Health & Care Focus

DRIVING YOU TO LIFELONG PROSPERITY

Spring 2016

SPOTLIGHT ON FUNDING OPPORTUNITIES

INSIDE

HAZLEWOODS
DRIVING LIFELONG PROSPERITY

Funding Opportunities – spoilt for choice?

For good quality operators and services, the social care sector is currently in fairly good health in respect of funding availability.

Mainstream High Street lenders are still extremely keen to fund the reasonably secure, low-risk businesses with good quality freehold property, management, CQC ratings and levels of occupancy. This market is quite competitive at present and terms are generally very good for a quality business.

If you move away from the high quality care business with asset backing, the High Street banking appetite to lend reduces. That said, it does not mean they will not lend and we have recently been involved in a number of debt financed transactions in domiciliary care, live-in care and foster care.

There is, however, still a need and room for additional funding streams and a number of our clients have successfully utilised different types of funding over recent months.

Alternative funding streams include the following:

GROUND RENT SALES. Selling the Ground Rent of the freehold property portfolio on a long and low yielding lease, whilst retaining a virtual freehold which does not affect senior security (i.e. existing bank loans), nor diluting the EBITDA multiple on sale. However, this may only be an option for larger portfolios of assets.

CROWD FUNDING. A number of our clients have used Crowd Funding for both working capital purposes and making small acquisitions. There is very often more appetite in these scenarios than via High Street banks. Confidentiality of information on a web-based system remains a key risk and costs of finance can be fairly high.

ALTERNATIVE INVESTORS SUCH AS HIGH NET WORTH INDIVIDUALS.
High Net Worth Individuals are frequently seeking better returns from their cash and continue to investigate bridging the "equity gap" in smaller transactions.

NON MAINSTREAM BANKS AND SMALLER INVESTMENT FUNDS.
There are a number of such institutions who are currently keen on lending into the sector. They tend to lend in slightly less asset rich companies, although the returns required by them will be higher and they may even lend to levels that require small equity stakes.

PENSION FUNDING. Pensions can be utilised to buy trading properties and going concern businesses, or even releasing cash back into the business. Specialist advisers are required but this method certainly has been used in the social care sector and day nurseries to release cash.

SALE AND LEASE BACK. Similar to the sale of ground rents, although in these circumstances, the entire freehold asset is sold and leased back on a long-term basis by property funds such as REITs etc. The properties will need to be of a high quality to interest the investors, but it can help operators expand their businesses fairly quickly.

SOCIAL IMPACT FUNDS.
A large amount of capital is being raised by the social impact funds who wish to invest not only to generate returns for their investors, but to benefit society in general. A number of such funds are seeking opportunities to lend money and/or invest in equity within healthcare businesses.

To discuss how these alternative finance routes can be utilised in your business and what options may be available to you, please do not hesitate to contact John Lucas or Andy Brookes.

BUDGET 2016

CORPORATE TAX

Corporation Tax rate to be reduced to 17% by 2020

Brought forward **Corporation Tax losses** will be available for offset against any income and in any group company from 1 April 2017. Where profits are greater than £5m, only 50% of profits above this amount can be relieved

Corporation Tax deduction for interest expense – will be restricted to 30% of EBITDA from April 2017 for large multinational companies

Loans to a shareholder of a close company will be subject to tax at 32.5% from April 2016 (currently 25%)

PERSONAL TAX

Personal allowance to increase to £11,500 for 2017/18 (£11,000 in 2016/17)

Lifetime ISA to be introduced for under 40s. Individuals can pay in up to £4,000 per annum with a maximum £1,000 bonus from the government

INDIRECT TAXES

Sugar tax – to be introduced from April 2017 to help address childhood obesity

SDLT on commercial properties to move to a progressive system

CAPITAL GAINS TAX

Employee shareholder status (ESS) – exempt gains will be capped at a lifetime limit of £100,000 after 16 March 2016. ESS agreements already in place will not be affected

CGT rates to decrease to 20% and 10% for higher rate and basic rate taxpayers respectively. The current rates of 28% and 18% will remain for residential properties

Entrepreneurs' Relief – relief extended to investors with a separate £10m lifetime investment limit available where an individual has subscribed for shares in an unlisted trading company which are held for at least three years

National Minimum Wage and the National Living Wage – what's next?

April 2016 marked the introduction of the National Living Wage ("NLW"), a result of which employees aged 25 are entitled to pay at a minimum rate of £7.20 per hour. The increase from the National Minimum Wage ("NMW") equated to a rise of 7.5%.

When introducing the NLW in July 2015, the headline grabbing proposal also indicated an intention to increase pay to £9 per hour by 2020. In order to reach this level of pay in the proposed timescale, we estimate annualised increases of nearly 6% will be required. This compares to changes in the historical level of the NMW which have broadly tracked inflation.

