

The Importance of a Buy/Sell Agreement

All group practices should strongly consider having a buy/sell agreement. Typically, a buy/sell agreement states that a physician's ownership interest in the practice cannot be sold to someone outside the practice without the approval of the other members of the practice. The other physicians in the practice have the option of buying the ownership interest at a price an outside party would be willing to pay.

A buy/sell agreement helps ensure that an owner-physician (or the physician's beneficiaries) will receive fair compensation for his or her ownership interest. The agreement also facilitates an orderly transfer of ownership and management. A buy/sell agreement can be drafted among shareholders of a corporation, partners of a partnership or an LLC, or even between an owner and a key employee.

Advantages

A carefully structured buy/sell agreement can:

- Help provide a smooth transition of control, management, and ownership to those who wish to continue operating the practice.
- Spell out the financial aspects of the transition.
- Establish a fair and reasonable price. (Most practices utilize predetermined formulas for valuation purposes. This allows physicians to plan for their eventual retirement or for a sale of their interest in the practice in advance of any actual retirement or sale occurring.)
- Help ensure the financial security of a deceased physician's family and other beneficiaries.
- Create a built-in buyer for a physician's interest.
- Establish, under certain circumstances, an estate-tax value for the stock.

Two Basic Types

There are two basic types of buy/sell agreements -- cross purchase and entity purchase (stock redemption). With a cross purchase agreement, the remaining owners agree to buy the departing owner's interest in the practice individually. With an entity purchase agreement, the practice itself agrees to buy the selling physician's ownership interest.

Funding

How purchases under a buy/sell agreement will be funded is a critical issue. A common approach uses life and disability insurance policies as the funding vehicles.

However, this can be a complicated arrangement if there are more than two owners since multiple insurance policies would be required.

Where life insurance is used to fund a cross purchase agreement, the physicians must be willing and able to pay the appropriate premiums. Younger physicians may be put at a significant disadvantage because premium costs to insure older physicians are generally higher. Inequities usually can be resolved by making appropriate salary adjustments.

A practice could fund the share purchase by borrowing money from a financial institution, from the selling practitioner, or from the estate of the deceased practitioner at the time funding is needed. The drawback of this approach is that it increases the practice's debt burden and imposes interest charges on the practice for the life of the debt. A third approach uses cash accumulated by the practice to purchase shares from the selling physician.

Other Matters

Tax issues should be considered when making decisions regarding the most appropriate type of buy/sell agreement for a practice. If a practice already has a buy/sell agreement in place, it's important to periodically revisit the document to make sure it is still appropriate for the practice's situation.