refuse to sell to the buyer. This result can be very undesirable for buyers and could ultimately cause the deal to fall apart.

Buyers may have less preferential tax treatment in a stock purchase. However, in certain circumstances, buyers can elect to treat the stock purchase as an asset purchase, thus securing a desirable tax treatment.

Merger

In a merger, two separate legal entities become one surviving entity. Under state law, the assets and liabilities of each are then owned by the new surviving legal entity. There are several structures that mergers can take.

The simplest is a forward merger, whereby the selling practice merges into the purchasing practice, and the purchasing practice survives the merger.

Sometimes, buyers will wish to keep the target practice as a separate legal entity for liability reasons, so the buyer will instead merge the target into a wholly-owned subsidiary corporation of the buyer, called a forward triangular merger. When complete, the subsidiary survives the merger, holding all of the assets and liabilities of the target practice.

Both a forward and a forward triangular merger generally require consent from third parties, as the target practice ceases to exist after the merger and all of its assets are owned by the surviving entity. A reverse triangular merger is similar to a forward triangular merger, except that the target practice is the surviving entity, instead of the wholly-owned subsidiary of the buyer.

How a merger is taxed depends on its structure. Generally, forward and forward triangle mergers are taxed as asset purchases while reverse triangular mergers are taxed as stock purchases.

In terms of required corporate approvals, mergers generally require approval only of the seller's board of directors and a majority of its shareholders (absent other requirements in its charter documents). This lower threshold is particularly appealing when a target practice has multiple shareholders. However, shareholders who vote against the merger will generally have appraisal rights under state law. Appraisal rights, or Dissenters' Rights, enable dissenting shareholders to petition a court to obtain the fair market value of their shares. This can complicate transactions and increase the buyer's costs.

Clearly, medical practice transactions can be complicated. Consequently, it is imperative that physicians have an experienced and competent team consisting of a consultant, accountant, and attorney who help you review all of your options and choose the one that ensures your practice’s continued success.

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