Consider YOUR options

So, you are ready to take the plunge and buy a pharmacy. The purchasing process can be exciting and exhilarating, yet at times challenging and confusing. A key component in streamlining the process is determining whether to buy the business's assets or the common stock, and why. As a buyer, you need to know the advantages, disadvantages, and tax strategies available for both types of purchases. Knowing which method is best for you is the first step toward a successful acquisition.

ASSET PURCHASE

Buying a pharmacy's assets is the most common method. When purchasing assets, the buyer creates a new entity and purchases certain assets of the selling pharmacy. For

The pros and cons of asset and stock pharmacy purchases

by Scott Sykes

example, a buyer may only choose to acquire the inventory, certain fixed assets, and goodwill/prescription files of the selling pharmacy. The buyer will need to establish the proper business structure and entity and obtain new federal identification numbers, a state license, Drug Enforcement Agency registration, National Provider Identifier numeric identifier, National Council for Prescription Drug Programs identifier, third-party contracts with various insurance carriers, and possibly other identifiers and regulatory approvals. This “start-up” process can take many months and working with an experienced health care legal specialist and experienced pharmacy certified public accountant is a critical step. Any missteps in this process can delay the pharmacy’s opening or even impede your ability to collect reimbursements from third parties.

An asset purchase has a few advantages. One is that it limits the buyer's liability. Generally, as a new pharmacy entity purchasing assets, the seller's liabilities do not carry over to the buyer. Another advantage is the tax write-offs on expenses available to the buyer. Fixed assets can be depreciated or expensed generally over a five- or seven-year period, which decreases taxable income, increases cash flow, and provides a quicker return on investment. Goodwill or prescription value, which is often the overall purchase's largest asset, can be amortized or expensed over a 15-year period, which again decreases taxable income, increases cash flow, and provides a quicker return on investment. An experienced pharmacy certified public accountant will help maximize these write-offs.

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Asset acquisition disadvantages include the time commitment and setup of the new pharmacy entity that will be buying the assets. The time it takes to handle the various regulatory matters such as NCPDP, NPI, DEA numbers, DEA "heat zones," Medicare, and PBM contracts, to name a few, can take months to approve and finalize. If the setup process is done incorrectly, this process can take years and even prohibit the pharmacy from gaining the proper approvals needed to open. Many of these disadvantages can be addressed on the front end with an experienced pharmacy CPA and legal health care advisory team, thereby making an asset purchase a common and overall wise acquisition method.

STOCK PURCHASE

Buying the stock of an existing pharmacy is typically preferred by the seller, not the buyer. With a common stock purchase, the buyer simply purchases the stock of an existing pharmacy from the seller. In this scenario, the stock buyer will walk into the pharmacy the next day as the owner. Nothing changes except who owns the pharmacy common stock (equity). There are fewer "start-up" processes required in a stock purchase compared to an asset purchase, which makes the setup process relatively easy and seamless. As stated previously, the seller often prefers this method because he or she treats the stock sale as a long-term capital gain if stock is held longer than one year. Long-term capital gains, in most cases, are taxed at preferential tax rates of 20 percent (for federal only).

Common stock purchase disadvantages include the risk of unknown liabilities, both direct and contingent. Since purchasing the common stock means the buyer is purchasing the entire entity, it also means the buyer inherits any prior year tax audits (state and federal), PBM audits, or Labor Department issues that may arise, if applicable. Unknown liabilities such as this are primary reasons why buyers avoid a common stock purchase.

The accounting and front-end due diligence with a common stock purchase is and should be extensive as the buyer looks to avoid any unknowns. An experienced pharmacy CPA will need to provide necessary due diligence to the financial records, tax returns, and the overall accounting system for the selling pharmacy. A knowledgeable health care attorney will be able to provide due diligence on the regulatory matters within that pharmacy and should be able to add contingencies and protections within the stock purchase agreement that address potential liabilities with the seller.

Another disadvantage for the buyer is the inability to write off the purchase of the common stock for tax purposes. As discussed previously, asset buyers can write off the cost of their purchase over time. Unfortunately, this is not the case with a common stock purchase and is often a major roadblock for the buyer. The only time a buyer will recognize a tax benefit of buying stock is when the buyer sells the common stock, which typically is many years down the road – not an ideal scenario by any means.

However, common stock purchases do have a few advantages for the buyer. When buying the common stock, generally the buyer does not have to worry about the regulatory issues and setup, and typically he or she will assume PBM contracts (and other contracts) already in place. With that said, there are some change-in-ownership notifications and regulatory steps that need to be taken with the various pharmacy regulatory boards, but these setup issues are much less onerous than starting a new pharmacy from scratch. Additionally, in areas where DEA "heat zones" are a major entry barrier into independent pharmacy, a stock purchase can be a viable option to circumvent those barriers.

OTHER OPTIONS

Clearly, there are advantages and disadvantages to both an asset and stock purchase. Being conflicted between what method is best can sometimes be a struggle between the buyer and seller. Luckily, the Internal Revenue Code has provided taxpayers with a "best of both worlds" election. The Internal Revenue Service Code Section 336(e) or 338(h)(10) election allows a taxpayer/buyer to purchase the stock of an existing pharmacy and treat the transaction, for tax purposes, as an asset purchase. As the buyer, you get the opportunity to buy the common stock and step in as the owner on day one, and you are able to write off or expense the purchase price of the assets purchased as part of the common stock transaction. The process and complexity of these elections is vast, not well known in the tax advisory community, and therefore not widely used or understood. Before considering these elections, you must find an experienced tax adviser who has knowledge in this area but be aware that these options are available if the circumstances and proper planning are in place.

When buying a pharmacy, an experienced legal health care advisory team, including a CPA, attorney, wholesaler, and banker, will be invaluable. There are many pharmacy ownership areas to consider that far exceed the scope of this article. Proper due diligence and long-term success as an entrepreneurial pharmacy owner begins with the right team. ■

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