Estate and Business Planning for the Retiring Physician

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Retiring physicians have much to think about for estate planning purposes.

Physicians who intend to retire and dispose of their medical practice will be faced with various estate and business planning decisions. One major decision is whether to sell or close the medical practice. Selling or closing a medical practice includes additional planning decisions. Once the medical practice is disposed of, the estate planning process will continue. The retired physician will need to review his or her estate plan, determine if any estate planning goals have changed since the estate plan was last prepared, and implement current estate planning goals after taking into account the current tax regime. This article discusses planning for disposing a medical practice and for implementing an estate plan after the medical practice is sold or closed.

Selling or Closing a Practice

Selling or closing a medical practice requires considerable advance planning. This article reviews some of the planning required and provides the reader with other resources to consult.

Medical practices are usually organized as sole proprietorships, general partnerships, corporations or limited liability companies (“LLCs”). If the practice is organized as a corporation, the corporation will have one or more shareholders. An LLC will have one or more members.

Sale of Assets

Usually when a practice is sold, the sale is completed by a sale of assets. If the practice is organized as a corporation or an LLC, the sale may be concluded as a sale of the ownership interest (stock in the case of a corporation and membership interest in the case of an LLC). For at least the last twenty years, the dominant method of selling any medical practice (or other business) has been by a sale of assets.

Planning for the sale or closing of a practice should start well in advance of the event. A sale which is completed within ninety days of the date the seller decides to sell would be considered prompt. Many sales would take much longer. The length of time required depends on many factors.

Hiring Professionals

One of the first steps a physician should take is to contact a number of professionals who can advise the physician throughout the entire sale process. These professionals should include the physician’s attorney and accountant. In addition, the physician should consider hiring a professional broker and appraiser. See a more detailed discussion of this issue below. It is important to contact these professionals before the physician attempts to negotiate the terms of a sale. If a physician begins to negotiate on his or her own without the benefit of professional advice, many loose ends can be left and the physician may be at a serious bargaining disadvantage in later stages.
At an early stage, the physician must evaluate the assets to be sold. Usually these include furniture, fixtures, equipment, an office (which may be owned or leased) and a professional practice. Of course, the patients of the physician can make their own choice of a new physician. By their nature, patients cannot be bought and sold. However, the practice may be sold as a going business. Under Missouri law, the appropriate evaluation method is comparable sales.

There are many ways to find a buyer for a medical practice. If the practice includes more than one physician, the most obvious buyer is one of the other physicians already in the practice. If the practice is organized as a corporation, the basic sale terms should be included in the “buy/sell agreement” entered into between the shareholders and the corporation. In the case of an LLC, the “buy/sell” terms are usually found in the operating agreement entered into between the LLC and its members at the time of organization. Another common way of finding a buyer is by hiring a carefully screened associate with the understanding that he or she will work for a stated period of time as an employee and will then purchase the practice.

**Hiring a Broker or Appraiser**

Many sellers employ a business broker. There are brokers who specialize in the sale of medical practices.

The advantages of using a broker are many. A broker should be familiar with the medical practice marketplace and should be aware of potential buyers. Buyers of medical practices, especially those in rural areas, are not easy to find. A broker who is familiar with the market is better able to find buyers than is the seller. A broker may also help appraise the value of the business. As noted above, the value of a medical practice should be based on comparable sales. However, information about comparable sales of medical practices is not publicly available. A broker who has information about comparable sales can help establish a value and therefore an appropriate asking price. When a seller does not know the value of the practice, he or she may set the price too high or too low. If the price is too high, buyers will be deterred. If the price is set too low, the physician might save a broker’s fee and lose a larger amount in the sale price.

The disadvantage of hiring a broker is that the fee (which may be in the range of 7% to 10% of the sale price depending on the broker and the range of services) is paid by the seller.

**Due Diligence Review**

There is certain information which almost any buyer of a medical practice will want as a part of an evaluation of the practice. A potential buyer who is already an employee or an owner of the practice may have less interest in reviewing the information. Therefore, a sale to an “insider” should take less time and be less costly. On the other hand, a sale to a person who knows nothing about the practice will require more evaluation by the buyer.

