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Converting a medical practice into a legal entity

Dear Sir or Madam,

Since the commencement of the Health Insurance Act on 1 January 1996, doctors can be in an employment relationship with a company. Accordingly, since then doctors are also entitled to found and operate their medical practice as a legal entity (as a AG or as an Ltd).

In 2015 the Federal Statistical Office collected structural data about the legal form of 14'217 locations of medical practices and health care centres. These data were published for the first time on 10 April 2018.

"A medical or a health care centre can provide medical service at one single location or at several locations. Depending on the number of locations, their legal forms may vary. In 2015, 91% of the medical practices and health care centres with just one location had been operating as individual enterprises, 7% as public holding company (AG) and 2% a limited liability companies (Ltd)."

If only medical practices with one single location are considered, then there is a preponderance of individual enterprises as legal form. On the other hand, once there is an expansion to two or several locations, then the legal forms of either public holding company or limited liability company become attractive.¹

Below we will show the most significant issues regarding the advantages converting a medical practice into a legal entity can have and which obstacles it can face.

Which obstacles does converting have to overcome?

Generally, converting a medical practice happens via an investment in kind after which the entire assets and liabilities of the medical practice are then entered into an annual or interim statement. The official founding of the company occurs with the public certification by a notary. Prior to that, there will be a foundation report which has been verified on its accuracy by auditors. Shares or voting-privileged shares are covered by the medical practice's equity. Therefore, liquid resources are not mandatorily required.

¹ Source: quoted from the Federal Statistical Office, published 10th April 2018.

Which significant changes affect the doctor's liability?

All executed contracts that the doctor had signed as a private person for his practice prior to its conversion need to be assigned to the company. Thus, only business assets can then be used for liabilities. The liability of the doctor with his private assets will lapse. However, all contractual obligations by the doctor remain unchanged, whether this be in a AG or an Ltd. He also remains responsible for services that he personally rendered. Patients can still assert their rights against a doctor who is accused of culpable conduct. In addition, the duties of the board of directors and the chief executive respectively need to be exercised even in a legal entity, and the body is responsible for its action.

Which tax benefits can occur after a conversion?

The doctor, as a private person, pays income tax on the entire profit he has made in a business year, and the equity of the practice is liable to property tax; due to progressive taxation this can lead to an enormous tax burden. However, this progressive taxation can be reduced by setting up a company. Being the owner of his company, a doctor then has a considerably more influence on the amount of the tax burden and on his income than the owner of an individual enterprise. He can choose the option of paying himself an adequate salary as an employee of his own company, and additionally he can also determine the amount of the dividend at the end of the year. Additionally, he also has the option of founding his company with the minimum capital and to enter the difference between equity and nominal and share capital as a loan for the company by the in-kind contributor on the debit side. This allows the doctor to pay interest on the loan without this income being subject to the Old age and survivors' insurance. The same also applies to the payment of a customary rent for possible consulting rooms which are part of his private property.

If the sale of the company is taken into consideration, then it might be worth leaving a certain part of the profit in the company. Despite the double taxation (Old age and survivors' insurance, tax on profit and tax on capital on the level of the company, plus income tax and property tax on the level of a private person), converting into a legal entity will lead to tax savings in most cases. Additionally, as there is also the option as an employee to simply build up a balance in the second pillar; these pension fund contributions can be entirely deducted from the income.

A considerable tax advantage can be gained by either the sale of the medical practice or the participation of new partners in the firm due to the expansion of the practice. In this context it is not the private practice that is sold to a potential successor or to a newly joining doctor, it is a share of the company that is sold. Consequently, the profit gained will be treated as tax-free capital gain, and not as liquidation profits for income tax as would happen when selling the practice. This particular aspect will be increasingly attractive if the practice has a large amount of hidden reserves and an enormous goodwill. However, the shares of the company need to be kept for at least five years after the conversion. During that period no changes to the ownership structure are possible, otherwise there will be supplementary taxation of the hidden reserves. Therefore, it is not possible to sell the medical practice within that period or to find additional partners to buy into the practice.

Conclusion

In the end, converting very often does make sense. However, the road towards it can be arduous, and not every configuration is possible.

In the past, artax Fide Consult AG has successfully advised several medical practices during their conversion to a legal entity and during the implementation of this process. We are looking forward to supporting your conversion.

Kind regards

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