Health & Care Focus

DRIVING LIFELONG PROSPERITY

Spring 2017

SPOTLIGHT ON PROPERTY SOLUTIONS AND SPECIALIST CARE

INSIDE

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Philip Hammond's first, and last, Spring Budget was big on laughs but, as widely predicted, small on anything else. At a time of economic uncertainty with Brexit, now was perhaps not the time for anything radical, which was clearly the Chancellor's view.

The tax announcements were few and far between, which was not a big surprise given that we are in a time of uncertainty with Brexit on the horizon. The stand out announcement, to take effect from April 2018, is the reduction in the dividend allowance of £5,000 to £2,000. Despite this announcement, there are still opportunities to structure remuneration effectively. Of course, the other significant announcement was the change to class 4 national insurance contributions, which has now been retracted!

The Chancellor announced more funding for social care, stating that there would be an additional two million people over 75 in ten years' time. The new funding will total just over £2billion to be spent as follows; £1.01billion in 2017/18, £674million in 2018/19 and £337million in 2019/20. The government has also published details of how the funding is to be allocated between the local authorities.

Mr Hammond hopes that this funding will reduce the pressure on the NHS, which received a further £325m investment for the local Sustainability and Transformation Plans and £100m to Accident and Emergency departments to reduce waiting times. Time will tell whether this boost to social care funding will be sufficient. However, there should be opportunities for companies in this sector over the next three years.

Looking to the future, the Government will also set out proposals in a green paper later this year to put the social care system on a more secure and sustainable long-term footing.

CURRENT VIEW OF SUPPORTED LIVING AND RESIDENTIAL LEARNING DISABILITIES SERVICES

PROPERTY SOLUTIONS IN SUPPORTED LIVING

In recent years there has been a continued rise in demand for Supported Living Services and, as a result, the range of services available has increased.

Historically, Supported Living care providers have been able to grow through acquiring properties, which they adapt and rent to the service user whilst also providing care and support. However, the preferred arrangement of local authorities, where there is a separation of care and support from the ownership of the properties in which the service users reside, has meant that many care providers are seeking an alternative property solution.

One such solution that has been rapidly gaining momentum is the partnership between a property investor, a Registered Provider (not for profit Housing Associations registered with the Homes and Community Agency) and the Supported Living care provider itself.

The diagram opposite shows the arrangement between the four key parties involved in these arrangements, namely the property investor, the Registered Provider, the care provider and the service user:

A number of property investment companies are either building new properties to be used for Supported Living, buying empty properties which are then adapted for the purpose, buying properties on a turn-key basis which require no adaptation or renovation, or simply buying portfolios of properties from existing Supported Living operators.

The Registered Providers benefit from not needing to buy or own the properties, but are able to continue to provide the services they were set up and designed to do. They are also sometimes able to charge higher rents to local authorities than the housing benefits received by care operators.

The care operators benefit through having access to a wider range of properties, allowing them to grow by providing more services to individuals in need of good quality housing, as well as divesting their responsibilities as property owners, such as the cost of property repairs.

TRANSITIONAL CARE

A further area of care which is growing rapidly is the rise of transitional services which provides intermediate support to children leaving registered care services.

It is clear there is demand from the local authorities, because the cost of looking after these children outside of registered foster care or children's homes can be far lower.

There have been a number of tenders recently for services which continue supporting young adults following their departure from registered facilities or foster care. A number of these transitional or leaving care services are unregistered with CQC or OFSTED.

Our transaction teams have seen a number of these services and we have noticed a significant variation in type of support offered and, indeed, the model of support offered compared to the more traditional services. Whilst this demand from local authorities is increasing, we understand that the apparent lack of regulation or oversight in this sector may cause concern for some operators, particularly those which are owned by larger financial institutions.

REGISTERED RESIDENTIAL CARE

Despite apparently being unfashionable and out-of-demand following the Winterbourne View case, our registered residential care clients continue to grow.

The general requirement by local authorities for high quality residential care services is becoming more and more apparent. With the inevitable squeeze on profit margins from both restrictions on fee income and wage rises through increases in the National Minimum Wage and National Living Wage, we are finding the higher quality, specialist registered units are growing faster than non-specialist providers.

As with Supported Living, it is more difficult now for residential care providers to acquire the best properties to meet the needs of these service users.

As a result, we are starting to witness property investors entering the market to work with care operators on a sale and leaseback basis, or providing alternative capital funding solutions.

