

Summer/Autumn 2009

**In this issue**

- 1 Partnership succession planning
- 3 Employment law update
- 4 Penalties are becoming more taxing for healthcare companies
- 5 Sheltered cottage built at a care home – watch the VAT trap

# Healthcare Matters

## Partnership succession planning

**Traditionally, the majority of healthcare professionals such as GPs, dentists, vets and care home providers have operated as partnerships.**

Recent changes in tax legislation resulted in a number of professional practices incorporating their businesses into limited companies to mitigate their overall tax liabilities. GP practices, though, were unable to incorporate under their primary care contracts, and many other healthcare providers chose to remain as partnerships.

There are benefits to operating as a partnership: the flexibility of self-employment and the direct involvement in the development of a business, which may not exist in a corporate environment with third-party ownership, plus all the financials remain confidential and no figures are released into the public domain at Companies House.

However, one of the most serious threats to the continued provision of GP healthcare services is the ability for existing partnerships to offer succession as the current partners consider their retirement options. It is vital, and in the interests of the remaining partners that 'new blood' is considered for the partnership to continue and thrive.

There are several issues to be considered when bringing a new partner into a business:

### 1. Legal implications

The legal status of a partnership is governed by the Partnership Act 1890. If a partnership does not have an agreement approved by all

the current partners, or no partnership agreement exists, then it is deemed to be a 'Partnership at Will' and the 1890 legislation applies. This could have extremely costly consequences, and it is in the interests of all partners to ensure that a partnership deed is in place and kept up to date, particularly as partners join or leave.

The partnership agreement should address the key issues that can cause conflict, i.e. profit shares (especially in the early years for new partners and changes to profit share), payment of tax liabilities, sickness and pregnancy terms, drawing levels, accounts and termination provisions.

### 2. Impact on existing profit shares

Understanding the impact on existing partners' share of profits is a key consideration.

A new partner will dilute the profit available for distribution to existing partners. If an existing employee is being offered partnership then a cost saving may be made as the employee's salary and other direct employment costs (National Insurance, superannuation etc) ceases to be paid, thus increasing the partnership profit available for distribution.

It is common for a new partner, in their early years in the partnership, to have a fixed profit share or receive a fixed percentage of parity. However, prior to taking on a new partner, the partnership should consider how the change in profit share and the expected changes to partnership profits will affect existing partners' share of profits.



# Partnership succession planning

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## 3. Tax implications

On the admission of a new partner, the partnership is regarded as a continuing business by HM Revenue & Customs.

In many cases, the partnership will meet the partners' taxation liabilities directly. Having an additional partner may well increase the overall tax liability, therefore budgets and cash flow forecasts should be prepared to ensure that the partnership will have sufficient cash resources to meet the January and July tax payments.

A new partner will be assessed for Income Tax under the opening year's rules and, initially, may have a different basis period from the existing partners. The first period of profits assessable on a new partner will not necessarily be their profit share from their first accounting period.

There is a risk that a reduction in profit share can constitute a disposal for Capital Gains Tax purposes, especially when there are assets (particularly property) being used by the partnership but actually owned by an individual partner.

## 4. Financial commitment for new partners

It is the norm for a new partner to contribute capital into the partnership, although this generally happens when the partner achieves parity or becomes a full equity partner.

If a new partner borrows to introduce capital, then they are likely to be able to claim tax relief on their interest repayments.

If a partnership owns its premises then an option to allow a new partner to buy into these premises may be included in the partnership agreement. If an existing partner is retiring at the same time a relatively straightforward transaction between the exiting and joining partners can be completed.

## 5. Skills and personality traits of a new partner

One of the fundamental reasons for introducing a new partner is to replace a professional skill that has been, or is about to be, lost on the retirement of a partner. The ancillary skills can be as important to the partnership as the management or financial knowledge. Potential partners' wider knowledge and skill base can pay dividends in the future.

Existing partners must satisfy themselves that a potential new partner is someone that will incorporate themselves into the culture and work ethic of the partnership. Inevitably, the partners will spend substantial periods of time working together, with all the stresses that will entail. Sound judgement is needed to be certain that a new partner will satisfy existing partners' expectations.

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The key to any succession planning is to ensure that not only the outgoing partner is content, but also that continuing partners are satisfied with the arrangements. This will sow the seeds for the future success of the practice.

Adopting a formal approach to succession planning is critical. You can ensure a smooth transition by having a partnership agreement in place, and by taking timely professional advice to help you overcome any issues during the process.





## Employment law update

**April saw some significant changes to aspects of employment law affecting all businesses, especially medical and veterinary practices and practitioners.**

**Any organisation which employs staff must be aware of these changes as ignorance of the law will not avoid potentially costly litigation.**

### A statutory week's pay

The statutory maximum figure for a week's pay, used when calculating redundancy payments, or the basic award in a claim for unfair dismissal, has risen from £330 to £350.

