

finance

Buying a practice

Geoff Long gets down to business.

In any but the tiniest business purchase, dentists need to go through certain procedures to ensure that they are not buying a pig in a poke. This is the so-called 'due diligence' process, under which you get someone, usually a dental accountant, to look critically at the figures and the underlying records to make sure that the business is as profitable as the accounts imply, and the assets are as valuable.

Bear two important things in mind:

1. Any claim by the current owner that there are more sales going through the business than actually turn up in the books. By definition, this claim is impossible to substantiate and is effectively an admission that the

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records on which you are doing your due diligence are unreliable.

2. If you are using an accountant to do the due diligence make sure you get one who has in-depth commercial knowledge about the business of dentistry. A high proportion of accountants are good at totting up figures but haven't got much judgment when it comes to the sharp end of running a dental practice. So, if you can find someone whose commercial judgement you trust, this will give you a huge head start in the process of evaluating the business and



agreeing terms. I would hasten to say that the above rather jaundiced view of accountants probably doesn't apply to any who write in *The Dentist*, who by definition are taking a proactive approach in keeping up-to-date with the world of dentistry.

The second stage is where you get the lawyers involved. This is particularly important in cases where you are buying the shares in a company. Even where you are just buying assets of a practice as a going concern, it is important to ensure that you have got the legal side of things tied down, including warranties and indemnities from the vendor. This will help you make a claim in the future if anything turns out not to have been what it was cracked up to be.

Limited company or sole trader

This is a vexed question that almost always comes up when you are buying a practice. If the business you are buying is currently being run as a limited company, should you buy the shares in the company from the shareholders or should you buy the company's assets?

This is an immensely important question from the tax point of view and tax is likely to be the factor that decides the question for you.

Many dentists may be expecting me to run into a long list of arguments going in both directions; some for buying shares and against buying

assets and some *vice versa*. Far from it! Buying assets absolutely wins hands down from almost every point of view.

Taking the non-tax aspect first, buying assets is a much more straightforward situation legally (even if the mechanics of the purchase are more elaborate). The chances of you buying a pig in a poke are minimised under the asset purchase route because you are not also treated as acquiring any liabilities that the practice might have and which you don't find out about until it is too late if you buy the shares. Of course you can claim on warranties and

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indemnities but what if these are not watertight? Or what if the vendor has emigrated and disappeared?

When you come down to the tax issues it gets even clearer: most practices these days have a value over and above what the vendor originally paid for the net assets. This premium is known as 'goodwill'. So a practice with net assets on its balance sheet of £100K may be worth £1m because of its earning capacity. In this example, the goodwill value is therefore the difference, that is £900K.

The problem with this situation is

that there is an inherent capital gain sewn up in the company shares, because if that goodwill was ever sold by the company it would have tax, probably at 28 per cent to pay on the £900K goodwill (assuming the practice built up the goodwill itself and didn't buy it from someone else).

So what you are doing in buying the shares is buying this inherent gain and therefore this inherent tax charge. If, in contrast, you were to buy the goodwill for £900K there is no inherent gain because you have a cost, that is £900K, which is equal to the value of what you have got. The same principle applies to assets such as buildings held within the company structure.

If, despite my insistent beating of the sole trader drum you are looking to trade through a limited company there is another major advantage in buying assets which is that you can claim tax relief for the goodwill in accordance with however much of that goodwill you write off in your accounts each year. If you buy shares, there is no relief for the underlying goodwill value.

The inherent capital gains tax can add anything up to 37.5 per cent onto your final tax bill when you come on to sell the practice yourself. ■

Contact Geoff Long on 01438 722224 or email office@dentax.biz