Buying & Selling a Practice

More and more often I am seeing an interesting occurrence with people selling their clinics for reasons other than relocation or retirement. In quite a number of sales I am seeing principals who have had enough of the stress of running a business and are prepared to sell out and become an associate so that they can relieve themselves of the stress and strain. This has significantly increased the number of practice purchases/sales in which I have been involved over the last 2-3 years.

The starting point for all of these transactions is trying to arrive at a suitable and realistic valuation for the business. What, after all, is the correct value of a practice? This is both a very simple and very complex process. If you are a seller – as high a price as you can get; if you are a buyer – for as little as you can get away with. Please note – there are 2 starting points for the starting point!

Starting point number 1 – turnover.

I normally expect to multiply these by something between 0.75 and 1.25. The reason for basing the initial approach on turnover is that this is probably the only really verifiable figure appearing in a set of accounts for the practice prepared by the seller. The turnover can be substantiated by a review of bankings; these may be slightly less than the turnover as a result of cash takings being used directly for either the practice or the principal's own drawings.

However, there is a flaw with the turnover approach in that if the practice includes in gross patient fees all of the income generated by associates who then take 50% of the fees as their income, this leads to an over exaggerated GPF.

Starting point number 2 – profit

The profitability of the business will not always be the profit as disclosed in the practice accounts as these often include items that reflect the seller's 'modus operandi', rather than inescapable expense of the practice. For example, motor expenses will vary considerably dependent upon the way in which you are set up for tax purposes in terms of 'primary business address' and their proximity to the practice premises.

It should be possible to isolate those expenses that are specific to the business (as against to the practitioner) and the profit derived on this basis should be taken into consideration. This leads into the concept of payback – how long do you feel it is reasonable to wait to get your money back. Most businesses will be sold on a 2 year payback i.e. purchase price equal to about 2 years average profit excluding unusual or practitioner specific 'additional' expenses.

The "base price" (or starting point) is therefore the lower of starting point 1 or starting point 2.

We then go into those factors which will serve to enhance or diminish the value of the business. I will try to keep this fairly simple, but in practice the weighting of each factor is usually a subject of much debate.

Are you buying premises and a practice together? Obviously this increases the price (excluding the cost of the freehold/leasehold) because the established patient base will be able to continue in exactly the same way as before.

If the premises are included but are on a lease, how good are the premises? What is the level of referrals from within the premises (assuming cross-disciplinary premises)? How suitable are the premises? How onerous is the lease (years to run, annual rent and service charges, when are the rent reviews, what limits are then on those reviews) etc?

If premises are to be included there are three key considerations; location, location and location! You then go on to the next level of consideration, proximity to public transport, car-parking facilities, passing trade etc.

Do the premises require redecoration or refurbishment? What will this cost?

What is the condition of any equipment being included in the sale?

What have the patient figures been like for the last year – look for new patients, cancelled appointments, do not shows, etc?

If you are being offered just a patient list, then you need to consider whether the patients will be prepared to re-locate to your existing or new premises. In any event, expect a 15-20% drop in patient numbers. These will be patients who were looking for an excuse to stop going on a regular/ semi-regular basis. Also if there are a large number of patients, how many of them have not been seen for 2 years or more? – do they actually have any value?

What is the local reputation of the business; if it is bad, why is it bad? If it is bad, you will have to work very hard to reverse that reputation. If it is good, how much of this is because of the personality of the outgoing principal, rather than their technical prowess.

What has been the turnover trend for the last three years? Why has there been this trend?

What is the vendor going to do afterwards? If they are moving away, are they prepared to be a ‘consultant’ during a hand-over period? (Do you want them to be?) Imagine if you buy a practice only to find that they have changed their mind about re-locating and have opened a surgery a mile down the road. Of course, with the current trend of selling but continuing as an associate, this could, in the long run, be an even bigger consideration. Where the principal moves away for the period of a restrictive covenant, normally 2 years, it could be harder for them to re-establish themselves in the area. On the other hand, after enjoying all of the money they earn for themselves for many years, if the principal has now stepped down to associate status, they may feel after a few years that they want to go back to a higher level of income.

As you by now appreciate, establishing a price is not simple and I strongly recommend that you use the services of a professional adviser whenever you are considering buying or selling a practice and/or patient list.