Whilst the changes are commendable, the challenges facing the health and care sector are obvious given its historical reliance on lower paid employees to deliver value for money. Moreover, the ongoing fiscal pressures limiting council expenditure on social care, particularly for domiciliary care operators, suggest a real challenge for operators in being able to operate profitably and sustainably.

Notwithstanding this, there are perhaps one or two glimmers of hope on the horizon in terms of future funding. Firstly, after six years of council tax freezes, the Chancellor has provided local authorities with the opportunity to apply increases from April 2016, including 2% specifically in order to fund social care.

Secondly, there may be certain concessions in the form of reduced National Insurance and employment costs for employers of staff and lower pay rates.

Finally, there may be an opportunity to manage pay grades where possible through the use of younger employees. It should not be forgotten that the NLW applies for employees aged 25 and over, whereas those aged between 21 and 25 will continue only to be eligible for the NMW.

It clearly raises a real challenge for health and care employers, particularly where the rate of pay, after adding National Insurance and holiday pay, are so close to the rates that local authorities are prepared to pay for an hour of care. However, on the basis that local authorities will have to continue to deliver these front-line services, it seems inevitable that councils will need to contribute to the cost of changes.

Recruitment and staff retention are critical and will help keep costs down. Avoiding recruitment fees, agency cost or training time for new staff must help. We have a number of ideas on how to recruit more effectively and retain good staff. After all staff are our key asset and we would be happy to assist you with our thoughts and ideas.

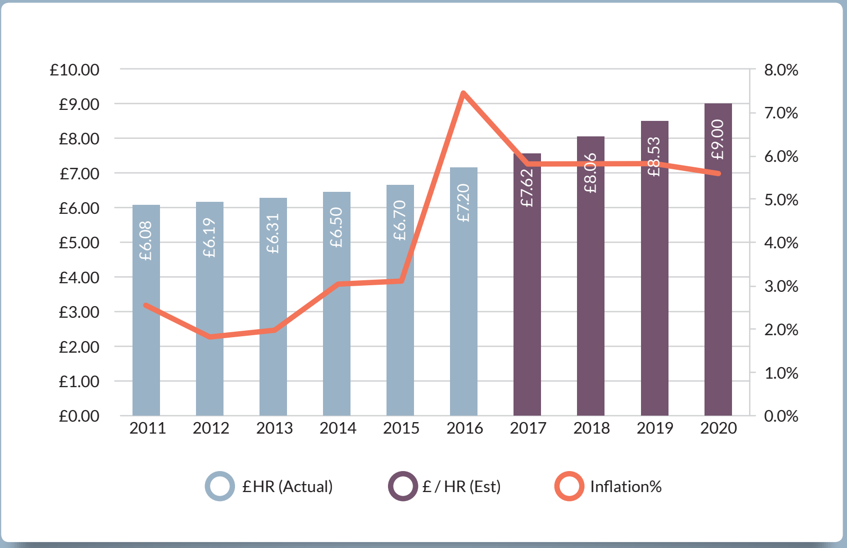
OTHER ISSUES IN RELATION TO PAY

As well as the changes to headline pay rates noted above, the health and care sector faces on-going scrutiny from HMRC PAYE compliance investigations and also in the form of on-going employment tribunals. The key areas of focus appear to be:

- Travel time (particularly pertinent for domiciliary care operators);
- Holiday Pay on overtime;
- Sleep-in shifts; and
- Training pay.

There seem to be few easy answers in this area and it seems likely that there will be further challenges in case law which may need addressing through legislation before such aspects are properly understood.

We would be very happy to discuss this with you and to talk through any concerns you may have and the ways in which some of our clients are seeking to mitigate these risks and challenges.



EMPLOYEE SHAREHOLDER STATUS – THE ESSENTIALS

Recruiting, incentivising and retaining key employees is vitally important for care operators. Tax efficient employee share schemes can be a way to achieve all of these objectives, whilst also preserving cash.

There are a number of different employee share schemes available and deciding on which scheme is right for the company can be a tricky task. In the past, the options have been a bit limited for care operators, as many were excluded as they do not meet the conditions to enable them to offer the most common tax advantageous share option scheme (Enterprise Management Incentives or EMI) to their employees.

A relatively new share plan that could be implemented by care operators is Employee Shareholder Status (ESS). Essentially, the employee is required to give up certain employment rights in return for a gift of shares worth at least £2,000 from their employer.

WHAT ARE THE BENEFITS?

The employee receives shares with potential for future growth and returns with a preferential tax treatment. The employer benefits from incentivising and locking in key employees whilst reducing their exposure to certain potential employment claims.

