Small Business Tax & Finance

The Independent Newsletter for Accounting Professionals and Taxation Advisors

Vol 18 No 3 September 2005

Vetting the Practice

Julie Butler answers thirteen questions veterinary surgeons should now be asking their advisors

The first of August 2005 was a significant date for the veterinary profession. This was the date by which the animal-owning public, Members of Parliament and the veterinary profession had to comment on the proposed update to the rather antiquated *Veterinary Surgeons Act 1966*.

The aim of the proposed legislation is greater transparency and casting a wider legal 'safety net' over vets and related 'health professionals'. The new Act should help control unorthodox and unregulated treatments by unqualified individuals but at the same time open up work currently restricted to the sole preserve of the veterinary surgeon.

This is therefore the time for all veterinary businesses to review their business practices and structures – will they lose business to other 'health professionals' or will they delegate efficiently and work out excellent cross-referral opportunities? How can this be incorporated into standard tax planning?

The questions to be asked are:

(1) Premises

When a Veterinary Practice plans to improve and re-equip their premises or buy new premises, are they achieving all the tax breaks they could?

The key is to maximise tax relief on moveable plant (the veterinary equipment). Plant qualifies for a 40% first year allowance whereas improvements to the buildings and site – the setting – have no immediate tax relief. Some areas of the premises can (surprisingly) qualify as equipment, for example telephone and computer lines. Tax planning to ensure maximum tax efficiency should be reviewed prior to the premises being bought or improved.

For equine practices with rehabilitation facilities, marginal areas are horse walkers and all-weather surfaces (see *Shove [HMIT] v Lingfield Park 1991 Ltd* [2004] STC 805 (CA) and *Anchor International Ltd v Inland Revenue Commissioners* [2003] STC (SCD) 115).

The angle of the proposed Business Renovation Allowance could be advantageous for practices starting up in or expanding into disadvantaged areas.

(2) Accommodation

If veterinary staff are provided with accommodation tax-free, should any protection be put in place?

A lot of veterinary practices have to provide accommodation for their staff for the 'proper performance' of their duties – for example, the staff live on the premises to check animals which are recovering from an operation or have to stay on the vets' premises. The provision of accommodation can be tax-free and it is essential that job offers, remuneration packages and employment contracts all reflect the ability to achieve tax-free status and to pass an employer compliance review (see Extra-Statutory Concession A60 *Agricultural Workers*).

Key arguments to support tax-free accommodation rely less on 'customary' rulings and more on the facts of the case and veterinary staff can benefit from this.

(3) Motor Vehicles

When staff of the veterinary practice are provided with motor vehicles, how can this be arranged both tax efficiently and cost-effectively?

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If the staff are able to take the vehicle home, which means it will not qualify as a pool car, then the tax treatment could be harsh, making the use of vans very attractive. To the vets' practice they qualify for 40% first-year allowances as opposed to a writing-down allowance restricted each year to a maximum of £3,000. An extra bonus is that VAT paid on vans is an allowable VAT expense – *i.e.* the input VAT can be claimed.

To the employee the tax benefit-in-kind for a van is currently very attractive at £500 a year or £Nil if there is no private use. (The rules change from 6 April 2007 when the benefit-in-kind becomes £3,000 per annum plus an additional £500 if fuel for private purposes is provided.)

To help avoid any question of doubt as to the business usage, the practice name signwritten on the vehicle can be a very effective argument and is anyway a cheap source of marketing the practice.

A lot of snobbery surrounds the choice of vehicle and essentially the practice vet needs capacity to store drugs and equipment that can be accessed from the back of the vehicle, to travel cost effectively and to promote the practice.

Vans can include twin-cab pick-ups and smart four wheel drive vehicles with blackened windows. Will tax efficiency win the day against the all-important perceived concept of 'image'?

(4) Incorporation

Has the veterinary practice trading vehicle been reviewed for tax efficiency – in other words, have you considered incorporation?

