A generation ago, the sale of a medical practice was much like the sale of any other business: A retiring physician would sell his or her practice to a young doctor and the practice would continue on as before. Occasionally that still happens, but changes in the business of medicine—most significantly the growth of managed care—have made a big impact on the way medical practices are bought and sold.

For one thing, there are far fewer solo practitioners these days, and polls indicate most young physicians will continue that trend. The buyer of a medical practice today is more likely to be an institution—such as a hospital, an HMO, or a large practice group—than an individual.

For another, because the rules governing such sales have become so nobly complex, the services of expert (and expensive) third parties are essential. While these issues may complicate matters, there is still a market for medical practices. However, you must do everything possible to ensure you identify the best possible buyer and structure the deal.

The first hurdle is the accurate valuation of your practice, which must be completed last month. (If you missed that column, go to www.skinallegrynews.com and click on “The Archival Collection” on the left-hand side.) Briefly, for the protection of both parties, it is important that the appraisal be done by an experienced and neutral financial consultant, that all techniques used in the valuation be divulged and explained, and that documentation be supplied to support the conclusions reached.

Keep in mind that the valuation will not necessarily equal the purchase price; other factors may need to be considered before a final price can be agreed upon. Keep in mind, too, that there may be legal constraints on the purchase price. For example, if the buyer is a non-profit corporation such as a hospital or HMO, by law it cannot pay in excess of fair market value for the practice.

Once a value has been agreed upon, you must consider how the transaction will be structured. The most popular structures include transfers of assets, purchase of corporate stock, or merger.

Buyers, especially institutional buyers, prefer to purchase assets because it allows them to choose only those items of value to them. This can leave the seller with several “odd lots” to dispose of. But depending on the circumstances, an asset sale may still be to both parties’ advantage. Sellers typically prefer to sell stock because it allows them to sell their entire practice, which is often worth more than the sum of its parts, and often provides tax advantages as described below.

The third option, merger, continues to grow in popularity. Usually this takes the form of a sale (actually a stock trade) of the medical practice to a publicly traded HMO, which issues its own stock in payment. Because these types of purchasers are exempt from the restrictions that apply to not-for-profit organizations, they can pay higher prices, and pay for goodwill, and the stock issued in payment of the seller’s opportunity to participate in future profits and appreciation of value. Stock ownership is not without risk, of course.

Tax issues must always be considered. Most private practices are corporations, and the sale of corporate stock will result in a long-term capital gain that will be taxed at 28%. As the saying goes, it’s not what you earn, it’s what you keep, so it may benefit the seller to accept a slightly lower price if the sale can be structured to provide significantly lower tax treatment. However, any gain that does not qualify as a long-term capital gain will be taxed as regular income—around 40% plus a Social Security tax of about 15%.

Payment in installments is a popular way to defer taxes, since they are incurred on each installment as it is paid. However, such payments may also be mistaken by the IRS for payments for referrals, which is illegal. And there is always the problem of making certain all the payments eventually are made.

The seller may wish to continue working at the practice as an employee, and this is often to the buyer’s advantage as well. Transferring to new ownership stages often maximizes the value of the business by improving patient retention, and allows patients to become accustomed to the transition. However, care must be taken, with the aid of good legal advice, to structure such an arrangement in a way that minimizes concerns of fraud and abuse. Congress has created a “safe harbor” to allow low continuing employment, but its scope is narrow and does not cover many common arrangements. To qualify, the sale of the practice, including any installment payments, must be completed within a year after an agreement is reached, and the seller cannot be in a position to make referrals to the buyer after a year.

DR. EASTERN practices dermatology and dermatologic surgery in Bellevue, NJ. To respond to this column, write Dr. Eastern at our editorial offices or e-mail him at sknnews@elsiever.com.