The potential seller should begin at an early stage to assemble the information which a buyer will want so that the information is readily available when needed. The following is a list of the kind of information which would generally be requested as a part of a “due diligence” review by a potential buyer:

- A profit and loss statement of the practice for at least the last three years.
- Tax returns for the practice for at least the last three years. The tax return and the profit and loss statement may be the same document.
- Information about the nature of the practice and patients.
- Information about all employees such as names, positions, dates of hire, wage rates, licenses held, continuing education status of each, rates of pay and details about all benefits provided.
- Information about the city and neighborhood where the practice is located along with demographic information.
- Sources of potential growth.
- Information about the office space where the practice is conducted. If the office space is owned by the practice or by the owner of the practice, the buyer will want the same kind of information about the building that any real estate buyer would request. If the space is instead rented or leased, the buyer will want a copy of the lease or rental agreement. In addition, the buyer will want to know if the lease an be assigned and if the landlord will consent to the assignment.
- Information about the furniture, fixtures and equipment in the office including the medical equipment and office equipment. The buyer will want all available details such as date of purchase, brand name, condition, purchase price, book value, warranty status, and the like.
- Information about all practice management and billing software, office systems, policies and procedures.
- Information about billing, including Medicare, Medicaid and other third party payors.

**Letter of Intent**

A sale agreement for a medical practice may be long and complex. However, the main economic terms can usually be summarized briefly. Sometimes, buyers and sellers enter into a nonbinding letter of intent before they sign the sale agreement. The advantage of a letter of intent is to provide a clear understanding of the economic terms and have both parties agree on those terms even though the agreement is not legally binding. The letter of intent is helpful as long as neither side tries to include every single term in the letter.
of intent so that it takes on a life of its own. Sometimes the buyer and seller make a transaction public once a letter of intent is signed. Timing of a public announcement is critical. If a sale is announced to the staff and then fails, serious problems can occur with employees.

**Economic Terms of Sale**

The main economic terms of a sale agreement include the following:

- **Purchase Price.** Of course, the parties must agree upon a purchase price. The purchase price may be payable in cash at the closing or may be paid over time. There can be a tax advantage to a time payment arrangement. However, if the seller agrees to receive the purchase price over a period of time, the seller has the risk of nonpayment by the buyer. Usually, the seller wants to be paid in cash at the closing.

- **Financing.** The buyer can obtain financing through a bank or another lending source. As noted above, seller financing is an option although most sellers try to avoid it.

- **Transition.** It may be an attractive selling point to the buyer if the seller agrees to stay during a transition period to help the buyer with the patients and office procedure.

- **Noncompetition Agreement.** Sometimes the buyer wants the seller to agree not to engage in medical practice within a stated number of miles of the previous practice location (or locations) and for a stated number of years. Such an agreement is generally enforceable when entered into in connection with the sale of a practice. If the physician is retiring or moving out of the area, entering into a noncompetition agreement is not a major concession. One of the factors to be considered in connection with a noncompetition agreement is the portion of the purchase price which should be allocated to it. The amount allocated to the noncompetition agreement would be taxed as ordinary income. The gain on the sale of the practice would be taxed at long term capital gain rates as long as the practice was owned for over a year.

**Closing a Practice**

Unfortunately, there are times when the practice cannot be sold. This is particularly true in rural areas. The shortage of physicians is far more acute in rural areas. There are certain matters which need to be resolved when a practice is either sold or closed. These items are discussed below:

- **Sale or Donation of Equipment.** If the practice is to be closed rather than being sold, the practice would still have medical and office equipment which can be sold. Any equipment which cannot be sold may be donated to a charity. The physician may be able to receive a tax deduction for such a donation. The physician should consult with an accountant on this subject. The equipment may need to be appraised before it is donated.

- **Tail Coverage.** Most professional liability insurance is written on a “claims made” basis. This means that the insurance coverage is only good for claims which are made while the insurance is in effect. In order to have insurance coverage after medical professional liability coverage is terminated, the physician purchases an extended reporting endorsement or “tail” coverage. The tail policy simply extends the period of time during which a claim can be reported to the insurance carrier.

Before a practice is sold or closed, the physician should contact the agent or broker from which the medical malpractice policy was purchased. Usually, there is a limited period of time during which the physician must notify the insurance carrier that he or she wishes to purchase a tail policy.

The statute of limitations for medical malpractice claims in Missouri is two years. However, the two-year time period does not begin to run for services rendered to a minor until the minor turns age 18. Also, the two-year time period begins to run for failure to diagnose when the failure was discovered or should have been discovered. These general rules are subject to some limitations. Because of the exceptions to the two year general rule, claims can still be asserted against a physician (or his/her estate) many years after a practice is closed or sold. For this reason, the physician should try to buy the longest tail coverage available.

- **Notice to Patients.** If the practice is sold or closed, the physician should give a written notice to all patients. If the practice is sold, the notice to the patients is usually in the form of a letter which states that the practice has been sold with an identification of the buyer’s name and address and a statement that a copy of the patient’s record will be given to the buyer unless the patient directs the seller to deliver the record to a different physician on or before a certain date. One important purpose of the notice is to avoid a malpractice claim of “patient abandonment”. For a patient who is in an active stage of treatment, more than a written notice may be required. For more details on avoiding a claim of patient abandonment, the physician should consult with his or her attorney who is familiar with this subject.

