



AMERICAN BAR ASSOCIATION

Tax Section

***VIRTUAL 2021* MAY TAX MEETING**

Representing the Professional Selling to or Purchasing a Minority Interest in a Corporate Practice

Closely Held Businesses Committee

May 13, 2021

The Panel

Moderator:

- Adam L. Abrahams, Meyers Hurvitz Abrahams LLC, Rockville, Maryland

Panelists:

- William P. Prescott, Wickens Herzer Panza, Avon, OH
- Morgan L. Klinzing, Troutman Pepper, Philadelphia, PA
- Galina (Allie) Petrova, Petrova Law, Greensboro, NC

History of Corporate Ownership of Professional Practices

I. History of Corporate Ownership of Professional Practices.

A. Dental Practices.

1. Who's the boss?
2. Dental, dental specialty and veterinary practice owners are very independent and do not like working for someone else.

B. Dental Specialty Practices.

C. Medical Practices.

D. Veterinary Practices.

History of Corporate Ownership of Professional Practices

E. Today.

1. Influx of corporate practices in dental, dental specialty and veterinary practices.
2. Practice ownership for dentists, dental specialists and veterinarians - entering practice is less important today than in the past.

Corporate Practice of Medicine (CPOM) Doctrine

II. CPOM.

A. Generally.

1. Statutory or common law restriction on beneficial ownership.
2. Designed to prevent medical practices from being owned and controlled by non-professionals.

B. The “Workaround” – Effective Consolidation for Tax Purposes.

1. Typical contractual arrangements.

Corporate Practice of Medicine (CPOM) Doctrine

2. Consolidation under Section 1504.

- 1504(a)'s direct ownership requirement satisfied with beneficial ownership of stock, not legal ownership.

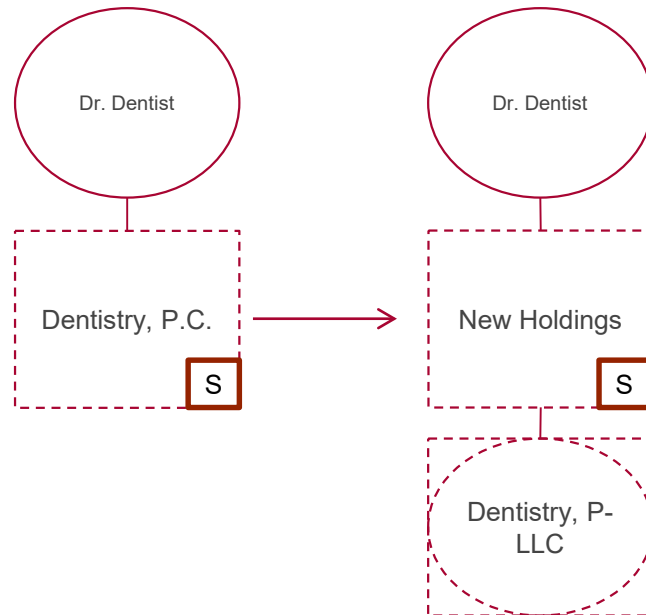
3. IRS Rulings.

- Rev. Rul. 84-79: Everything but legal title equals direct ownership.
- PLR 9605015: Physician-employee with voting, management and economic restrictions not beneficial owner.
 - Revoked by PLR 9752025.
- FSA 199926014: No beneficial ownership if precluded by state law.
- PLR 201451009: Beneficial ownership of medical practice due to voting power and economics.

Corporate Practice of Medicine (CPOM) Doctrine

C. Typical PE Acquisition Structure.

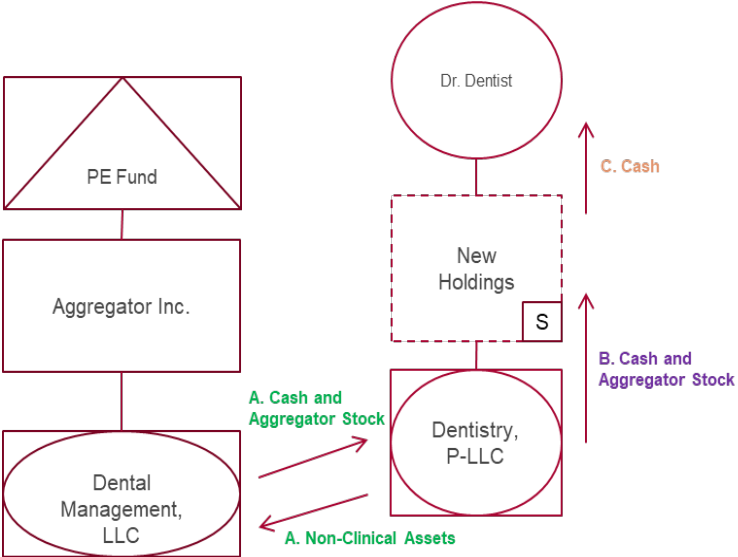
1. Restructuring of Medical Practice Formed as an S Corp – Rev. Rul. 2008-18.



