Practice Structures

Information provided by MAS (Medical Assurance Society)

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INTRODUCTION TO PRACTICE STRUCTURES

Currently we see three main group practice structures in medical practice:

- Cost-sharing (group practice) arrangements
- Partnerships
- Company Structures, being either Service (cost-share) or Trading (profit-share) companies

If you are purchasing into an existing group practice then the structure of this practice will be some form of associateship, partnership or company entity. At a personal (individual) level you need obtain specialist professional advice as to the most suitable structure for you to operate your practice from.

The following is a brief description of the different types of practice/business structures:

Sole trader

A self-employed sole trader is the simplest 'entity' for a private practitioner. A sole trader is personally liable for all debts and liabilities (and conversely benefits from all equity and assets) in respect of the practice.

As a sole trader you are required to make provisional taxation payments and complete an annual return, as well as personally register for GST, (if income exceeds the threshold of $60,000 per annum), and complete returns. There are no specific costs or legislation associated with being a sole trader.

Partnership

If you are to join a 'group practice' it may be that you are required to join a partnership. A partnership generally involves a profit sharing arrangement between partners.

The principles of partnership law are provided for under the Partnership Act 1908. Partners are jointly and severally liable for the debts and liabilities of each other. Exit and entry of partners is cumbersome, with the dissolution and formation of a new partnership required. There are no specific costs to form a partnership, and the partnership can enter into an employment contract with the practitioner to obtain PAYE employee status.

Associateship or Cost Sharing Group Practice
This arrangement generally started with independent practitioners coming together in part to save costs. It is a cost-sharing arrangement between individual practitioners/practices to achieve economies of scale, ease administration and reduce some of the heavy workloads of medical practice. It is not a legal entity but is able to operate a bank account and register for GST.

Although practitioners retain their independence, this arrangement could be seen as a partnership in some instances. This can have the effect of making practitioners 'jointly and severally' liable for the breaches by others in the associateship. This may be the case, despite arrangements in practice agreements to the contrary. It is important nevertheless that responsibilities and roles of practitioners are formalised in a practice agreement.

Company
A company is a separate legal entity and is regulated by the Companies Act 1993. The shareholders (owners) of a company are only liable to the extent of their shareholding in the company (limited liability).

Forming a company for your practice offers:

- Name protection
- Limited liability, although in most cases personal guarantees will be required for leases, company borrowings etc, and claims by patients and others with respect to your professional competence or skill will still fall on you personally
- The ability to hold surpluses in the company outside personal ownership, and some income splitting
- Ease of business transfer by sale and purchase of shares
- A proven framework to operate a business is provided by the Companies Act 1993

The Companies Act does impose duties on directors, who can be held personally liable (unlimited personal liability) for breaches relating to these duties. There are set up and compliance costs associated with trading as a company but these are not significant.

In group medical practice, at the practice level, we tend to find two different types of company structures –

- A 'service company' structure that involves a company set up between independent practitioners/practices to provide services and share costs, or
- A 'trading company' structure that owns all the group practice assets and goodwill with working owners (or their entities) having a shareholding in the company.

In all instances, it is important to have practice (shareholders) agreements in place. For more information on these different company structures, or on practice agreements, please contact the MAS Business Advisory team at business@mas.co.nz or phone 0800 800 627.

General
In recent years medical practitioners have been allowed to work through company structures, and it is now more common to have a range of entities at the practice and personal level. The right mix of structures can provide suitable asset protection, be tax effective and maximise income, whilst minimising compliance issues and costs.

The following looks at the different group practice entities in a bit more detail:

Partnership

Nature A 'partnership' practice would usually exist when practitioners carry out the practice business in common with a view of profit. Generally a partnership would have some form of profit sharing but some group practice cost-sharing arrangements could be deemed to be partnerships.

The main principles of partnership law are codified under the Partnership Act 1908. Most formal partnerships would have a partnership agreement setting out such details as how accounts are kept, profit sharing arrangements, what occurs in the event of death/expulsion of a partner or sale of a practice, any restraint of trade covenants, how disputes are resolved etc.

Costs Minimal set-up and maintenance costs, which are dependant on the nature of the partnership agreement and amendments thereto.

Taxation GST registration required when taxable activity exceeds the threshold level ($60,000 in 2014 tax year), but one GST number will suffice for a partnership

Each practitioner earns actual income (profit) distributed, and is taxed according to their individual status.

Transfer Entry and exit of partners to the practice is cumbersome, with the dissolution and formation of a new partnership required. Contracts for practice borrowings, leases etc. often have to be amended or cancelled and new contracts arranged, to bind new partners and release outgoing partners from their responsibilities under the contracts.

Liabilities Partners are jointly and severally liable for the liabilities of partners in connection with partnership and in some instances their liability could extend beyond the area of partnership business. Both partnership and individually owned assets are vulnerable to creditor claims against partners.