One fly in the ointment for registered residential care has been the consultation paper from the Care Quality Commission and the guidelines they issued in February 2016 regarding the registration of new learning disability or mental health units. These guidelines indicate that it is difficult for units with more than six beds to be registered. We have seen this in practice, with a number of Registered Providers struggling to obtain CQC registrations for properties they have built, regardless of the needs of the local area or consultation with local authorities, families and service users. There is a current consultation (https://goo.gl/qHtvnR) and the outcome of this consultation in March/April 2017 will be of interest to registered residential care providers.

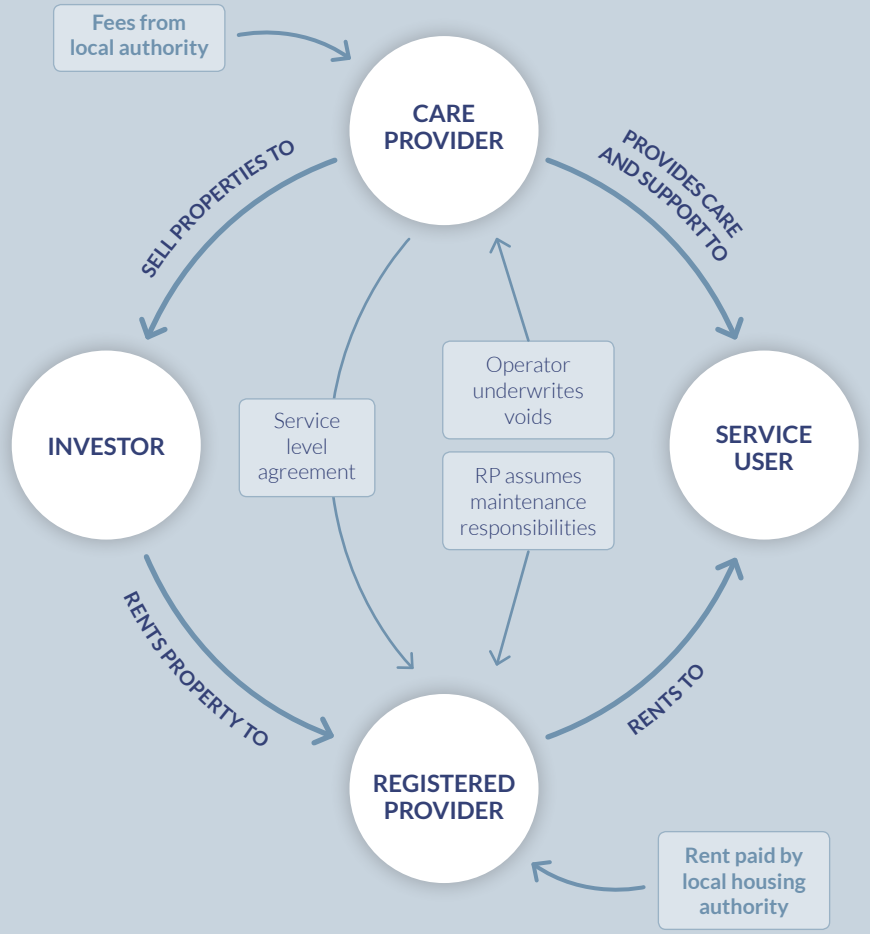
VALUE OF SPECIALIST ADULT CARE BUSINESSES

Overall, the market for specialist care, be it Supported Living or registered care homes, does appear to be on the rise following two to three years of transactions using lower multiples of profits. It is generally acknowledged that the multiples used in valuing companies have risen and some transactions of fairly significant size are currently underway in the market and this is expected to continue throughout 2017.

If you have any queries about how to:

- grow your specialist care business;
- raise finance or explore opportunities to grow with investment partners; or
- plan for a potential exit/sale in the next 6 to 18 months or beyond;

please contact John Lucas to discuss your options and to discuss how other operators in the specialist care market are adapting to the new environment.



EMPLOYEE SHARE SCHEMES – THE OPTIONS

Employee share schemes can provide a way to incentivise existing staff as well as attract new employees. They also offer employees a stake in the business which in turn will help to improve performance whilst preserving cash.

In our Spring 2016 Focus we looked at Employee Shareholder Status (ESS) as a potential employee share scheme for care operators. However, the generous tax advantages of this scheme were abolished for any new schemes not in place by December 2016.

So, what other options are there for employers in the health and care sector?