- **Record Retention.** The physician who is selling or closing the practice should retain either the original
or a copy of the patient records. These will be needed to defend any claim which might be asserted and to comply with the law which requires each physician or his or her designee to keep medical records for seven years from the date of the last treatment. Section 334.097 RSMo Supp. 2010. If the physician relies on an agreement by the buyer to provide the record if needed, the buyer may not comply and the physician may be unable to defend a malpractice claim which is asserted against him or her.

BNDD and DEA. Most physicians are registered with both the Missouri Department of Health and Senior Services, Bureau of Narcotics and Dangerous Drugs (“BNDD”) and the United States Department of Justice Drug Enforcement Administration (“DEA”). The BNDD and DEA should both be notified prior to closing or selling the practice. If the practice is sold, the buyer will need to make a separate application to both BNDD and DEA.

BHA. If the physician retires, he or she has the option to file a retirement affidavit with the Missouri State Board of Registration for the Healing Arts (“BHA”). A retired physician must not engage in active practice or hold himself or herself out as being in active practice. 20 CSR 2150-2.125 (10). If the BHA requirements are satisfied, BHA may (at its discretion) waive the retired physician’s continuing education requirements. Section 334.075 RSMo 2000. There are procedures under which a retired physician can return to a full license status by complying with certain continuing education requirements. 20 CSR 2150-2.125 (11).

Estate Planning After the 2010 Tax Act

Once the medical practice is sold or closed, estate planning for the retired physician will change course and will involve the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (“2010 Tax Act”) that President Obama signed into law on December 17, 2010. In general, the 2010 Tax Act provides tax relief for gift, estate and generation-skipping transfer (“GST”) tax purposes by lowering tax rates and increasing exemptions. Key changes are as follows:

- **Increased Gift, Estate and GST Exemptions Through 2012**
  - Through 2012, the gift, estate and GST taxes are unified
    - $5 million exemption for each tax
    - Maximum 35% rate for each tax

- All tax rates and exemptions will “sunset” again after 2012
  - $1 million gift, estate and GST exemptions are currently scheduled to return in 2013
  - Maximum tax rate of 55% is currently scheduled to return in 2013

- **Portability of Estate Tax Exemption Through 2012**
  - Through 2012, a decedent’s unused estate tax exemption is “portable” to a surviving spouse.
  - In other words, if an election is made on a timely filed estate tax return, a decedent’s unused exemption amount can be used by a surviving spouse for gift and estate tax purposes through 2012. Hopefully, Congress will continue portability after 2012.

- A decedent’s unused GST tax exemption is not “portable” to a surviving spouse.

- **Changes enacted by the 2010 Tax Act are summarized as follows:**

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1 This amount will be indexed for inflation.
2 The GST Exemption is currently adjusted for inflation. The $2.2 million amount is a rough estimate.
3 The capital gains rate for collectibles and certain depreciable property is higher.

The 2010 Tax Act provides significant planning opportunities only through 2012. If possible, those planning opportunities should not be wasted.

Planning Through 2012

When Congress enacted the 2010 Tax Act, it did not eliminate or modify any planning techniques that were available before that Act. Thus, estate planning “as usual” is available at least through 2012. Planning techniques that are still applicable include the following:

- Tax-efficient revocable trusts that establish trusts for holding assets exempt from estate and GST taxes;
- Family limited partnerships and LLCs for gifting and valuation discount purposes;
- Irrevocable life insurance trusts (ILITs) for paying death taxes or funding bequests;
- Irrevocable “split interest” trusts for charitable and non-charitable purposes, such as Grantor
Retained Annuity Trusts (GRATs), Grantor Retained Unitrusts (GRUTs), Charitable Remainder Annuity Trusts (CRATs), Charitable Remainder Unitrusts (“CRUTs”), Charitable Lead Annuity Trusts (CLATs) and Charitable Lead Unitrusts (CLUTs). All of these trusts provide are “split interest” trusts because they establish interests that the creator of the trust retains and gives away. These planning vehicles are useful because the interest given away is either reduced in value for tax purposes or is deductible for tax purposes. Trusts benefited by the current low interest rate environment are GRATs and CLATs.

- Irrevocable trusts where the creator of the trust is taxed on all trust income to enhance the benefit provided by the trust to family members. These trusts are often called “grantor trusts” or IDITs. The creator of these trusts either gives or sells assets to these trusts and pays income tax on the income generated by these trusts. Under current tax law, such tax payments do not result in an additional gift.

Giving assets to one or more irrevocable trusts to use up part or all of the $5 million gift tax exemption should be considered. For example, a physician who is married should consider having each spouse create a trust for the other spouse that uses part or all of each spouse’s $5 million exemption. The trusts are drafted in such a manner to prevent reciprocal trust treatment for tax purposes. The trusts benefit the marital unit without being included in either spouse’s estate for estate tax purposes.