The individual will only be subject to income tax and National Insurance on the acquisition of the shares in respect of any value given in excess of £2,000. On disposal, there is no Capital Gains Tax (CGT) charge providing that the shares were valued at less than £50,000 at the time of acquisition and agreement was entered into prior to 17 March 2016. In the 2016 Budget speech, the Chancellor announced a lifetime cap of £100,000 on Capital Gains for agreements entered into after this date.

WHAT IS THE CATCH?

As mentioned, the individual will be required to give up certain employment rights in exchange for the shares. The employment rights sacrificed include; unfair dismissal rights (excluding automatically unfair reasons e.g. discrimination), statutory redundancy pay, the right to request flexible working and certain rights to undertake study or training.

It is, however, possible for the employer to offer some of the rights sacrificed back in the employment contract. The individual may, therefore, be left in a position not too dissimilar to a 'normal' employee, but with added incentivisation and tax benefits.

WHY ESS MIGHT WORK FOR YOU?

- **Growing business** – ESS will be particularly attractive to growing companies. The individual will be incentivised to improve the performance of the company and will receive CGT free growth (up to £100,000).
- **Entirely discretionary** – The employer can choose who to offer ESS to. The shares are gifted free of income tax for the individual (providing the value does not exceed £2,000).
- **Groups** – ESS can be offered shares in a subsidiary company, unlike other HMRC approved schemes, which need to have shares issued by the parent company.
- **Any trade or business activity** – there are no exclusions based on the activities of the company.

IS YOUR COMPANY STRUCTURE COSTING YOU MONEY?

Over the last few years, we have come across a number of situations where an existing business structure has cost operators significant amounts of money on sale. This could have been through increased tax on the sale of the business, or through the structure of the business causing uncertainty to an acquirer and thus reducing the multiple of profits, which they are willing to pay for the business.

It is important to ensure, well in advance of a company sale, that the structure of the business is as attractive and tax efficient as possible.

Situations which can cost you money if not correctly structured include:

- Not having a share structure that allows for Entrepreneurs Relief (in many cases the owner can believe they qualify for Entrepreneurs Relief, but the rules are different to the old Taper Relief regime);
- More than one trade in the company that is being sold and the cost of extraction;
- Having properties outside a company (maybe owned personally) when it would be beneficial for buyers and sellers if they were inside the company;
- Extracting cash prior to sale rather than retaining the cash in the business to benefit from Entrepreneurs Relief;
- Previous use of employment benefit trusts, EFRBS or other disguised remuneration schemes;
- Non-trading assets such as second homes or investment assets etc, being held by the company, which need reorganising prior to sale.

If any of these issues could be a concern for you or you have any other business structuring queries, please do not hesitate to contact a member of the Health and Social Care team. We are happy to talk through the work we can do to help you reorganise the business and ensure you achieve maximum value for your business whilst ensuring that tax paid on the sale is minimised.

Apprenticeship Levy – implications for groups of companies

As announced during the Chancellor's Summer 2015 Budget, an Apprenticeship Levy is set to come in from April 2017. Following consultation, HMRC has now released draft legislation with further detail on how it will operate. Based on the initial drafting, it appears that there could be wider consequences for groups of care companies than anticipated, with many being subject to the new levy.

The Apprenticeship Levy will be charged at 0.5% of the care operators total payroll bill, with a Levy Allowance of £15,000 available to offset against this. The initial view, therefore, was that any employers with a payroll bill of less than £3 million would not be affected by the new rules.

The legislation, however, as currently drafted provides that, for connected companies, only one company will be eligible to receive the levy allowance. Companies will be treated as connected for the purposes of the Apprenticeship Levy based on the old associated company rules. Therefore, groups of companies i.e. where one company is under the control of the other company as well as companies under the control of the same individual(s) will be caught.The group can elect which company receives the allowance but there does not appear to be any provision to transfer any excess allowance to other group companies.

So, take an example of a group with two companies, each having a payroll of £1 million. Logic would state that there is no Apprenticeship Levy, as the payroll will be less than £3 million for the group. However, you have to elect which company receives the £15,000 with no ability to transfer the excess. Therefore the "unelected" company, on the basis of draft legislation, will be subject to the levy at 0.5%, i.e. £5,000.

Conversely, if the group had all of its employees in one company, with a total payroll of £2 million, there would be no Apprenticeship Levy due.

This was not what was anticipated, given that the Government stated it would only affect the top 2% of payrolls. If the rules stand, as drafted, we would expect all groups of companies to be subject to the levy to some degree, where they have employees in two or more companies.

Hopefully changes will be made before the rules are enshrined into legislation.