### Holiday entitlement

- All employees are now entitled to a minimum of 5.6 weeks of paid holiday (this equates to 28 days if they work a five-day week) but note that this can include Public Holidays.
- Payment in lieu of statutory holiday entitlement is not permitted, although payment in lieu of any leave above the statutory entitlement can be allowed depending on the employment contract in place.
- Although there is no need to reissue completely new contracts for the increase in statutory holiday entitlements, you do need to let your employees know about the increased entitlement in writing. This should be done through a contract addendum, individual letters or a general notice.

### Statutory dispute resolution procedures

At some point, all practices find they have to use the disciplinary or grievance procedure to deal with an employee issue. Some parts of the Act, however, have been replaced with a new framework that is based on the ACAS (Advisory, Conciliation and Arbitration Service) Code of Conduct.

The following are some of the main changes now in force:

- There is a need to deal with issues informally (as the first step of the procedure).
- There is no automatic unfair dismissal for a failure to follow the procedures.
- There is no requirement for an employee to raise a grievance before making a tribunal claim.
- There is no extension of time to raise a claim if an employee does raise a grievance.

Tribunals will still expect employers to be fair and reasonable in dealing with issues, to use mediation to resolve issues if possible, and for employers to deal with matters in a prompt and consistent manner.

If your disciplinary procedure complies with the ACAS Code, no action needs to be taken. If it does not, your procedures need to be updated. Changes to the Employment Act 2008 are now effective - this means that a dismissal will be deemed to be automatically unfair by an employment tribunal if you have failed to follow the statutory dismissal procedure.

All employers should therefore now review their disciplinary and grievance procedures. Any employer who dismisses an employee and unreasonably fails to comply with the new ACAS Code of Practice on discipline and grievance may have compensation awarded against them to the employee (although the maximum statutory uplift has decreased to 25%).

### Flexible working

The right to request flexible working has been extended to parents of all children aged 16 and under. We can therefore expect an increase in the number of requests for changes to working hours. As is currently the case, there are formal procedures that you need to follow in considering an employee's request for flexible working.

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### Further legislation coming up

- Agency workers - The UK Government hopes to introduce legislation implementing the EU Directive on temporary agency work this year. This would entitle agency workers to the same basic working conditions with comparable permanent employees after spending just 12 weeks in a job. This may well have a significant impact on those organisations that rely heavily on agency staff in permanent positions or as cover for other staff absences and the employment of locums.
- Holiday entitlement and long-term sick leave - A decision is expected later this year on the relationship between annual holiday leave and long-term sick leave. The Advocate General has given her opinion that workers can accrue, but not take, paid statutory annual leave during a period of sick leave. She also stated that where sick employees cannot take their full statutory holiday entitlement in the appropriate year, the outstanding entitlement must be granted at a later date or, if employment is terminated, a payment in lieu of that entitlement must be made. It remains to be seen if the European Court of Justice (ECJ) will agree.
- An ECJ decision is also awaited on whether the UK's default retirement age of 65 can be objectively justified under the age discrimination legislation.

Kingston Smith LLP can offer advice on the above matters via our HR consultancy, HR Insight Limited.



## Penalties are becoming more taxing for healthcare companies

**The Revenue is taking a much tougher line on tax irregularities and, as part of this, is introducing a much more punishing penalty regime across the board for all taxes. Under the new regime, the Revenue will be able to impose a penalty for inaccuracies in returns or other documents or if you fail to notify the Revenue of an under-assessment to tax.**

The amount of each penalty will depend on the Revenue's assessment of the behaviour that led to the inaccuracy. In practice, this means the degree of reasonable care taken by the taxpayer; whether or not the error was deliberate; and whether or not the disclosure of the error was prompted by the Revenue. The more serious the behaviour behind the error, the higher the penalty will be.

The main change from the previous regime is the level of minimum penalty that can be imposed given a certain set of circumstances. In the past, it has been possible to negotiate with the Revenue so that penalties of more than 15-20% of the tax outstanding were rare, provided the case was well argued by the taxpayer's accountant.

Take, for example, a case where a drugs company (ABC Ltd) has failed to put in place a system for identifying entertaining expenditure in its substantial advertising budget. As a result, entertaining expenditure is incorrectly set against profits and the resulting underpaid tax amounts to £40,000.

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If the understatement of tax is discovered by the Revenue in an investigation, the error is classified as a 'prompted disclosure'. If the Revenue then successfully argues that no systems were in place to prevent the error arising, they will additionally classify it as 'deliberate'. Under these circumstances, the penalty will be between 35% and 70% of the underpaid tax. The maximum penalty could be reduced, depending on the 'quality of disclosure' during the investigation. This essentially means the level of help given to the Revenue in quantifying the inaccuracy and the degree of access given to the company records. A reasonable abatement would be 80%, so the resulting level of penalty is 35% plus 20% of 35%, or 42%. This equates to a penalty of £16,800 on underpaid tax of £40,000.

The new rules will apply for errors in Tax Returns or other documents for periods starting on or after 1 April 2008, filed on or after 1 April 2009.

In addition, increased penalties have been introduced for late filing of company accounts. Private healthcare companies that have to deliver a set of statutory accounts to the Registrar every year now face penalties of up to £1,500 for late filing.



