Company pitfalls

Spot the bear traps before you fall into them – **Russell Abrahams** discusses the safest way to buy an incorporated practice

An incorporated dental practice is a limited company, as distinct from a sole practitioner or partnership. So far, so good.

Incorporated practices are on the rise, so if you are seeking to buy a private dental practice, there's a good chance it will have been incorporated. The bad news is that many dental practices have been improperly incorporated – perhaps by accountants or solicitors unaware of the complexities involved. This can bring problems for the buyer, as I'll outline in this article. (Note that I'm talking about purely private practices – incorporation of NHS or mixed NHS/private practices is even more complex.)

Incorporation involves the proper transfer of the assets and liabilities of a practice to a limited company. Assets may include, for example, dental chairs, equipment (such as cabinetry), portable equipment (such as OPG), autoclaves and stock.

One big asset that needs to be transferred is goodwill. This can be tricky to deal with where there is an NHS contract, but fortunately, where the practice is exclusively private, the transfer of goodwill to the company is very easy to achieve.

Transferring ownership

Transferring ownership of assets held on finance will not be possible without the agreement of the finance company, and it may be that the asset is rented to the limited company under a separate agreement. Note that, for different reasons – usually involving tax liability or, in the case of property, depending on if it is freehold or leasehold – not all assets and liabilities are transferred.

When it comes to buying an incorporated practice (I'll call it the 'company' from now on), a number of adjustments need to be made to the agreed purchase price. These relate to the assets and liabilities of the incorporated practice. For example, £100,000 in the company's bank account would be a significant asset while the company's tax bill is a liability. The tax bill will not be payable until after the sale is completed, but it needs to be provided for, as it transfers to the buyer.

Completion accounts

All acquisitions of limited companies require the preparation of a set of so-called 'completion accounts'. They form the basis for determining the final purchase price payable under the 'sale agreement'.

Completion accounts can take different forms and the principles by which they are drawn up and who will prepare them should be agreed between buyer and seller.

The only part of the completion accounts we're interested in here is the

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balance sheet, which will show the net assets of the company at the completion date. Here are some of the items you are likely to find on the balance sheet:

- The goodwill and equipment will be shown as nil value because they are part of the agreed purchase price
- If stock is included in the agreed purchase price, it will also be shown as nil value
- There will also be tax liabilities, cash-at-bank hire purchase (HP) liabilities, general creditors, book debts, employee claims and associates' fees obligations
- If we were talking about an NHS or part NHS practice, there might also be clawback shown
- The cost of preparing the completion accounts will effectively be met by the seller.

These amounts will be totalled on the balance sheet and will create a balancing sum, which will be used to adjust the final price (also known as consideration) to be paid for the company.

Incorporation loan

A major liability that may appear on the balance sheet is the incorporation loan. If, as is usually the case, the company didn't pay the practice owner cash when incorporation took place, it would have owed the purchase price to the owner instead. This is a debt required to be repaid out of future profits (after corporation tax). Thus, the amount outstanding on the loan will have been reduced since incorporation, but there could still be a large six-figure sum owed by the company to the owner of the practice at the time of the sale of the company.

In this case, the purchase price (still subject to the adjustments shown on the balance sheet in the completion accounts) is technically reduced by the amount outstanding on the loan. The purchaser then lends to the company an amount equivalent to the outstanding loan. On completion, the company repays the seller and then owes money to the buyer.

To put it simply, the buyer takes over the amount outstanding of the incorporation loan.

There are a number of tax consequences arising from these transactions, but that's for another article!

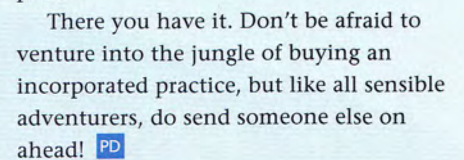
A done deal?

You may think that, having shaken hands on a deal to buy a practice for, say, £800,000, you could be faced with finding a lot of extra cash (as much as £100,000 or more) when adjustments are made as per the completion accounts. Your solicitor should address this possible risk in two ways when drawing up the sale agreement.

Firstly, and most importantly, the company must be required to provide a pro forma balance sheet to anticipate the likely asset and liability position on the completion date. This should assist the parties to agree, contractually, the adjustment likely to be required as a result of the completion accounts.

Secondly, your solicitor should agree an upper limit, so if the balancing sum is £40,000, but an upper limit of £20,000 has been agreed, this is all that will be paid.

There you have it. Don't be afraid to venture into the jungle of buying an incorporated practice, but like all sensible adventurers, do send someone else on ahead! PD



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