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Buying and Selling a Professional Practice

This article gives an overview of buying and selling a professional practice, be it a medical, dental, accounting, veterinarian or other practice.

Finding the Deal. The first step is to find a deal. Talk to people in the industry. Find out if an owner of a practice is looking to sell and retire, or if an up-and-coming associate is looking to buy. If you have a longer timeline, consider hiring an associate and grooming him to take over (from the buyer's side, consider being that associate). If that doesn't work, hire a broker who specializes in your profession. Lastly, remember that for most professional practices, only someone licensed in CA in the profession may buy and own the practice.

Due Diligence. Both the buyer and the seller should go about the due diligence process in a business-like manner. Most buyers of a professional practice have experience in the profession and understand what to look for, so I won't belabor the issue. At a minimum, (1) check the seller's professional license for a history of complaints or litigation, (2) review the practice's financial statements and tax returns for the past three years, (3) analyze whether the seller's relationship with patients or clients can realistically be transferred to you (conversely, beware if the relationship is so intensely personal that it can't be separated from the seller), (4) beware of prior employee / contractor misclassification in the practice, and (5) check for liens, unpaid back taxes (including sales taxes), unpaid workers compensation, unpaid trust fund taxes, unpaid vacation liability, unpaid bills, and current and potential lawsuits.

Deal Terms. Purchase price is the primary deal term. Be sure to consider taxes, because it's the after-tax price that counts. Payment terms are almost as important as the total purchase price. For professional practices, usually you use some combination of cash, promissory note, and earn-out (which is money that is paid over time based on the practice's post-closing performance). Sellers love cash and buyers love earn-outs. Also consider who collects the accounts receivable that were booked before the closing date.

Another deal term is legal structure – will it be a stock or asset sale? As a rule of thumb, buyers want to buy assets and sellers want to sell stock.

- *Stock Sales.* Here the buyer takes the entire professional corporation, leaving all contracts, assets and liabilities in place for the buyer. The buyer gets a carry-over basis, while the seller pays taxes on the appreciation in their shares (with no double-tax). This is why sellers love stock sales.

- *Asset Sales.* Here the buyer takes the assets of the practice but not the liabilities (except those that he agrees to assume); also the buyer gets a stepped-up basis in the assets. This is why buyers love asset sales. The seller keeps the un-assumed liabilities, and might incur the dreaded double tax (if he uses a C corporation), that is, the corporation pays taxes on the asset sale, then the shareholders pay taxes again when the corporation dividends the remaining purchase price to them.

Fixing Prior Defective Work. All of us, even professionals, make mistakes. When buying a professional practice, the deal terms should include the fix-up of the seller's prior defective work, and also the purchase of tail insurance for the seller. For patients / clients who stay on, usually the buyer will re-do, for free, defective work done by the seller. Hence the buyer and seller need to allocate the responsibility and costs for the re-do work + the time period for doing the work, for example, for the first year after closing, the buyer might do the fix-up work then charge the seller some agreed-to fee for the work.

Deal Documents. The first deal document is a letter of intent, also called a term sheet. The parties use a letter of intent to confirm basic deal terms. The letter of intent should not be binding on the parties, except for such matters as due diligence procedures and perhaps a lock-up or exclusive period within which the seller may not field other offers.

Once the parties agree to the basic deal terms, they can move on to the binding deal documents, including the purchase agreement. In the purchase agreement, the seller makes representations about the practice. This allows the buyer to recover back some of the purchase price if any of the representations is materially misleading, for example, the seller did not disclose certain liabilities. Representations are not a substitute for due diligence, but they do provide additional security to the buyer.

The last important piece is the non-competition agreement. In most cases, the buyer should receive a non-competition agreement from the seller. Otherwise the buyer is at risk that, after collecting the purchase price, the seller will set up a competing practice across the street.

This whirlwind tour is over. Remember that buying or selling a professional practice is a complex process. Legal, tax, accounting, valuation and psychology issues are all involved. Get help from professionals.

Funny Papers

TEACHER: Glenn , how do you spell 'crocodile?'
GLENN: K-R-O-K-O-D-I-A-L'
TEACHER: No, that's wrong
GLENN: Maybe it is wrong, but you asked me how I spell it.