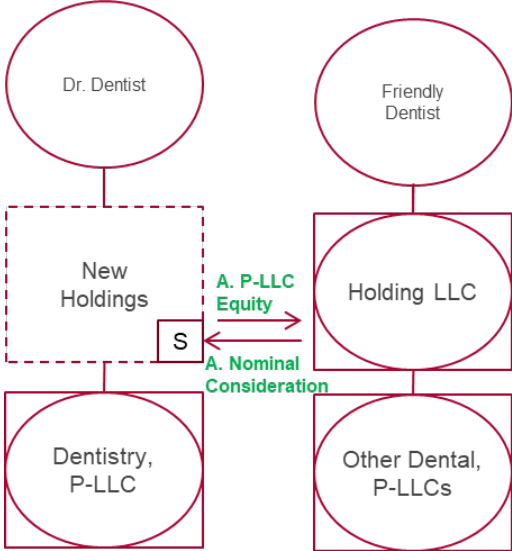
Corporate Practice of Medicine (CPOM) Doctrine

2. PE Acquisition Structure.

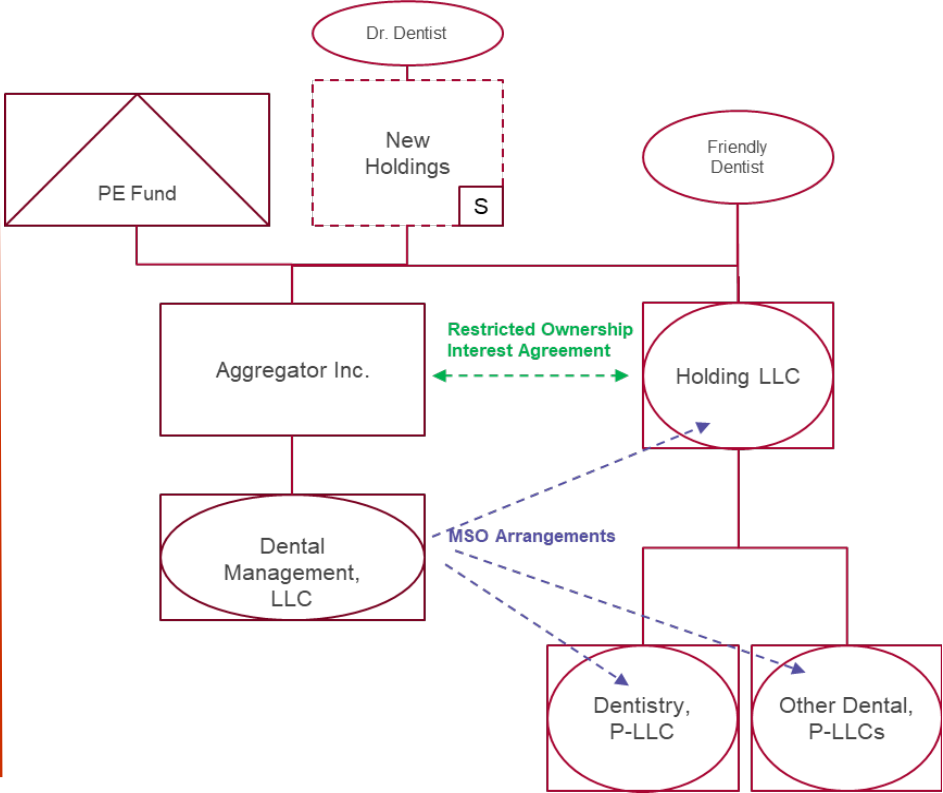
Step 1: Sale of Non-Clinical Assets



Step 2: Transfer of Dentistry P-LLC To PE-Friendly Employee-Dentist



Step 3: Management Services Arrangement



Selling a Dental, Dental Specialty, or Veterinary Practice

III. Valuation methods:

A. Asset based valuation

B. Market based valuation

1. Multiples of gross revenue
2. Comparable practices

A. Income based valuation

1. Capitalized earnings
2. Discounted cash flows

Selling a Dental, Dental Specialty, or Veterinary Practice

A. Asset Based Valuation

Value all tangible and intangible assets individually:

1. Accounts receivable
2. Equipment – Practice and Office
3. Supplies – Practice and Office
4. Patient/Client Base and Goodwill

Selling a Dental, Dental Specialty, or Veterinary Practice

B. Market Based Valuation: Multiples of Gross Revenue

Gross collections

\$1,000,000

Multiplier

65% (low)

