

Marmer Penner Inc. Newsletter

Written by Steve Z. Ranot, CA•IFA/CBV, CFE
Edited by James A. DeBresser CA•IFA/CBV

Dangerous Reliance on Business Brokers and HST Transition Rules

In addition to chartered business valuers, there are certain business brokers who specialize in valuing professional practices generally for health care practitioners. We have seen their reports for the value of dental, optometry and veterinarian practices, for example. While these business brokers sometimes value these professional practices for matrimonial purposes, most of their valuations are to assist the practitioners in real transactions. For that reason, their valuation conclusions may be inappropriate for net family property (“NFP”) purposes.

First and foremost, these reports tend to value just four assets – inventory of supplies, equipment, leasehold improvements and goodwill. A practice may hold significant amounts in bank accounts, accounts receivable and prepaid expenses, but these assets as well as practice liabilities are generally ignored by business brokers. The brokers do not consider these other assets and liabilities when determining a value for purposes of real transactions, since most prospective purchases do not consider buying or assuming them. In general, a buyer does not purchase the vendor’s bank account or accounts receivable. For

matrimonial purposes however, it may greatly understate the practice's value to ignore these other assets.

Secondly, business brokers often do not consider the contingent income tax costs of disposition. Failure to consider a client's contingent income tax costs may materially overstate his or her net worth at a particular date.

Lastly, it may be unsound to rely upon a valuation prepared for sale purposes by a broker as evidence of value at or near valuation date because they typically earn a commission for selling the practice. Under the terms of some broker arrangements, the practitioner must pay the broker a selling fee even if he opts not to sell the practice, as long as he receives at least one offer that is greater than or equal to 90% of the appraised value. Accordingly, these broker prepared "valuations" may have a downward bias since the broker is more likely to earn his commission if he arrives at a lower value.

This is the final newsletter before the introduction of the *Harmonized Sales Tax* ("HST") in Ontario. As a result, all services that were previously subject to only GST and not the *Ontario Retail Sales Tax* will now be subject to a combined 13% tax. Unlike other services, this newsletter's cost will not be increasing. However, most legal and accounting fees for matrimonial clients will increase by 8% after June 30, 2010. In general, HST applies to services provided on or after July 1, 2010. The HST would generally not apply, however, to a supply or a service if all or substantially all (90% or more) of the service is performed before July 1, 2010.

Consider the following example:

A person hires a law firm to perform a service during the summer of 2010 but is not invoiced and does not pay for the service until August 2010. One-third of the service is performed in each of the months of June, July and August 2010. The HST would apply to the consideration that is for the part of the service performed in July and August – that is, two-thirds of the consideration.

However, if 90% of the service was performed in June 2010 and 10% was performed in July 2010, no HST would be required on any portion of the service even though some was performed after June 30, 2010 and the invoice was issued after June 30, 2010. In order to simplify matters, professional services firms may wish to invoice all unbilled work-in-progress on June 30, 2010 in order to avoid the risk that non-HST-taxable services might inadvertently be invoiced after June 30, 2010 at the higher tax rate.

This newsletter is intended to highlight areas where professional assistance may be required. It is not intended to substitute for proper professional planning. The professionals at Marmer Penner Inc. will be pleased to assist you with any matters that arise. Please feel free to visit our website at www.marmerpenner.com.