### Sheltered cottages built at a care home – watch the VAT trap

**Occasionally a Tribunal decision looks a bit like one of the famous judgements of the late Lord Denning, who appeared to first decide what the fair end decision should be and then developed his analysis of the facts and law to arrive at this conclusion. This could be said to be so in the case of JFB & FR Sharples, where the decision looked to be the correct one, but not necessarily the one you might first expect when reading the detail.**

Mr and Mrs Sharples were in partnership. They purchased a care home for the elderly, together with some surrounding land which was vested in a pension fund, of which Mr & Mrs Sharples were both the pensioners and two of the three trustees. The remainder of the land was owned by the partnership.

A couple of years after acquiring the land, planning permission was granted for the building of seven sheltered housing units in the form of cottages on the retained land. Each cottage was to be self-contained, separated from the care home and sharing a communal garden with the other cottages. The planning permission contained 11 conditions of which only number 11 was relevant to this appeal. It stated that the freehold in the sheltered housing units shall not be sold assigned or disposed separately from the main care home.

HMRC objected to the zero-rating of the construction and or first grant of a major interest in the sheltered units. It claimed that the phrase “separate use, or disposal” in the legislation meant that in order for a building to be eligible for zero-rating it must be

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**If you have been denied zero rating, you should seek advice as to whether or not you could dispute the denial.**

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capable of both separate use and separate disposal, and that these units failed because they could not be separately disposed of by virtue of planning condition number 11.

The argument put forward by the Sharples team was that the separate disposal was not prohibited but severely restricted. They adduced evidence that the disposal to their pension fund was an exclusion to the prohibited condition in the planning consent. HMRC argued against this stating that the exclusion permitting a transfer between the Sharples and the pension trustees was there because the trustees owned the main care home and such a transfer would not split the ownership of the cottages and the main care home.

Customs lost, not least because the Tribunal agreed that the disposal of the freehold was not prohibited but restricted as a transfer of the cottages from its owners to trustees of a pension fund, and that separate use of the cottages was also permitted. But perhaps the Tribunal had at the back of its mind that the fair result is that sheltered cottages separate from the main home ought to be zero rated.

If you have been denied zero rating in a similar situation, you should seek advice as to whether or not you could dispute the denial. If you are planning a development which has similar aspects to the above case, you should also seek advice before your planning application is made, as the planning permission can clearly impact on the VAT treatment.

# Dates for your diary

## 25th June

A special seminar for the Charities Sector, to be held at the Ramada Hotel in Hemel Hempstead, will look at best practice in corporate governance.

## 5th July

Final date to agree 2008/09 PAYE Settlement Agreements.

## 6th July

Deadline for notifying HMRC of benefits/expenses paid to directors/employees.

## 19th July

Final date for postal payments of any outstanding Class 1A NICs for the tax year ending 5 April 2009.

## 31st July

Due date for second Payment on Account of Income Tax owed for 2008/09.

## 5th October

Deadline to notify HMRC of chargeability to income tax or capital gains tax if no tax return issued.

## 19th October

Payment of tax and Class 1B NIC due under PAYE Settlement Agreements.

## 31st October

Submit your 2008/09 self assessment tax return if filing on paper, to avoid an automatic £100 penalty.

Kingston Smith runs an extensive programme of seminars. To access the full programme and book your place visit [www.kingstonsmith.co.uk/events](http://www.kingstonsmith.co.uk/events)

## Contact us

More information about Kingston Smith LLP and our services can be found at [www.kingstonsmith.co.uk](http://www.kingstonsmith.co.uk)

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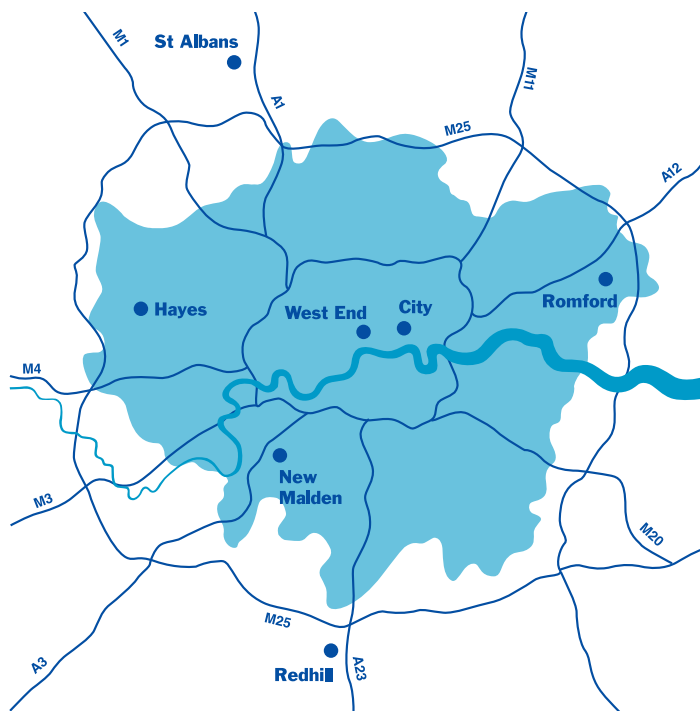
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