HOW DIVORCE COULD AFFECT YOUR MEDICAL PRACTICE

Monica Kaden
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Introduction

Divorce is not a pretty word in any context. It can create scars that last a lifetime and have a ripple effect on children, relatives, friends, and, if you own your medical practice, even your employees.

We asked experts to walk us through what could happen to a medical practice during a physician's divorce proceedings. While other issues during this difficult time are surely important (kids, retirement assets, home equity, etc.), our aim in this article is to focus on the things that will affect how a doctor will continue to earn a living.

Determining Where You're Vulnerable

Whether or not your practice value is up for grabs will differ depending on where you live. Unless your practice is considered marital property in a common law or community property state, your practice may not even be on the table for discussion.

If you already had the practice when you married and you didn't put it in your spouse's name, it's typically considered a nonmarital asset. If, however, you began in your practice while you were married, a divorcing doctor will retain varying percentages of the practice's value, depending on the factors surrounding the marriage and the situation.

If you live in 1 of the 9 “community property” states (including California and Texas) that generally require a straight 50-50 split of assets accumulated during the marriage, the value of the practice itself or the increase in the practice's value since the marriage are amounts that will be contested and disputed during a divorce.

“There’s no set percentage as far as how much the physician retains of the value of the practice; if the marriage began while a person was in medical school, the spouse has a much greater claim than if the person married at an older age and had an already-established practice,” says David J. Schiller, Esq., tax attorney in Norristown, Pennsylvania. “Key factors are the duration of the marriage and the stage of the marriage at the time of divorce.”

It sounds logical, but it can get tricky. Your spouse’s lawyer will argue that a devoted spouse -- one who gave up a potentially promising career to further the physician’s aspirations or who worked in the office part-time at reduced pay or without pay -- is entitled to a larger share of the pie. And a judge may agree, increasing the spouse's share of the property to be divided or alimony entitlement.

New Jersey, for instance, allows for several types of alimony, including "reimbursement alimony," says Barbara L. Feinberg, a family law attorney in Rockaway, New Jersey. “Reimbursement alimony,” she explains, “can be awarded if the non-doctor spouse helps put his or her partner through medical school then divorces before being able to enjoy a better lifestyle—or, as the law says, the 'fruits of the earning capacity' associated with the medical degree.”

What Gets Divided, and How?

A few states, including New York, have formulas to determine what such “intellectual property” -- in this case, a medical degree -- might be worth in a divorce settlement. But many experts, including quite a few in New York, say the law has gone too far because it forces professionals like doctors and lawyers to give up money they haven’t earned yet. They'd like to see this part of the law abolished. And it may yet happen.ï

What happens in cases where both spouses are physicians? Does the division of medical practice assets trend closer to 50-50 even if they don't live in a community property state?

The situations would differ depending on whether the divorcing physicians are in private practice or are employed and on the amounts of their relative incomes. Being partners in a private practice changes the situation.

The division of medical practice assets would generally be close to 50-50 if the couple started the practice together or became partners in it around the same time, says Sparta, New Jersey, attorney Jacqueline M. O'Donnell, a principal
with O'Donnell & Dumbroff. She adds that the couple can avoid splitting up this shared asset if they simply agree to continue working together after the divorce, admittedly a rare scenario.

"If that's not likely to happen," she says, "one of the doctors will have to be compensated for that portion of the practice that's deemed to be marital property. The same would apply to a doctor who works as a salaried physician in another practice: He or she would be entitled to a share of the equity in the spouse's practice."

**What Happens to Your Office?**

The goal of divorce proceedings isn't to break up your office but to value it accurately so that the spouse can get an appropriate financial value of his/her share.

"Usually the claim is against the value of the practice, not the practice itself," says Schiller. "The spouse is not interested in getting a portion of the practice but in getting a compensatory amount; the spouse is not getting a part of the business, like an owner selling an NFL team. All we're really talking about is money in terms of a buyout."

Any real estate that you own will have to be appraised separately from the practice assets. While the office's value is considered fair game in a divorce (minus any outstanding mortgage and other building-related debts), it's not something that comes under the umbrella of the typical practice assessment.

"The building is considered a 'non-operating' asset," says Monica Kaden, MBA, a healthcare entities valuations expert and senior appraiser with Fischer Barr & Wissinger in Parsippany, New Jersey. To put a fair value on it, you'll need a real estate appraiser with experience in commercial properties -- preferably someone with experience in medical real estate, which often can't be easily reconfigured for other uses. To find a pro in your area, start with the Appraisal Institute (www.appraisalinstitute.org; click on "Find an Appraiser."