80% (high)

Net income

\$650,000

\$800,000

Selling a Dental, Dental Specialty, or Veterinary Practice

C. Income Based Valuation: Capitalized Earnings

Gross collections	\$1,000,000
Expenses (incl. owner's comp.)	<\$750,000>
Net income	\$250,000 (25% margin)

Capitalization rate	30% (low)	20% (high)
Practice value	\$833,333	\$1,250,000

Selling a Dental, Dental Specialty, or Veterinary Practice

C. Income Based Valuation: Discounted Cash Flows

Gross collections		\$1,000,000
Expenses (incl. owner's comp.)		<\$750,000>
Net income		\$250,000 (25% margin)
Growth rate		2% annually over 10 years
Discount rate	31% (low)	23% (high)
Practice value (NPV)	\$812,878	\$948,501

Selling to a Corporate Group

IV. Selling a Dental or Dental Specialty Practice to a Corporate Group.

A. Benefits.

1. Higher selling price than with a private purchaser/traditional valuation methods vs. lengthy repayment periods.
2. Guaranty of continued employment.
3. Really good practices may be fully paid in cash at closing – this has been the case in veterinary practices for some time.

Selling to a Corporate Group

B. Risks.

1. Hold-backs based upon performance that the former owner probably will be unable to control.
2. Requirement of continued employment – How long?
Negotiable?
3. Hold harmless from State Dental Board issues.
4. Corporate practice may fire former owner who wants to work part-time.
5. Negotiate possible staff pay and benefit levels.

Selling to a Corporate Group

6. Change of life circumstances to leave.
7. Management/change of ownership.
8. Failure to pay the doctor or staff properly, including bonuses.
9. Failure to pay hold-backs.
10. Security interest in the practice should a default occur/ability to obtain lease/retain premises if real estate is owned by the former owner.
11. Failure to hire the associate/successor when agreed to.

Selling to a Corporate Group

12. Use of name – need permission under all circumstances.
13. Restrictive covenants should go away and apply to the corporate purchaser under certain triggering events.
14. Restrictive covenants should go away if the corporate practice is out of business, as opposed to sold.
15. Long-term lease or real estate purchase/right of first refusal.
16. Ability to practice somewhere.

Post-Sale Arrangements

C. Post-Sale Arrangements:

1. Clawback on resale
2. Earnout – milestones and thresholds
3. Employment agreement terms
 - Termination: “for cause” and “no cause”
 - Liquidated damages for early termination (termination fee)
 - Compensation for of services provided after termination notice
4. Restrictive covenants – reasonableness
 - Permitted services
5. Succession agreement

Selling to a Corporate Group

D. Summary.

1. Get fully paid at closing or at least more than fair market value from a private buyer.
2. Security interest for hold-backs to get the practice back.
3. Ability to quit if certain triggering events occur.
4. Ability to practice elsewhere.

Becoming a Minority Owner

V. Becoming a Minority Owner in a Large Private or Corporate Practice.

A. Corporate Practice.

1. Beware of overly-restrictive covenants, especially for specialists.
2. Ability to quit over poor management and deficient patient care.
3. Change of ownership.
4. Investment returned, unless fired, as delineated in shareholder/member employment agreement.

Becoming a Minority Owner

B. Large Dentist-Owned Practice.

1. Meaningful ownership.
2. Management responsibilities for primary location.
3. Performance based upon primary location.
4. Coverage at other locations.
5. Ability to buy primary location.
6. Ability to lease/purchase facility.
7. Share in windfall/sale to a corporate practice.

Becoming a Minority Owner

8. Ability to buy practice with lease/purchase of facility
9. Windfall if the practice is sold to a corporate buyer.

Becoming a Minority Owner

C. No Matter What.

1. Ability to leave and have investment returned.
2. Overly-restrictive covenants.
3. In a large dentist-owned practice, if the practice does not want to retain the new owner, there is an increase in the buy-out depending upon the terms of the shareholder/member employment agreement.
4. Incremental buy-ins to correspond with S-corporation distributions.

Becoming a Minority Owner

5. A corporate practice is distinguished from a large dentist-owned practice by capital from outside sources.
6. Generally, depends on the extent that restrictive covenants go away if the practice is out of business, as opposed to being sold.

Becoming a Minority Owner

D. Summary.

1. Always maintain the ability to leave unscathed.

Selling or Becoming a Minority Owner

Summary and Thoughts.

Selling to or joining a corporate or large dentist-owned practice as a minority owner has risks unless safeguards are delineated in the sale and purchase or partnership agreements.

Questions?

All attendees can submit questions via the chat feature on the virtual meeting interface.