Taxes: To Transition Now or Later

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With a new administration coming toWashington, we can all expect that some changes are likely. The possibility of tax law changes after the upcoming elections and uncertainly surrounding the current state of the economy, both sellers and buyers have many things to review.

For the seller, the allocation of purchase price comes with the possibility of dramatic tax ramifications. In apportioning the purchase price, the largest amount of the purchase price is usually allocated towards the seller's goodwill. In 2008, the tax on goodwill is set at the capital gains rate, currently fifteen percent (15%).

Plans that have been discussed by the two major party candidates include anything from zero to a ten or twenty percent increase in the capital gains rate (depending on what report you read and when you read it), which means up to $20,000 additional tax paid to the IRS on every $100,000 allocated towards goodwill. The other major allocation category is equipment. This category is typically taxed at personal income rates up to the cost basis and then capital gains on the remainder. Currently there is up to a 20% tax differential between goodwill and the seller's personal income rate.

So, as a prospective retiring doctor, what can you do? Obviously there are always two options; transition now or transition later. In this decision, though, you need to discuss with your advisors a strategic plan of action. It may be worthwhile to consider selling before tax policy can be changed, even if you are considering slowing down in your practice and will continue working for another year or two.

You might consider part-time employment inside the practice if it is feasible for the purchaser to employ you, and if not, look for employment outside the area of your restrictive covenant. Your practice may be so profitable that this type or timing of transition would not be in your best interest. Your current takehome pay even with a larger tax liability later may outweigh the ongoing part-time pay plus the comparative tax savings of a practice sale this year. Each situation should be carefully evaluated prior to making the decision to retire from your practice.

As for buyers, the tax implications are probably not a major factor in a decision to purchase now or after 2008. There is currently an immediate depreciation for equipment of up to $250,000 which is set to expire after this year. However, the entire purchase price of a practice is depreciable for a buyer: 3- 5 years for equipment and 15 years for goodwill, so it is generally an issue of timing and not whether a tax break will be lost.

More of a consideration for buyers continues to be the availability of good practices to purchase. While our own research and statistics from the ADA may indicate that we are in, or will soon be entering into a buyer's market with more sellers than buyers nationally, within the state of Florida this may not be the case anytime in the near future. Florida will continue to be a desirable location to live and a good quality practice with a strong cash flow will sell, sometimes with multiple purchase offers.

So, as a buyer, what should you do? Look now for the good practices, even if they are not in the specific location that you would most desire. This may include looking at practices just outside of the urban areas within a 30-45 minute commute. If that is not realistic, be prepared to pay for a quality practice when it comes available, as nobody can predict when the next great practice will come along. Overall, resist the uncertainty that the economy is currently breeding. Practices statewide have seen some downturns; some down ten to fifteen percent or more this year. This decline, like others we've experienced though, is due to the general state of the economy and is expected rebound as the downward cycle levels off and then turns positive, leaving you with the benefit of delayed work and patients in need of treatment.

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A new administrative policy is likely as both candidates are keenly poised to “fix” the economy. Buyers should consider that they will not only see patients coming in for delayed treatment, but the possibility of cash rebates to consumers and investment incentives for business owners. Accelerated depreciation for new equipment may be preserved which could allow for an advantageous environment to replace older chairs, purchase new technology or take the steps to go digital and paperless. Combining these incentives with the possibility that a seller may be further motivated to sell before a tax law change could result in an opportunity for you and a kick start to your private practice career.