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Case Studies: Scenarios Nos. 1, 2 & 3

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Scenario No. 1

The owners of three of the larger cardiology practices in the Northern Virginia area have decided to partially integrate in order to achieve economies of scale and to increase their market power in the face of increased vertical integration of third-party payors with primary care physicians, acute care hospitals and other subspecialists in the region. One of the groups is a partnership with four partner-physicians. Another is an S corporation with six shareholder-physicians. The third group is a C corporation with ten physician-shareholders. The groups propose to form a P.L.L.C. to be owned by the three groups. They are uncertain as to whether the affiliation will work out. Therefore, they wish to facilitate a break up and do not wish to completely integrate. They discussed that the three groups would retain their furniture, fixtures, equipment and other fixed assets and lease same to the P.L.L.C. While they propose that all revenues will be billed and collected by the P.L.L.C., existing receivables will be collected by the three groups and distributed to their respective physician-shareholders as bonuses. They propose that direct expenses, other than compensation to physician-shareholders of the groups, will be paid by the P.L.L.C. and most other expenses and salaries and bonuses to physician-shareholders will be paid by each group.

The three groups have advised you that they contemplate full integration in three to five years. Therefore, they need flexibility in the short-term. However, they are also concerned whether they will recognize built-in gains tax upon the partial or complete integration, whether the resulting entity or entities will be able to continue to use the cash method of accounting, whether the resulting entities will be able to bill for all charges to third-party payors including Medicare and Medicaid, what should be done with the groups' existing retirement plans and what other significant tax, legal and accounting issues must be addressed.

Scenario No. 2

Assume the same facts as Scenario 1 except that the three groups wish to fully integrate at the first closing.

Scenario No. 3

Mr. and Mrs. Jones own, through a general partnership between the two of them, "Discount Pottery Barn", a group of five retail outlets which sell various products to the general public. Because of the concept, the products sold and the Jones' merchandising flair, the outlets are very successful. Revenues and profitability in the partnership have dramatically increased every year in its 8 year existence.

At the urging of the Jones' accountant and banker, they have developed a 5-year business plan and are negotiating for the purchase of 6 additional outlets from a third party. While they can finance the purchase from savings and conventional bank financing, they recognize that they may need venture capital or other equity financing within 2-3 years to accomplish their business plan. On a longer term basis, they believe that some day their enterprise may be a candidate for a public offering to finance continued growth, to curtail indebtedness or to allow them to take a large amount of cash out of the enterprise. They also realize that for various reasons, they might sell the enterprise or its assets before going public.

You are one of the advisors they are consulting. Please advise them as to the structure of an organization that would enable them to retain flow through tax treatment as long as possible, while protecting their personal assets from the risk of the enterprise and maximizing the ability for the enterprise to be sold some day with only one level of tax or taken public.

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