There are also some sellers who pick a figure out of thin air for no reason other than that is what they want and have no regard for whether the price is reasonable. The problem when dealing with these situations is that you could find yourself investing time and money in putting forward offers etc. Only to find that there is no chance of ever reaching a mutually acceptable figure.

The bottom line is that the value is what a willing buyer and a willing seller agree on – whether it is supported by the facts or not.

One other point to be aware of – a number of companies will offer to put together a valuation report for you, which is fine, but don’t be sucked into paying thousands of pounds for it. Most valuers, including me, tend to have a standard format saved on their PC and they just change those areas specific to the practice in question. So as a guide using my charge out rate of £250 per hour, I would expect the charge to be somewhere between £1,000 and £1,500 absolute tops.

Tax from the buyer's perspective

For the buyer the acquisition has to be broken down into three separate & distinct areas. Firstly there is the goodwill itself, secondly there may well be some equipment associated with the premises and thirdly there may well be acquiring the freehold of the premises, or taking on a lease or a licence.

Goodwill. Believe it or not the tax treatment here depends on what trading entity you buy it as and what relationship the buying entity has to the selling entity (sorry for the jargon). A sole trader cannot get any tax relief for buying goodwill. All that happens here is that an acquisition value is established which will come into the calculation of Capital Gain Tax if the goodwill is sold on to another party at some later date. The same applies if you are buying as a partnership or joint venture.

If, however, you are buying as a company *and* you are buying from an unconnected party, then you can write off the goodwill over a period of time and claim the write off against tax. This is one of the reasons I often suggest people who are sole traders or partnerships set up as a company before acquiring a practice with a reasonable amount of goodwill.

For example suppose you buy a practice with £60,000 of goodwill. As a sole trader or partnership you get no relief for this until you sell it (how many years on?). As a company you could choose to write this off over 5-10 years giving you a tax deduction of £6,000 - £12,000 which means a tax saving of £1,260 - £2,520 per year for the first few years, although under the current (FRS02 or 105 accounting regulations) the write should be five years unless you can demonstrate a good reason for choosing a different period..

Just to confuse the issue, if you buy as a company from a connected party, you don't get tax relief on the write off of goodwill. The most common form of buying from a connected party is where you are a sole trader and incorporate the business (to take advantage of the lower tax rates for companies). Here, you as the seller are very much connected to your own company so cannot get a tax write off for the goodwill. This doesn't mean that incorporating is a bad idea but we don't have space to go into this further in this article.

Equipment. The rules for buying equipment are that you can set against tax 100% of the cost of all equipment that you purchase up to a maximum of £200,000 in each year. Unfortunately motor vehicles are specifically excluded from this. Those of you who have been in business for a while will be used to claiming just 25% per year. If you buy a block of second hand equipment from another person then, as there is a change of owner, the buyer can claim the full 100% on the acquisition of 'new' equipment (i.e. new to the buyer even if pre-used).

Go back to the idea of changing from sole trader to company. The purchase of equipment by the company from the sole trader will qualify for the 100% tax relief so this is a way of accelerating the tax relief on equipment.

Premises. Now we enter the minefield that is property tax. I am not going to go into too much detail otherwise I'll use up the rest of the magazine! Let's start off with buying the freehold. If the purchase price is £250,000 or more then VAT will be chargeable. As you are trading in a VAT exempt capacity you cannot get this VAT back. Suppose you have a deal where the seller wants £252,000 for the building and £2,000 for equipment. They may have to register for VAT on the sale of the building generating an additional cost of £44,100 which you cannot recover, so the total cost has gone up from £252,000 to £296,100. But if you agree to change the prices to £249,000 for the building and £5,000 for the equipment, no VAT applies and you are back down to £252,000.

Then there could be SDLT (Stamp Duty Land Tax). This applies to the sale of commercial premises and also to the granting of leases so you could find yourself having to pay this on top of the purchase price (and the VAT if applicable). A word of warning here – some solicitors interpret the legislation in a way that says that SDLT is applicable to goodwill if purchased with a building. I disagree with this approach for the following reason.

If you buy just the goodwill from someone else there is no SDLT. If you buy the goodwill and set up around the corner to the old practice, there is no SDLT. If you buy the goodwill and the building next door to the old practice, there is no SDLT on the goodwill. Therefore, just because you are buying both the building and the goodwill at the same time, it makes no sense that SDLT should be payable on the goodwill.

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