Selling assets to one or more irrevocable trusts can also rely upon the $5 million gift tax exemption should the IRS contend that a gift occurred because the assets were sold at less than fair market value. For example, a physician could sell assets to a trust established for the benefit of the physician’s descendants. The transaction would be structured to allow future asset appreciation to remain in trust for the benefit of the physician’s descendants. Despite best efforts to sell assets for fair market value, the IRS might claim otherwise, thereby resulting in the use of part or all of the physician’s $5 million exemption against any gift element of that transaction.

Whether one or more of these tools should be used will depend on the physician’s estate planning goals and belief as to whether Congress is likely to make the gift, estate and GST taxes more onerous after 2012. For example, Congress has considered whether to require GRATs to exist for a minimum of 10 years because of the IRS’ dislike of beneficial short-term GRATs. Most GRATs today are created for only a two or three year period.

Physicians should consider obtaining a design proposal first that analyzes various planning techniques and provides the physician with a choice on techniques to use. These proposals usually include memoranda, schedules and computations that enable the physician to make an informed decision about which planning tools to use.

Planning for All Estates

Physicians still need estate planning even though the federal estate tax may not apply to their estates. A physician needs core estate planning documents such as wills, durable powers of attorney for financial and health care purposes, revocable trusts and possibly asset protection irrevocable trusts. Some of the reasons to use those documents are as follows:

- A durable power of attorney for financial purposes is needed for incapacity planning. It designates an agent to make important financial decisions when the physician is unable to make those decisions. This type of durable power of attorney can eliminate probate court appointment of a conservator.
- A durable power of attorney for health care purposes designates individuals who will make important health care and mental health treatment decisions should the physician become incapacitated. This type of durable power of attorney can eliminate probate court appointment of a guardian.
- A will is important because it is often the primary document for directing how state death taxes, debts and last illness expenses are to be paid and it often directs how tangible personal property is to be divided.
- A revocable trust is needed for various reasons, some of which are as follows:
  - It is used in conjunction with a durable power of attorney for incapacity planning and probate avoidance.
  - It is often used to protect assets from the creditors of a beneficiary (other than the physician if the physician created the trust) and replaces outright transfers of assets;
  - It is often used to prevent the surviving spouse of a second marriage from disinheriting the descendants of the physician’s prior marriage;
It is often used to encourage distributions that preserve family values and incentivize beneficiaries to become or remain productive members of society. Various types of incentive provisions exist and cover subjects such as education, full-time employment, commencement or maintenance of a business, and distribution restrictions if a beneficiary engages in substance abuse.

It is often used to hold the amount that is exempt from federal estate tax so that it is not included in the estate of a beneficiary should the beneficiary’s estate increase in size so that it becomes subject to federal gift or estate tax.

It is often used to create perpetual trusts for the benefit of grandchildren and lower generations that are not subject to estate or GST taxes as a result of the allocation of the physician’s GST exemption to those trusts. Remember, the new “portability” feature under the 2010 Tax Act only applies to the estate tax exemption, not the GST exemption. Thus, a decedent’s surviving spouse cannot use the decedent’s unused GST exemption. By implementing perpetual generation-skipping trusts upon a decedent’s death, the decedent’s GST exemption is not wasted.

It is often used to create a trust that is exempt from state death taxes. Many states have estate or inheritance tax exemptions of $2 million or less, so a trust established to use that exemption can save state death taxes the rates of which are as high as 16 percent. By implementing such trusts upon a decedent’s death, the decedent’s state death tax exemption is not wasted.

An irrevocable trust can be established under a specific Missouri statute for the benefit of the physician and other individuals that will insulate trust assets from the physician’s creditors if certain procedures are followed. Such trusts are useful if the physician’s malpractice “tail” coverage is short term.

Summary

Retiring physicians have much to think about for estate planning purposes. The authors stand ready to help physicians sell or close their medical practice, navigate the 2010 Tax Act, take advantage of current planning opportunities, and prepare appropriate estate planning documents. Every estate is unique, so it is important to contact an estate planning advisor before taking any action.

References

1. If the practice (or its physicians) participates in Medicare, Medicaid or any other federal healthcare program, and if the seller will be in a position to make referrals of patients after the sale, an appropriate evaluation of the assets is critical. Under these conditions, if the practice is sold for any more than fair market value, the excess over fair market value may be interpreted to be a payment in return for post-closing referrals in violation of the Anti-Kickback Law. Violation of the Anti-Kickback Law is a felony. If these conditions apply, the physician should hire an attorney with experience in fraud and abuse matters at the outset of the transaction.

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