Buying, Merging or Selling Your Practice

During periods of economic slowdown, small business owners in the public service sector (i.e. lawyers, accountants, and physiotherapist's) may form partnerships by merging their practices. By doing this it makes the combined firm more efficient, and gives them a better chance of survival. Also during these times many self-employed professionals decide to sell off their practice and take a job somewhere. When these situations arise its always good to know what your practice is worth, and what tax and accounting issues to consider before agreeing to merge or sell. I'll look at buying and merging a practice in this article, and cover selling in the next.

- What's My Practice Worth?

Valuing a service related business is difficult. There are a few guidelines that you should first consider. Valuation is always based on subjective opinions, two individuals can come up with very differing values depending on whether they are the buyer or the seller.

- Tangible and intangible assets

-- Tangible assets are things that you use in your practice; i.e. examining tables, chairs, etc., and are fairly easy to place a value on.

-- Intangible assets are what's been built up throughout the time your practice has been in business, i.e. patents, copyrighted material, patient lists, GOODWILL!

-- Of all the assets that get valued when businesses are sold, goodwill is the hardest to put a price on. Goodwill is the difference between the purchase price of a practice, and the fair value of the net identifiable assets of that practice. Therefore goodwill can only be quantified when a business is sold. For a physiotherapy clinic, goodwill would most likely be its list of regular patients, but it could also be the reputation of its staff or its affiliation with a particular doctor. When valuing goodwill it is better to start with the offer price and work backwards.

-- Like any asset Goodwill has a limited life. Once a practice has purchased goodwill, the way it gets accounted for on the financial statements and tax return has changed. Before the corporate accounting scandals in the US, Goodwill was treated in both countries as if it had a life of 40 years, and was amortized off over that time on a declining balance basis.

-- However because of the creative accounting that was done with goodwill, it no longer gets amortized. Instead, an annual goodwill impairment test is applied and it's then shown at its purchased
cost, LESS any impairment in its value each year. If Goodwill is no longer worth what you paid for it, an "impairment loss" gets written off in that year, and it doesn't get written back up if its value return's. Nortel took a $10 billion impairment loss at the end of 2001.

- What's a Fair Offer Price?

In the Financial Planning industry when a planner is offering up his or her book of clients to another planner, the benchmark is two years residual service fees (between 1 and 1.5% of the market value of the assets the planner is currently administering). In public practice accounting, it's between one and two years' worth of gross billings. I would think that a physiotherapist's practice would be similar to this. In the end however the fair price is whatever someone's willing to pay. If you are financing the purchase of another practice, the bank's going to want to be certain of the value of all the assets you are purchasing, not just the goodwill. Usually they will want to see two years audited financial statements of the practice you're acquiring.

- What's Involved with Merging Two Practices?

When two service related practices agree to combine their businesses, the first major decision is whether to incorporate or not. As I've stated before the two are treated very differently in the eyes of the CRA. I'll look at it as if the two practices AREN'T incorporated, just combined to form a partnership. A partnership is considered a "flow-through entity". This means that once the net partnership income is calculated, each partners proportionate share of that income "flows through" to that partners tax return. With gross partnership income and all the related expenses treated like any other business.

The partner's share of the partnership income gets taxed in the same form that it originally came into the partnership. It could be self-employed income, (either professional, business or rental), or investment income, or foreign income. The partners are liable for all debts incurred by the partnership. Charitable and political donations made by the partnership, and dividends and foreign income received by the partnership, flow their tax credits through to the individual partners. Any gains or losses from the sale of capital assets owned by the partnership are included in the net income of the partnership.

When a partner transfers property to a partnership, they're deemed to have sold it, and the partnership purchased it, at its fair market value, thus a rollover. That partner would receive an increase in their partnership interest as payment for the rollover property. The types of property that can be rolled over are: Capital property, inventory, intangible assets and land. The fair market value...
of the rolled over property is something CRA is very sticky about, since it's a non-arms length transaction. With the forecast for an improving economy in this country, many self-employed professionals are looking to increase the size and capacity of their practices now, so as to increase profits later.


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