ENTERPRISE MANAGEMENT INCENTIVE (EMI)

An EMI is an HMRC approved share option scheme and is generally only taxable on the employee on disposal. With no income tax or national insurance due on the grant or exercise of the options, an EMI can be a very tax efficient way to incentivise and recruit employees.

For residential care operators, however, the opportunity to offer an EMI to its employees may be limited as one of the conditions is that the company must be carrying on a 'qualifying trade'. Operating or managing a nursing home or residential care home is explicitly excluded from this definition. However, businesses which are generally able to utilise EMI schemes include:

- Domiciliary Care (including supported living providers);
- Complex care in peoples own homes;
- Foster care;
- Education (depending on type of education and the legal structure).

For further details of the restrictions and tax advantages, see our comparison below.

GROWTH SHARES

Growth shares allow employees to participate in the future growth of the business. The individuals are awarded the shares from the outset but will only receive a return on disposal if a certain financial hurdle is reached. Care operators would have the flexibility to set the participation hurdle over which the employee could participate.

Such schemes are proven to help improve the performance of the business by giving employees a stake in the business and aligning both shareholder and employees' interests. Generally, they have the same rights as ordinary shares such as voting and dividend rights.

Growth shares are more commonly used for start-ups or private equity backed businesses with significant debt such that the initial value of the shares is relatively low and has prospects for growth.

From a tax perspective there should only be capital gains tax on disposal of the shares. Appropriate valuation of the shares, as with any scheme, is also key.

UNAPPROVED OPTIONS

Unapproved options do not offer the same tax advantages as an HMRC approved scheme or option, but as a result are much more flexible and straightforward to implement.

Care operators could design the share scheme tailored specifically to fit their business and their employees, without having to meet specific conditions set with approved options. As mentioned, however, the downside is that they are likely to result in higher tax charges on the employee (see table below).

AN OVERVIEW

When implementing an employee share scheme there are many aspects to consider, including which employees to offer it to, an award or option scheme and HMRC approved or unapproved.

We can provide advice on the most appropriate employee share schemes for your business including design and implementation. We can also assist with share valuations and obtaining approval from HMRC where appropriate.

	EMI	GROWTH SHARE	UNAPPROVED OPTION
Award or option	Option	Award	Option
Income tax/NI on grant	No	N/A	No
Income tax/NI on exercise	No except if at less than market value or after 90 days of a 'disqualifying event'	N/A	Yes, taxed on difference between market value and price paid on exercise
Capital gains tax on disposal	Yes on profit realised	Yes	Yes on profit above exercise price
Corporation tax relief	Yes	No	Yes
Company restrictions	Gross assets of less than £30m, less than 250 employees, must be an independent company and have a qualifying trade	None	None
Monetary limit	£250,000 per employee, up to a maximum total of £3m	None	None
Employee restrictions	Employees working less than 25 hours per week unless it equates to at least 75% of their working time. Employees owning more than 30% of the shares are also not eligible	None, but employees will only realise a profit on the shares where the valuation exceeds a pre-determined value	None

TIME TO TREAT YOURSELVES AND YOUR STAFF?

Although the tax legislation isn't awash with 'tax free' opportunities for employees and directors, there are a few worth being aware of.

LONG SERVICE AWARDS

Tax free awards can be made to employees or directors provided that they have worked for the business for at least 20 years, have not received a long service award in the last 10 years and the award is worth less than £50 per year of service. The excess is taxable if the award exceeds this value.

The award is only tax free in the hands of the employee/director provided that it is non-cash.

TRIVIAL BENEFITS

The Trivial Benefits exemption that was announced in the 2016 Finance Bill will make it easier to be a generous employer, without the potentially negative tax effects.

A Trivial Benefit has to satisfy the following criteria:

- No more than £50 per benefit (or an average of £50 if the benefit is provided to a group of employees and it is not possible to work out the exact cost per employee);
- Not cash or a cash voucher (but shop gift vouchers are allowed);
- The benefit is not provided in recognition of work done or an employment duty; and
- There is no contractual entitlement to the benefit.

If any of these conditions are not satisfied, the benefit is taxed in the normal way, subject to any other exemption (such as the annual staff function exemption). Importantly, if the cost exceeds the £50 limit, the whole of the benefit is taxed, not just the excess.

For non-director employees, the employer can provide as many trivial benefits per year as it likes; there is no annual limit. For directors there is a limit of £300 per tax year. To be clear, a director can receive up to 6 trivial benefits of £50 per tax year, or more if smaller denominations, but no more than £300 in total per tax year.

