JKY's Physician Newsletter

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Buy-Sell Agreements: Providing the Security for Your Medical Practice and Family Members

Ever wonder who would take over your practice if you died or became disabled? How would your death or disability affect the remaining partners of your practice? How about if one of your partner dies or becomes disabled, how is their interest to be handled? The actual consequences of these issues can cause a severe derailment to your business if you're not properly prepared. To ensure protection from unforeseen events, it is always recommended for you and your partners to have a properly drafted buy-sell agreement in place.

Anytime you have a practice with more than one partner, implementing a buy-sell agreement becomes imperative. It allows each partner to understand the transition plan necessary if a partner dies, retires or becomes disabled; and what steps or procedures the remaining partners need to take to buy-out the outgoing partner's share. In other words, a buy-sell agreement is a legally drafted agreement between the partners of the practice ensuring that the other partners have the ability and resources to purchase the shares/ownership interest of a practice if a partner dies, retires, or becomes disabled.

In such a situation, it becomes far simpler and less costly for the partners to simply adhere to the already existing agreement, as opposed to beginning the negotiation process with the outgoing partner or their heirs. Although the terms of an actual buy-sell agreement vary depending on the specific practice and the dynamics of it, more or less, the overall concept remains the same. The essential purpose or goal to be served is having the structure in place to cover three major trigger events: (a) Death; (b) Disability; and (c) Retirement.

Below is a simple illustration on how a buy-sell agreement would function in a real-life scenario:

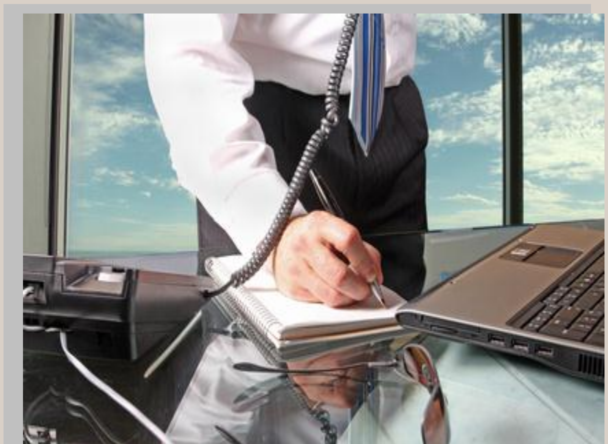
Dr. X, Dr. Y, and Dr. Z start a medical practice with each having equal ownership interest in the practice (33% each), as well contributing equally in terms of patient productivity. Dr. X hears about the importance of a buy-sell agreement and decides to have it implemented in their practice.

The steps they took included:

1. **Appraising the Practice:** This can be accomplished in one of two ways: (a) Asking an appraiser to come in and conduct an actual appraisal of the practice; (b) reviewing the previous financial documents and placing a value on the practice using the prior figures generated. The purpose of this step is to know how much each share is worth.

2. **Drafting a Buy-Sell Agreement:** This step would involve the services of an attorney experienced in working with physicians and drafting such agreements.

3. **Funding the Buy-Sell Agreement:** The simplest approach to funding a buy-sell agreement is for each partner taking out a life and disability insurance policy on each other. Therefore, in the event a partner dies or becomes disabled, the remaining partners would be relieved to know they already have a structure in place allowing them to receive the life or disability benefit in order to have the funds to purchase the outgoing partner's ownership interest. To ensure the policy limit remains reasonable and stays in-line with the true value of the practice, it is advised to update the valuation of the practice annually to make sure any changes in the policy limit becomes adjusted at the time.



After a few successful years of practicing, Dr. Y suffers an unexpected stroke and dies. Knowing that Dr. Y's contribution to the practice was instrumental in their success, the surviving partners are left knowing that a third of their practice's income has disappeared. In addition, Dr. Y's family is going through their own personal distress, since Dr. Y left behind a wife and two minor kids.

However, to help alleviate these issues and concerns, the surviving physicians referred to their buy-sell agreement. The life insurance policies that was initially taken out when funding the agreement allowed Dr. X and Dr. Z to receive a large lump-sum, which was used to buy-out Dr. Y's ownership interest of the practice. That amount used to buy-out was paid to Dr. Y's Revocable Living Trust, which then in turn listed out the instructions for Dr. Y's beneficiaries. Thus, resulting in having Dr. X and Dr.

"An ounce of prevention is worth a pound of cure."

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Z as joint partners of the practice and just as importantly, ensuring Dr. Y's family has the financial capability to move forward with their lives.

The above scenario is one that has occurred in many people's lives, however unfortunately the plan was not always in place. With simple planning, the surviving partners and Dr. Y's family avoided the unnecessary and sometimes unpleasant task of negotiating. It also demonstrated the importance of how buy-sell agreements can play a crucial role in securing your practice's future. Most importantly it allowed for the partners and their family members to be protected.

Planning for the unexpected is always difficult, but rather than waiting for that unexpected, tragic event to occur and then figuring out solutions, be a step ahead and bring ease to your partners and their heirs by implementing a sound buy-sell agreement.

DEDICATED. DETERMINED. DEPENDABLE.