

Recent Case Serves as Reminder to Take Care in Structuring Sales of Physician Practices

Physicians Should Carefully Review Documents to Verify Information Accurately Reflects the Desired Structure of the Sale

Over the past few years, hospitals, health systems, and practice management companies have increased their efforts to acquire physician practices. Moreover, physician groups are increasingly interested in selling their practices to these interested purchasers. The primary reasons for this trend are varied but in general are prompted by an increased focus on the delivery of medicine in a seamless integrated system by all health care providers.

For physicians or other health care providers that are considering practice sales, care should be taken in structuring the sale to minimize the federal taxes payable as a result of the sale. In general, there are two choices to structure the practice sale:

- **Stock sale:** Under this sale structure, which works only if the practice is incorporated, the physicians sell stock in their professional corporation or professional association to the interested purchaser.
- **Asset sale:** Under this sale method, the practice itself sells its tangible and intangible assets to the purchaser.

In addition to these two choices, the sale can be structured as a hybrid using a combination of these sales methods. A final and much less common option would be for a portion of the sale consideration to be paid by the purchaser to one or more selling physicians and characterized as a sale of personal goodwill.

For both tax and non-tax reasons, from the seller(s)' perspective, the preferential method for a practice sale would be option 1 (sale of stock). Under present tax law, a stock sale generates capital gains to the selling physicians. For physician practices organized as "C" corporations, the tax savings from a stock sale as opposed to an asset sale are much greater due to federal taxes that



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will be payable by the incorporated practice and by its shareholders on liquidation of the corporation and the resulting distribution of the net after tax proceeds of the sale.

In addition to taking care in structuring the sale using these available options, physicians should make certain that the sale documents actually reflect the structure agreed to by the seller(s) and the buyer. This latter issue was addressed in a recent Fifth Circuit Court of Appeals case in which the sellers of a business tried to restructure the sale when they became unhappy with the tax consequences that arose from the sale under the documents that they had executed.

In *Makric Enterprises, Incorporated v. Comm'r*, 119 AFTR 2d ¶2017-580 (5th Cir. 2017), the Court of Appeals for the Fifth Circuit affirmed a finding of the Tax Court that no mutual mistake was made in the sale of a closely held company's stock that would require a reformation of the transaction. At issue was whether a sale of stock owned by a holding company in its wholly owned subsidiary should be recharacterized as a sale by the holding company's shareholders of their stock in the holding company. The shareholders contended that they believed that they were selling stock in the holding company; however, the sale

documents indicated otherwise. The Fifth Circuit rejected the taxpayer's argument on appeal that there was a mutual mistake in the sale documents that would require reformation of the sale structure in the manner sought by the taxpayer.

The lesson to be learned from the *Makric* decision is that even if physicians who are contemplating a sale of their practice group decide after consultation with their advisors that a sale should be structured in a certain way to minimize federal tax consequences, they should carefully review the sale documents to verify that the documents accurately reflect the desired structure of the sale.

Although the tax differences of the various sale options will decrease if tax reform is enacted as has been proposed by President Trump, this tax legislation will reduce but not eliminate the tax differences from the two different sale options.

Moreover, state law (for example, in those states that have the so-called "corporate practice of medicine" doctrine) may drive how practice sales can be legally structured in which case, the legal aspects of the sale may limit the options to structure the sale. As a result, in those states, the asset sale structure may be the only option. If so, the asset sale will generally result in a higher tax bite against the sale proceeds.