The trivial benefits do not count towards taxable income and need not be reported on a PIID.

Employers who hold 'staff awards' evenings need to be careful as vouchers or gifts given in recognition of services provided do not qualify for the exemption.

Overall, the changes to the rules provide greater clarity and will allow employers to give staff high street vouchers without the negative tax implications.

STAFF ENTERTAINMENT

An employer can entertain staff with no tax implications for the staff members, provided that the event/events are available to all staff, and the annual cost is no more than £150 per head.

The rules surrounding this dictate that the event has to be an annual affair (such as a summer barbecue or Christmas party). Additionally, the way that the exemption works can be confusing. For example, if there were two annual events costing £100 per head each, the first would be covered by the exemption but the second would be taxable in full, rather than just the £50 excess.

Please contact us for help on this, we would be delighted to assist.

ATTRACTING AND RETAINING STAFF IN THE CARE INDUSTRY

It is estimated that by 2030, the number of people aged over 85 will have doubled, and so recruiting and retaining staff in the care sector is only going to become even more important.

Finding the right people with the right qualities, skills and values is not always easy, but cutting corners and lowering standards will only create more problems and cost to managers and business owners. It could also damage your reputation.

Obviously, to attract and retain quality people, you have to offer appropriate rewards. However, money is not the only motivator (and probably not the highest motivator) in order to attract the right calibre of people. It is important to focus on building your 'talent pool' and trying to retain as many staff as physically possible.

BUILDING YOUR 'TALENT POOL'

Consider raising awareness of your company values and culture through various forms of media, whether that is your website or social media. Ask yourself what makes our business unique, why should someone choose us?

Ensure that you know what your employees are saying about you on job boards and employer review websites.

Consider setting up structured work experience placements targeting school leavers. Build relationships with your local schools and colleges. Demonstrate that you can provide a fulfilling and rewarding career with opportunities to learn new skills, gain qualifications and progress. Look at offering apprenticeships. Put structured training programmes into place and build your own talent pool. It might need a bit of effort at the beginning, but in the long term, you will have developed a steady stream of potential talent.

STAFF RETENTION

In terms of retention, you need to deliver and not disappoint. People want to feel part of something and it is not difficult to achieve. Making small things happen such as a clean, inviting place to work, providing good staff facilities and an open and friendly working environment. Invite feedback from your staff, even if at first you receive some negatives, demonstrate you are listening, consider suggestions and give feedback. Consider internal briefings, team meetings, cross team training, employee of the month awards, trivial benefits (mentioned in the article above) or little treats. You never hear an employee moaning about too much communication, but you will often hear complaints of little or no communication. Add an element of fun or a social event, providing staff with the opportunity to get to know each other and bond as a team. Give them a feeling of belonging and it may well be returned by their loyalty.

The cost of care conundrum

Recent changes in the National Living Wage (NLW), coupled with an increasing number of employment tribunal decisions, are pushing employment costs ever upwards.

The introduction of the NLW from April 2015 and the recently notified increase to £7.50 per hour with effect from April 2017, leaves this Osborne policy legacy on track for hitting the aspiration of £9 per hour, or close to it, for all employees over 25 by 2020. This above inflation increase, coupled with changes to the personal tax regime, is seeing low paid workers enjoy quite significant increases in their pay, at little cost to the Exchequer.

For providers, however, the impact of this, together with recent judicial and indeed HMRC guidance, creates a rather bleak picture, when coupled with the social care funding crisis that local authorities are experiencing.

What is noticeable is that despite the increasingly worker friendly message, the reality of care commissioning is that Councils are reticent to pay providers in a way that mirrors the experience of operators. Below are examples of this in action.

SLEEP-IN PAYMENTS

Local authorities have long been happy to commission sleep-in shifts, as these have been perceived as a cost-effective way of delivering night staffing whilst staff may not actually be required for a large proportion of the shift in question. Historically, local authorities may commission sleep-in shifts where the care workers were paid at rates of between £30 and £45 per night.

In recent months, we have noted that HMRC consider that employees should be paid at the minimum wage for sleep-in duties. Effectively, this suggests that there should be no distinction between a sleep-in shift and a waking night. The approach from HMRC has been very aggressive in many cases. We have many clients who operate sleep-ins and are looking at ways to mitigate this risk/cost. We have seen a number of very robust arguments put forward in relation to not only HMRC's approach, but also things that can be done to mitigate the risk.

