SYNSTRAT

Selling Your Dental Practice – Why Pay Unnecessary Tax on Sale?

It's all in the valuation approach.

A dental practice is invariably sold as a 'going concern', i.e. its goodwill and its equipment, including furniture, fixtures and fittings, are sold together as part of an operating business.

Whereas some valuers choose to estimate the value of the equipment separately item by item, they invariably arrive at a value significantly above its depreciated value. If sold on this basis, the difference above depreciated value is taxable income.

By contrast, the goodwill component of most dental practice sales will be tax-free, since it is likely to fall into the category of:

a. Practices purchased prior to capital gains tax being implemented on 20 September 1985; or
b. Practices the sales of which fall within the guidelines for the sale of small business active assets.

The latter rules are a little complicated, as there are successive concessions and partial rollover to superannuation funds involved. Individual circumstances need to be checked with accountants. However, most dentists end up paying no capital gains tax on sale of their practice goodwill.

The Important Issue
The important issue is that the valuers who value the equipment separately and come up with values which are significantly above depreciated values are creating a tax trap for vendors.

Example
Consider a practice worth $600,000. Its equipment has a written down value (depreciated) value of $30,000 but is serviceable and there's a lot of it.

Synstrat's Valuation Approach
Synstrat arrives at the practice value of $600,000 and deducts the $30,000 of written down value of the equipment to arrive at a goodwill value of $570,000. The practice meets the small business active asset sale conditions and no tax is paid.

The alternate valuer's outcome is as follows:

They assign estimates of values to equipment, furniture, fixtures and fittings which total $150,000 and hence goodwill is $450,000 assuming the same practice parameters.

As previously, the goodwill is treated as an active business asset and after the various processes are followed, no tax is paid.

However, the equipment realises a taxable income to the seller of $120,000 ($150,000 minus $30,000). This $120,000 is added to the vendor's other taxable income and taxed at the vendor's marginal tax rate. Depending upon other income, including investment income etc, the additional tax payable could be as high as $55,800.

Equipment Values
The inherent problem with assigning equipment value separately is that it is guesswork, because the actual market for secondhand items of equipment, furniture, fixtures and fittings is too thin to be a reliable guide. Only some items are saleable and where dealers exist in a market there is a wide gap between the price a dealer will pay to acquire a secondhand item and the price at which they will on-sell. There has to be because of holding and storage costs and the risk that some items will not be onsaleable. That raises the question as to whether there is any definitive evidence of the market values of equipment as assigned in valuers' lists.

The only time a whole practice suite of used equipment is sold is when a practice is sold, and hence the equipment is part of a going concern package.

Impact of Government's Investment Allowance
The secondhand market was further impacted by the Federal government's temporary investment allowance of 50% (plus normal depreciation) on purchases of new dental equipment, which was an economic measure applied to alleviate the impact of the global financial crisis. This caused a large amount of equipment replacement to occur earlier than would have otherwise been the case. That resulted in an instantaneous devaluation/exhaustion of the secondhand dental equipment market.

Now, two years on, the ceasing of the Medicare Chronic Disease Dental Scheme will have an instantaneous result of the virtual instantaneous closure of about 1000 dental operatories, and create a substantial surplus of dental equipment within many existing practices. That too will cause a substantial devaluation in whatever secondhand dental equipment market exists post the investment allowance period.

Put simply, the market for many items of secondhand dental equipment has evaporated. Therefore, lists of practice equipment with a figure put against each which purport to be dental practice equipment valuations are no more than a figment of somebody's imagination. The persons who value practices in this way cannot give an assurance to the dentist concerned that they could readily find buyers for all the individual items of equipment at the prices they have put down.

An operating dental practice with patients and the equipment necessary to produce the level of fees exhibited in its financials and bankings is a 'business going concern' and must be valued as a going concern using accounting principles.

The fees and profits are generated from the 'going concern'. Dental invoices aren't split between amounts allocated to goodwill and amounts allocated to equipment usage.

If selling your practice, speak to Synstrat about valuation. If you go down the wrong path the outcome can be costly.

Copies of Synstrat's booklet ***Buying and Selling General & Specialist Dental Practices*** can be obtained by emailing your name and postal address to annie@synstrat.com.au

Best wishes to all.

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