



Timothy A. Brown



Nancy Brewer, CA

Professional Incorporation

Tips for Negotiating the Purchase & Sale of a Practice

PART II

This article will address the art of negotiating the purchase and sale of an incorporated practice and provide a few tips for both sides as to how they may view the key issues.

Disclosure

As a licensed business broker, I act as an agent for the seller, never the buyer. However, I have several ethical obligations to the buyer, one of which is full disclosure of all material facts. There are those who advocate “dual-agency” whereby the agent claims to work for both buyer and seller equally — but I firmly believe that it’s best to know which “master” I serve when negotiating a transaction. With that said, some of these tips are intended for the benefit of the buyer, to improve his or her odds of success and to negotiate a fair price, in terms of tax efficiency. Accountants normally provide this advice to the buyer, for a fee, and I do not wish to replace their expertise, however, much of the art of buying an incorporated practice is common sense.

Structuring the Deal

Why are the majority of transitions now completed as a share sale? One reason is the excess of buyers versus sellers, especially in the GTA. Thus sellers often have the upper hand when dictating the terms of a sale. Most sellers are insisting on a share sale and they are getting what they want. While price is usually a topic of negotiations, in some cases our clients set their price as firm (not negotiable) and we regularly obtain offers at such prices.

Occasionally the buyer may be able to negotiate a reduction in the price, based upon the argument that if the seller receives the proceeds of a sale tax free, he or she can at least share some of the windfall with the buyer by lowering the price. To what extent the price is lowered is based upon the undepreciated value of the assets within the corporation. Such assets are rolled into the corporation prior to sale (this is called a Section 85 rollover), providing a buyer with some future write-offs and thus minimizing a portion of the after-tax disadvantages of buying a corporation.

Negotiating Points — Seller

Sellers seek to obtain the highest price and to pay the lowest (if any) taxes on sale. The best advice for the seller is to incorporate early, preferably two years prior to sale, or at a minimum, ensure that the majority (90 percent) of the assets you are planning to sell are actually used in day-to-day practice. If your corporation has investments, automobiles, cash or others assets, they will not be sold with the company and must be removed two years prior to sale. Many sellers choose to form a new professional corporation just before the sale to be sure it is not full of old assets and liabilities. Contact your accountant for further explanation.

Negotiating Points — Buyer


The buyer cannot attempt a price adjustment unless he or she knows the exact structure of the corporation. If the seller has rolled undepreciated assets into the corporation, the buyer may have some future tax relief — but be aware that the extent of such relief is dictated by the value of those assets.

- For example, a relatively new and modern practice with over \$300,000 of un-depreciated assets on the balance sheet was recently sold. This situation was very favourable for the buyer and no price adjustment was negotiated — it sold for the asking price, as a share sale.
- In another recent sale, the corporation formed by the seller owned nothing but some very old equipment, all of which had already been completely depreciated. The buyer (with the help of his accountant) was able to effectively negotiate a price roughly six percent lower than the asking price for the shares.

There are many variables that may affect price adjustments, and a calculation of the “lost tax-shield” will help determine what — if any — adjustment will be fair. I act

for the seller and seek to obtain the highest price on the most favourable tax terms. However, every buyer deserves fair treatment, even in this over-heated market, so we normally promote a negotiated price that is fair to all parties.

Conclusion

I predict that more and more sellers will continue to seek the share sale method, and that buyers, particularly in the GTA, will learn to live with the post-purchase tax scenarios these share sales provide. When the market becomes more balanced again, buyers will likely regain some negotiating power and the after-tax impact of professional incorporation may become more favourable. In the near term however, it remains a sellers’ market and tax issues will remain a major item of negotiation. 

Timothy A. Brown is the President & C.E.O. of ROI Corporation & ROI Capital, companies that specialize in dental practice appraisals, brokerage, consulting, locum placements, associate-ships and practice financing across Canada. Timothy can be reached at 905-820-4145 or timothy@roicorp.com.

Nancy Brewer, Chartered Accountant, maintains a practice in Burlington, Ont. She may be reached at nancy@nbrewer.ca or 905-631-6638.

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