In practice, however, commissioners have not revised the effective hourly rates paid for sleep-in support to be commensurate with daytime and waking night shifts (presumably given budgetary pressures). In response to this, we have seen one local authority, where the hourly rate for daytime care was £13.38 per hour, increase its sleep-in allowance to £8.58 per hour (its sleep-in allowance was previously £37.19 per night, typically for a 9.5 hour shift). The increased rate is only payable to providers who pay their staff at NLW or NMW rates.

So whilst the reality is that, for the employer, the cost of employing a member of staff for a daytime or sleep-in shift could well be the same, the fee receivable is very different!

TRAVEL TIME

It is now broadly accepted that travel time for workers travelling between appointments should be treated as working time for the purposes of determining the number of hours when calculating the average rate. Recent cases that have gone to tribunal, coupled with HMRC PAYE inspections, have certainly brought this into sharp focus.

That said, Local Authorities are still frequently commissioning homecare visits of 15 minutes or less, where it is a challenge to deliver a safe and appropriate service. The ability to fund travel time across multiple short visits is therefore a real headache for operators, particularly those in rural areas.

TRAINING

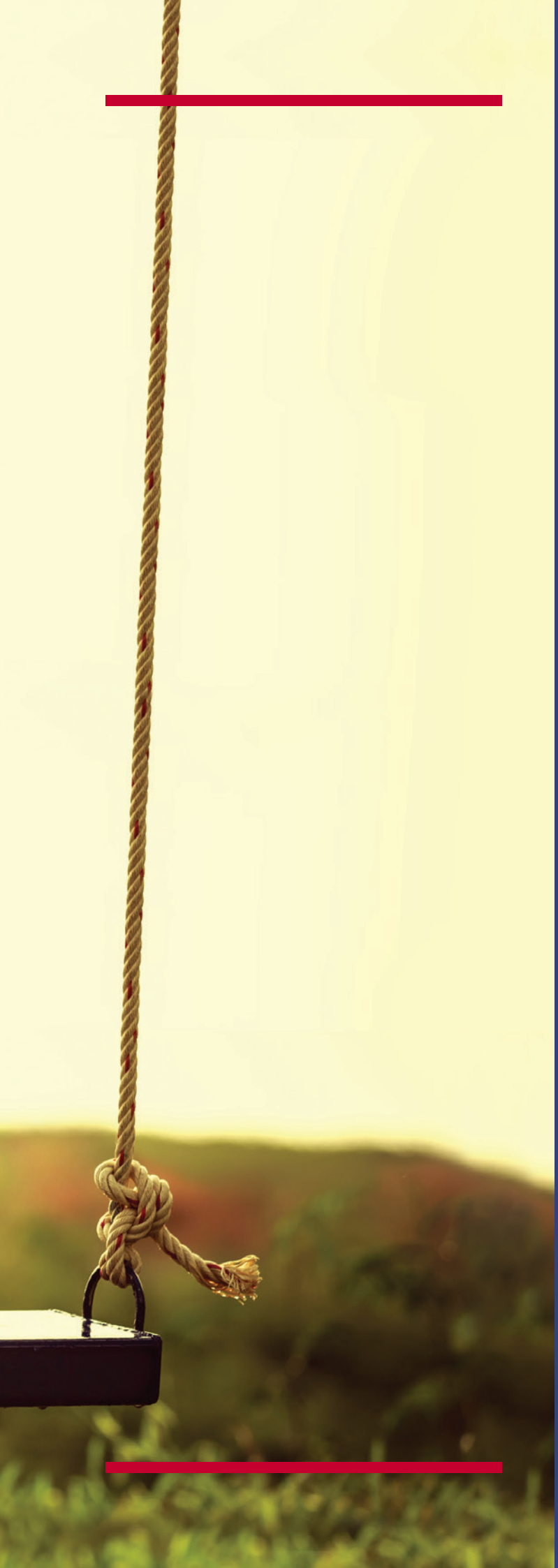
Training time (including time spent travelling to training if not just home to work) can, and generally does, count as 'working time' for NLW or NMW. If time spent training is deemed to be working time, it must be paid at the appropriate rate.

Our article in this publication on staff retention, could be key to helping mitigate the cost of training.

CONCLUSION

For social care operators, the question of sustainability of service delivery, once the above factors are considered, has been brought into sharp focus. This pressure is heightened when HMRC's investigations and attitude are taken into account.

