

Purchasers: Expect to Pay More for a Practice because of Lower Professional Corporation Tax Rates



Graham R. Tuck
H.B.A., C.A.

Reality today is that purchasers are incorporating when buying a practice. The tax rates for the first \$300,000 (and by the new Federal budget \$400,000 in 2007) net income after payments to the all doctors for their remuneration, is only about 19%. This means there is about 81 cents on the dollar left over to pay the loan to purchase the practice. In the past, we used personal tax rates to calculate this excess earning capacity and often there would only be 60% or less left over to pay for the loan.

The new Federal budget also proposed a reduction in the Federal Professional Corporation tax rate from 13.2% to 11.5% in 2008. In 2009, a further reduction proposes to reduce the Federal tax to 11%. The provincial rate is scheduled to remain at 5.5%.

All our valuations, using the 2005 financial statements, are now being valued using the new Professional Corporation Tax rates. This generally means that the "Goodwill" value of the practice will go up. The extent of the new increased goodwill value will reflect very strongly on the number of recall and active patients. The more patients, the higher the value will increase. All the additional value will go to "Goodwill" as the "Equipment", "Leasehold Improvements" and "Supplies" are set values. The total assets do not become more valuable because the practice makes more net income after taxes.

The most positive impact will be noticed in practices with a lower billing per patient, which in turn has produced a low net income. The least impact will be on practices with a high billing per patient and a low overhead as there is a limit on the value of a chart – few charts with high billings per chart is a high risk for most purchasers.

Does this mean that practices are less affordable? No, the practice value in general should still be equal to five or six times the net income after tax. Due to the taxes being lower with the Professional Corporation Tax Rate the purchaser will have more money remaining to pay for the practice.

What does this mean to the Vendor? Your practice will be worth more. It would not be unreasonable to have a 33% increase on the “Goodwill” component of the value. Some practices with conservative dentistry could be worth even more.

You do not have to incorporate to take advantage of this lower tax rate but it may be advantageous to do – talk to your accountant.

If you are incorporated you can sell assets or shares. The sale of shares may be very tax advantageous for you even when the value will be lower – again, consult your accountant, as your situation is unique to yourself.

What does this mean to the Purchaser? You must incorporate to purchase a practice. If you do not incorporate, your personal tax rate will not allow you to afford the purchase of a practice.

What is going to happen in the future? It appears that taxes are going to drop and your practice will become more valuable, although most of the gain is already in place with the current lower tax rate for Professional Corporations.

Graham Tuck, H.B.A., C.A., is the broker/owner of Professional Practice Sales (Ontario) Ltd., which specializes in the valuation and sale of dental practices. He can be reached at (905) 472-6000 or 1 (888) 777-8825 or by e-mail at: grtuck@rogers.com.