Incorporation can not only give some protection from liability but it can also represent favourable tax savings. The move from a sole trader or partnership can mean the tax-efficient transfer of goodwill and the ability to draw down on loan accounts. Vets normally like to leave money in the practice. Retained profits will be taxed at the corporation tax rate of 19% as opposed to the personal tax rate of 40%. The company offers the opportunity to make junior vets 'directors' without having, initially, to give away ownership.

Veterinary practices have a history of fall-outs and changes of structure. Shareholder agreements which protect the interests of each of the vets, directors' service agreements and partnership agreements are essential.

(5) Self-employed status service providers

Is there any scope within the veterinary profession to engage people, especially locums, on a self-employed basis?

Where the circumstances and facts represent a true self-employed relationship, then yes. The recent rush of employer compliance reviews on veterinary practices focusing on status issues of locums does not preclude genuine self-employed arrangements existing and both parties enjoying the tax benefits of this status.

(6) Promoting the Practice – Sponsorship

How can expenses incurred by vets, who are involved in animal 'hobbies' or professional competition, achieve tax relief for the practice?

The training given to the veterinary profession does not often equip them for marketing and the hard sell. It could be argued that the professional relationship between veterinary surgeon and animal owner would be eroded through hard sell tactics. The key to marketing is personal contacts and trust. The animal owner needs to understand the alternatives available. Veterinary work is not just a science; it becomes an art when alternative treatment is available – for example, animal destruction or salvation – and explanations as to the emotional and financial costs attached need to be provided for owners.

Obtaining clients for the veterinary practice through linked activities – such as showing, competing or playing polo – can be very beneficial to the practice. Where there are a number of partners, this can best be achieved by way of sponsorship arrangements – for example, the practice sponsors the local point-to-point, eventers or show dog for the season. Well drafted sponsorship agreements with clear evidence of the benefits to the practice are the key to efficient tax saving. The Inland Revenue does look closely at all such arrangements so facts to support commerciality must be available.

(7) Pension Reform

Vets have a reputation for not providing for their own pensions as they often plan to rely on the future sale of the practice. But the value of practices has been falling, as so many vets just start up on their own without purchasing goodwill. How should a vet provide for his or her future?

'A' day for pensions is 6 April 2006. The new régime should make pension legislation easier to understand and easy to use. For many vets who are 'asset rich' and 'income poor' there could be a lot of scope to use these new provisions effectively.

The concept of vets having their own pension funds as opposed to just writing out cheques to a scheme is becoming a more common concept which is widely understood by the profession. Obtaining an independent review of the pension options should be high on the veterinary practice's 'to do' list.

(8) Practice Division

Now that more veterinary practices have incorporated, how is practice splitting in a Limited Company generally approached?

The Limited Company can be split without CGT consequences if Revenue clearance is obtained first. If part of the practice is to be sold on to a third party clearance can also be obtained to try to obtain Business Asset Taper Relief (BATR) for the vendor without the BATR clock having to restart.

(9) Inheritance Tax (IHT)

Whilst most vets plan to live to enjoy a very happy retirement, what IHT angles should be looked at in deciding the structure of the practice?

The aim should be to achieve 100% IHT relief on all the shares in the veterinary practice. The key problems are likely to be the value of goodwill and the freehold property. With regard to the latter, for various reasons the property is often kept outside the practice accounts. Examples of the reasons for keeping freehold property outside the practice would be the lack of Business Asset Taper Relief (BATR) in a limited company or where the structure of the ownership of the freehold property is different from the practice structure. A common procedure is for the property to be let to the practice at full market rent. As the asset is owned outside the practice, the

IHT relief could be restricted to only 50% relief as opposed to 100%. The allocation of practice loans should be reviewed for all areas of tax efficiency.

(10) Freehold property held outside the practice

If the freehold property is held outside the practice, what is the most tax-efficient way of treating this ownership?

The problem of the possibility of 50% IHT relief has been noted. A formal lease agreement should be in place between the owners of the property and the practice and the rent should be at full market value. The property income will be net of relevant loan interest and specific costs on the individual Tax Returns. The rental income route can be a very NIC-efficient way of withdrawing monies from the practice. The treatment of loans needs reviewing in terms of both the practice and the specific vets who need to borrow the money for a business purpose.