Borrowings All borrowings are contracted in individual practitioner names as no legal entity exists as such.

Popularity Although many practices operate under a non-entity type arrangement that could be seen in some circumstances as a partnership, there are now fewer practices that operate as a formal profit sharing partnership status. Most partnerships were formed prior to the ability of medical practitioners to operate under a company structure, and as such they are probably less common in new practice structures.

Associateship or Cost Sharing Group

Nature A 'group practice' is where practitioners operate together without a separate legal entity involved. Three doctors working in the same premises and trading as 'ABC Medical Centre' would be an 'associateship' group practice if there was no company, trading trust or formal partnership involved. The most popular form of group practice structure is where practitioners agree on a way of sharing costs to their mutual benefit rather than on a system of dividing up income with other entities. There are many variations to the basis of cost sharing including:

- a equal percentage split between practitioners
- a percentage split proportional to income earned/hours worked per practitioner
- a pro-rata split based on the staffing and administration utilisation of each practitioner.

Costs Low set-up and maintenance costs that are dependant on the nature of any practice agreement and group practice arrangements.

Taxation GST registration required when taxable activity exceeds the threshold level ($60,000 in the 2014 tax year), but one GST number will suffice for a group practice. Each practitioner earns actual income generated and is taxed according to their individual status - agreement on allocation of costs only required.

Transfer Transfer of ownership can be messy - it depends on the practice agreement and ownership of practice assets. Some assets can be owned jointly and others by individual practitioners. Contracts for practice borrowings, leases etc. often have to be cancelled and new contracts completed.

Liabilities Practice assets are vulnerable to creditor claims as can be all individual practitioner assets when all practitioners are defendants. If trading as a 'non-entity' the practice could be deemed to be a partnership. In this situation then all practitioners that make up the 'practice' could be held to be personally liable for the actions of one practitioner or staff member.

Borrowings All borrowings are contracted in all the individual practitioner's names as there is no legal entity to lend to.

Popularity Still a popular 'structure' for medical practices - most evolved from sole practitioners that joined together to share costs, prior to the ability to operate the medical practice through a company structure.

Company

Nature A company is a separate legal entity and directors/shareholders are only liable to the extent of the company's paid up shares, subject to any breaches of director's duties etc.

Companies are regulated by the Companies Act 1993 and to the extent that it does not contravene the Act or its own constitution. A company is managed by the elected directors, who must act in the best interest of the company. The Companies Act imposes duties on directors.

Costs There are set up and compliance costs associated with trading as a company. Initial set up costs would depend on the complexity of the company structure and the nature of any shareholder agreements etc., but direct annual compliance costs are not be significantly more than alternative structures.

Transfer Transfer of ownership with a company structure is simple and inexpensive and effected by transfer of shares.

Liabilities As a company is a separate legal entity it can contract in its own name without recourse to the shareholders, who are provided with limited liability protection unless personal guarantees are provided.

Taxation Profits are subject to company tax at a current rate of 28 per cent (2014 tax year) and profits paid to shareholders by way of dividends have imputation credits. GST registration is required when a company is carrying out a taxable activity that exceeds the threshold level, currently $60,000 per annum in the 2014 tax year.

Borrowing The Company has the ability to allow a 'registered general security' to a prospective lender. This is a floating charge over all the assets of the company, including such items as debtors and medical supplies.

Popularity Many practices, both individuals and groups now operate through a company structure.

In respect of a group practice companies are typically formed for one or more of the following reasons:
1. For asset ownership
2. For business ownership (trading company)
3. To provide services to independent practice owners (service company).

Service Company

- Generally owns the group practice fixed assets (practice 'goodwill' is owned by individual shareholder Drs or their entities).
- Employs all group practice staff (not principal Drs).
- Provides services (except principal medical services) and holds group practice contracts.

- Does not 'own' principal income streams but levies principals (or their entities) with costs on agreed basis.
- Value of shares often limited to the market value of the fixed assets as any 'goodwill' only relates to the management structures, leases held etc., not the patient income streams.