Whilst the social care levy on council tax gives local authorities a degree of latitude in future fee settlements with providers, we believe there is a lot to be done on costings and negotiating with Local Authorities. In addition, operators need to be ever more thoughtful about the ways in which they manage their biggest asset, their staff. It is vital to spend more time thinking about how to develop your business and what the right approach is. We see very many care businesses and learn lots from our clients and would be happy to discuss things with you.



WHAT IS WORKING CAPITAL?

If you are buying or selling a care business, one area which often causes a headache during the process, is the concept of working capital.

Working capital is the amount of cash 'locked-up' in a business. In a care business, this is typically the difference between your trading assets (amounts owed from local authorities or private purchasers plus work done, but not yet invoiced) and the total of trading liabilities (payments to staff which have been accrued, PAYE and NI and trade creditors).

In residential care settings, where invoices are raised in the month of service and often paid in the month of service, working capital can be very low or zero. In specialist services, such as domiciliary care or supported living, where invoices are raised in arrears and then paid by local authorities sometime after that, working capital can be much higher.

A positive working capital balance (i.e. debtors greater than creditors) is what is known as the 'lock up', which typically needs to be left behind at sale to run the business. In other words, a buyer will pay you for assets that are surplus to this, but not the locked-up sum itself.

In order to minimise the effect of working capital on the deal, a business should control the amounts owed by local authorities or other purchasers as carefully as possible. Keeping this number as low as possible means you will receive more when you sell the business. Try to extend the payment terms for creditors, as this can also reduce cash locked-up in the business, so the maximum cash can be extracted on a sale.

If you wish to discuss how to minimise working capital in your business, or indeed estimates of how much value you could potentially be leaving in a business on a sale, please do not hesitate to contact Andrew Brookes or John Lucas.

COMPANY CORNER

AUDIT AND ACCOUNTS UPDATE

A recent change in company legislation that may impact on operators, is the change in audit thresholds (the level at which a company or group is required to have a statutory audit of its annual accounts).

For accounting periods commencing on or after 1 January 2016, companies will qualify as small sized and exempt from audit if they meet two out of the following three criteria:

- Turnover less than £10.2m (£12.2m for groups);
- Gross assets (fixed plus current assets) less than £5.1m (£6.1m for groups); and
- Average employee numbers of less than 50.

The two out of three criteria must be met for two of the last three financial periods, based on the new size limits.

The new size criteria will mean that some care businesses will now be able to claim an audit exemption from their December 2016 year end onwards, should they so choose (provided that an audit is not required by other interested parties e.g. the bank or a minority shareholder).

A further change for periods beginning on or after 1 January 2016, that small company operators need to be aware of, is that abbreviated accounts are no longer able to be filed at Companies House. Instead, 'filleted' accounts can be filed, which comprise a condensed version of the financial statements produced for shareholders. Increased disclosures are required in filleted accounts, compared to abbreviated accounts, which include a detailed breakdown of all balance sheet headings, average employee numbers by category and in certain circumstances, transaction with related parties including directors' and shareholders' remuneration.

Contact us to see if this may be appropriate for you. We would be happy to advise.

TAX UPDATE

Dividends reform

The 2016-17 tax year brought about a new regime for the taxation of dividends. The tax credit has been abolished and new higher rates of tax on dividends apply (the effective rate of tax was increased by 7.5%). To soften the blow slightly, a new £5,000 dividend allowance has been introduced.

Directors' loan accounts

Depending on the circumstances of the individual, interest on directors' loan accounts may no longer be subject to income tax, due to the new £1,000 'personal savings allowance', as well as the existing £5,000 'starting savings rate'. Directors may want to look at charging interest on their loans where they haven't historically done so, or check that the interest rate is set at an appropriate level to ensure they are maximising this allowance.

Due to the above changes, it is possible in certain circumstances for a director shareholder of an owner-managed company to receive the first £22,500 of remuneration, without incurring any income tax or national insurance liabilities (£45,000 for a couple) in 2017/18.

With all the recent changes in income tax rates noted above, together with a recent reduction in the corporation tax rate (20% down to 19% on 1 April 2016), it is definitely the time for owner managers to review their business and remuneration structure to make sure it is as tax efficient as possible.

We have many ideas on how to optimise the tax position. Further examples include transferring shares between spouses or to adult children to help fund university costs, through the use of the £5,000 dividend allowance noted above.

Should you wish to discuss this further, please contact Andrew Brookes, Rachael Anstee or Simon Worsley.

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