(11) Loans to support the veterinary practice

My client is about to buy into a veterinary practice and wants to know how to structure the borrowings tax efficiently.

If loans are needed to finance a combination of freehold property and general practice working capital, there is scope for tax-efficient planning for both income tax and IHT. For example, if the veterinary premises are owned outside the practice, it would be IHT-efficient to raise the loan against the property, because the loan will reduce assets which only attract 50% IHT relief as opposed to assets which attract 100% IHT relief. This also makes commercial sense, because loans against freehold property are always easier to obtain than against pure business assets. The purpose of the loan must be documented – this is important if the loan arises from a 'remortgage' of a personal property.

(12) Capital Gains Tax consequences

My clients, a veterinary practice, are proposing the sale of their valuable premises as a development site to a local developer. What are the Capital Gains Tax consequences? The property has been owned by the 'practice' since before 1982. There have been changes in the partnership since then and a former partner still owns a share of the property.

If the property is kept as a business asset within the business accounts then the property should qualify as a business asset for BATR (Business Asset Taper Relief). The base cost should be the 1982 value, plus almost 105% indexation up to 1998. The 10% CGT rate should be achieved on the gain. It is assumed that the property is not held within a Limited Company in which case no BATR will be allowable but indexation will apply. Likewise if the property is held outside the partnership, there could be problems in obtaining full BATR if the owners of the property are not involved in the business. The rules regarding this involvement were relaxed on 6 April 2004 by the *Finance Act 2003*. However, such mixed treatments of the assets will create complex CGT calculations.

If the property is owned by a husband and wife and one of the spouses is not involved in the business, then that half will not benefit from the attractive 10% CGT rate. That half would be treated as an investment asset, not receiving any reductions in the potential gain for at least three years. Furthermore, non-business-asset taper relief is much lower than BATR, only giving an equivalent 24% CGT rate after ten years, rather than 10% after only two years.

Fortunately, with careful tax planning between the spouses, the eventual tax liability could be significantly reduced.

The share of each partner in the property will be treated differently depending on how long each has owned his or her specific share. It is assumed that when there have been changes to the partnership there was a revaluation of the property and a new base cost for CGT. Rollover relief should also be reviewed. The former partner will effectively be letting the asset to the practice and will have a complex CGT calculation which will possibly include 'tainted taper relief'.

From a planning point of view, if the freehold property is outside the practice and it would be tax-efficient for the property to be moved into the partnership, there would be Stamp Duty complications.

(13) Tax Enquiries

My clients, a veterinary practice, incorporated prior to 2003 and included the goodwill on incorporation at a high value in order to maximise retirement relief. There is currently a tax enquiry focusing on the valuation of goodwill on incorporation and on the alleged suppression of cash takings. Is it correct that these are popular areas for attack? What protection arguments should be put in place?

The valuation of goodwill on incorporation is certainly an area of 'tax attack'. A veterinary practice does have a number of advantages to support the high value. Veterinary practices are bought and sold on a fairly regular basis and there are goodwill formulas and criteria that can be used. If there have been changes in the ownership before or after the date of incorporation it is likely that goodwill was not only valued but bought and sold. This can then be used as a 'benchmark'. Where there have not been any valuations to use as a comparison, a professional valuation can be obtained to support the figure used on incorporation. *Inland Revenue Tax Bulletin Issue 76*, dated April 2005, sets out a full guideline on the subject of overvalued goodwill.

Turning to the alleged cash suppression, essentially veterinary services are sold to the private sector and so Inspectors may assume there is potentially a large exposure to cash. The reality is however different due to the growing use of credit cards, a large proportion of veterinary fees being paid by pet insurance and (in the bloodstock and racing world) the need to pass on the cost of veterinary fees to owners. In addition, the charging structures are so disciplined, and the reconciliation to hours worked and medicine sold so easy to achieve, that it would be foolish to suppress cash receipts.

Also, in old-fashioned veterinary practices there is great competition as to who bills the most, rather like in competitive firms of accountants!

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