"You might also need to consider whether there's rental income being paid by the practice, other tenants, or both," says attorney Barbara Feinberg. "That'll have to be factored in as well."

What if you're divorcing and don't want to relocate your practice? You don't necessarily have to sell and move, but the court will expect you to compensate your spouse for a portion of your equity in the building. There are a number of ways you can do this. For instance, you could sell your portion of the building to your partners and rent space back from them -- and then compensate your ex based on the money you received for your portion of the building.

A commercial properties expert can help you establish a fair monthly rent. "There's no actual transaction," Kaden explains. "It's just to get a number for the couple to work with." There may be other possible arrangements permitted under the laws in your state, so ask your attorney. But whatever you decide, both parties to the divorce must agree to it in writing.

**How Your Partners and Employees Could Be Affected**

The practice valuation process could in some cases create fear for your partners (or yourself). It's not unheard of that in some practices, some cash payments are not reported, and the physician is actually earning more than he or she is reporting.

"If there is a belief that there is fraud occurring in the practice, and there is unreported income, this could create a blackmail scenario," says Schiller. "If a doctor says he's making $150,000, but the spouse says, 'I know you're really making much more,' through the discovery process, the accountant may go through the books and uncover this." There have indeed been cases where financial fraud was uncovered during the discovery process, says Schiller.

Your staff might feel the sting, too. Word of an impending divorce is bound to make your employees nervous. They may fear the practice will have to close, move, or be absorbed by another practice, making some of their jobs redundant and possibly ripe for the chopping block.
As such, you may have to exercise some damage control if word of your split comes out. If you live in a small community and there’s a nasty, drawn-out battle, your reputation may suffer, and, by extension, your practice may suffer as well. And, unless you practice solo, there will be your partners to consider: The mud-slinging could affect the flow of patients, especially via referrals, and even the ability to recruit new physicians and ancillary providers.

**Getting an Accurate Assessment**

To divide the value of your medical practice fairly, you’ll need to get an accurate appraisal that takes into account the accounts receivable and the physical assets of the practice (diagnostic equipment, supplies, computer hardware and software, capital improvements, furniture, and the like) as well as any intangible assets, such as goodwill, office location, payer mix and type of contracts, or the skills and experience of your employees.

“Goodwill has both a professional component -- the doctor's ability to generate referrals, for instance -- and a practice component, which would include things like the quality of the workforce, the electronic medical records system, or the number of patient charts,” says Kaden.

Even the phone number can be included among the intangible assets, Kaden says. To determine this, you’ll need a professional, someone with experience in assessing the value of businesses and medical practices specifically. The appraiser will examine the income the practice has generated over the past 3-5 years and factor in any “add backs,” for the purposes of determining the doctor’s support obligation. These would include perks that may have been paid through the practice, such as health insurance, auto expenses, and club memberships. If you’re in a solo or small practice, expect to pay between $6000 and $8000 for an appraisal and written report of this depth.

Adds Schiller, "For a solo practice, courts are increasingly saying that there is no good will." All of the positive benefit of the practice resides with the practice owner, and if he leaves, there is no remaining good will.

In order to value the practice fairly, it’s important to get the right expert and for both parties to trust this person. A good place to start is with the National Association of Certified Valuators and Analysts (800-677-2009; www.nacva.com) or the American Society of Appraisers (800-272-8258; www.appraisers.org).

Does each spouse need his or her own valuation? "I've seen couples who started with one expert, then one or the other questioned the fairness of the assessment, and they each wound up going out and hiring their own expert," says Kaden. "It's much more harmonious -- and a lot cheaper -- for the doctor and spouse to agree to use one person. It makes it very difficult for the parties to settle if they wind up with 2 separate appraisals that are far afield from each other."

**Conclusion**

There are plenty of practice issues to address in a divorce. It's often difficult to know in advance where the sore points will be, but there will surely be a few.

Mediation is an option for some couples, says O'Donnell. She has seen it work successfully for some doctors; sometimes, it's used to divvy up the value of a medical practice and sometimes it's used for custody and other "noneconomic" issues. "However, if the couple can't agree on the value of the practice, or at least settle on a value range, mediation is going to be a challenge," O'Donnell warns.

To borrow an old saying, an ounce of prevention is worth a pound of cure. If you're considering -- or are currently in -- a serious relationship, check out Medscape's article, Doctors and Marriage: Should You Have a Prenup?
Contact Monica Kaden:
Phone: (973) 267-1400
mkaden@markspaneth.com

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