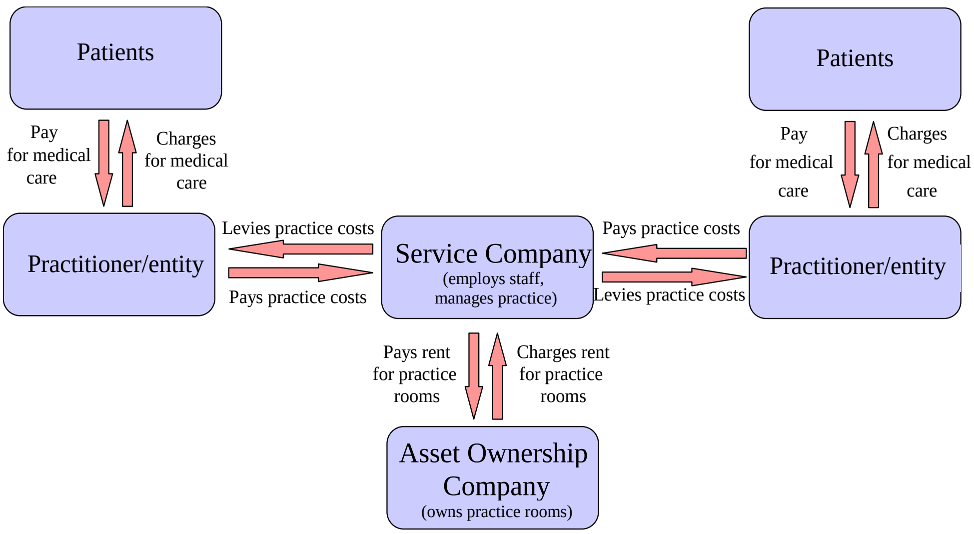
Advantages

1. Liabilities limited to individual practitioner or practitioner entity, (professional, general, etc), directors and company assets – partnership or cost sharing alternatives could mean all 'partner/partner entities' liable.
2. Most business arrangements are contracted in company name.
3. Owns practice assets (separate company or entity often owns major assets such as medical rooms to protect against creditor claims).
4. Allows independence of doctor to produce own income streams and have own practice goodwill, subject to shareholders agreement terms.
5. Individual doctors able to practice as any 'entity' structure.

Disadvantages

1. Problems assessing value of individual practice or company goodwill factors – what value relates to the management structures, leases etc as opposed to the 'patient base'.
2. Company has limited 'control' over the operation of the individual practices. No single corporate practicing 'model' and financial incentives are at individual practitioner level first rather than at the group practice level.
3. Capitation based funding has made equitable financial arrangements more complex.
4. Lack of control by company over sale or transfer of patient base by practitioner. This needs to be detailed in the shareholders agreement.

Service Company Structure



<u>Trading Company</u>

- The company generally owns all the fixed assets and the goodwill associated with the total group practice patient base as well as the management structures, leases etc.
- Principals (or their entities) own shares in the company generally in relation to their investment into the company.
- The company employs or 'contracts' with the principals (or their entities).

Advantages

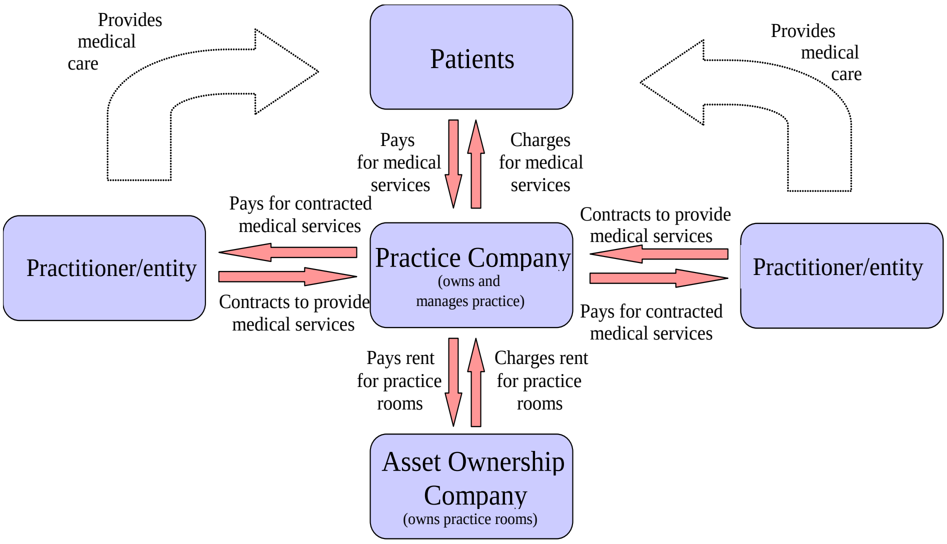
1. Company has total 'ownership' and more ability to manage group practice standards with a clear governance and management structure.
2. All contracts are held through the company.
3. Better group branding with enrolment and success 'incentives' at company level rather than individual practice/practitioner level.
4. Financial risk (and return) held at the group company level.
5. Ease of entry/exit for practitioner with sale of shares (agreed process by way of the shareholders agreement)
6. Able to distribute to principals and shareholders in a number of ways including:
    - clinical remuneration (employment or contract for services)
    - directors fees
    - dividends to shareholders

Disadvantages

1. Doctor loses direct 'ownership'/control of patients – control is through shareholding and/or directorship (shareholders agreement) and employment or contract for services arrangements.
2. The personal services attribution rules may apply to individual principals working through personal entities – discuss this with you professional taxation advisers.
3. Trading under a single business model often requires a significant mindset change for those that have been operating independent practices previously.

See next page for Trading Company structure diagram.

Trading Company Structure



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