PEOPLE OF SIGNIFICANT CONTROL REGISTERS

The Small Business, Enterprise and Employment Act 2015 introduced the People of Significant Control registers (PSC register).

From 6 April 2016 all companies and LLPs will be required to keep the new statutory PSC register in preparation for the need to file this information at Companies House from 30 June 2016.

A PSC is anyone in the company who meets one or more of the conditions listed in the legislation.

This is a person who:

- Owns more than 25% of the company's shares;
- Holds more than 25% of company's voting rights;
- Has the right to appoint or remove a majority of the board of directors;
- Has significant influence or control over the company; or
- Has significant influence or control over a trust or firm.

One of the reasons behind this change is to improve transparency around who owns and controls UK businesses. This is also a measure to improve the UK's reputation as a fair place to do business.

The register looks straight to the top to find out who the ultimate owner or controller of an entity might be. This would include an LLP and also covers foreign jurisdictions.

The penalty to directors or Persons of Significant Control who don't comply with the statutory requirement is a fine or a two year jail sentence.

You may elect to keep your PSC register on the public register at Companies House or to hold the register privately.

We can help you ensure you are compliant. Please contact Colette Reeves, our Chartered Secretary, on 01242 237661.

ENTERPRISE INVESTMENT SCHEME – THE NEW PENSION?

New rules which come into effect from April 2016 of this year will significantly restrict the tax relief higher earners can obtain on their pension contributions. The rules introduce a tapered annual allowance whereby individuals will lose £1 of their annual allowance for every £2 they earn over £150,000, subject to a minimum annual allowance of £10,000. This in effect means that any individual with earnings in excess of £210,000 will only be able to contribute £10,000 into a pension in any year and still receive tax relief on their contribution.

This has meant many higher earners are looking at what other tax efficient savings options there are available to them, to compensate for the huge reduction in their pension contribution allowance.

One such investment opportunity which is attracting much attention is the Enterprise Investment Scheme (EIS).

The EIS was originally introduced in 1994, and its aim is to encourage investment into small unquoted companies through a series of tax reliefs.

These reliefs include:

- 30% income tax relief on any contributions into EIS funds, subject to a maximum investment of £1 million per year.
- The ability to defer the payment of an existing Capital Gains Tax liability through investment of the gain into EIS qualifying shares.
- Almost all investments into these schemes qualify for Business Property Relief at 100% meaning there is no Inheritance Tax liability on these shares.
- All monies held within EIS funds should grow tax free.

Investors often approach EIS funds with caution, due to the higher risks involved with investing in such small companies. However, in more recent times, many EIS fund managers have attempted to mitigate many of the risks involved.

This can be done in a number of ways. For example, some funds have assets backing the investment, including property and technology, whilst other investment funds have a clear predetermined exit strategy, meaning there is a known clear plan for the fund not reliant on other unknown factors.

With over 40 EIS funds currently available, it can be very difficult for investors to decide which is the most appropriate fund for them. Hazlewoods Financial Planning use a series of research and analytical tools to filter funds to help recommend the most appropriate ones to clients.

Please contact Kyle Nethercott on 01242 682141 or kyle.nethercott@hazlewoods.co.uk should you wish to discuss this in more detail.

Company corner

DIVIDENDS REFORM

The 2016-17 tax year brings about a new regime for the taxation of dividends. The tax credit has been abolished and new higher rates of tax on dividends apply. To soften the blow slightly, a new £5,000 dividend allowance has been introduced. This could present an opportunity for owner managed care businesses which should look to ensure that both spouse's allowances are utilised where possible. We have ideas on how to optimise the tax position!

PERSONAL SAVINGS ALLOWANCE

From April 2016, a new personal savings allowance is introduced, exempting £1,000 of interest income from tax for basic rate taxpayers and £500 for higher rate taxpayers. Those paying tax at the additional rate will not receive an allowance. Banks are no longer required to deduct tax from interest at source. However, for the time being care operators will still be required to withhold tax when paying interest to individuals. So unfortunately, for now, CT61s still need to be completed.

DIRECTORS' LOAN ACCOUNTS

Depending on the circumstances of the individual, as described above under 'personal savings allowance', as well as the existing £5,000 'starting savings rate', interest on directors' loan accounts may no longer be subject to income tax. 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.

MAKING TAX DIGITAL

There has been a lot of press about digital tax accounts and the end of the tax return for self assessment, with a move towards quarterly reporting. However, in the latest roadmap from HMRC, they have also confirmed that this move will not be restricted to individuals. By 2020 it is expected that digital accounts and quarterly reporting will also apply to corporation tax and VAT.

THE SERVICES WE PROVIDE

Our Health and Social Care team is happy to discuss matters arising from this newsletter, as well as any other issues relating to your business or personal financial affairs.

- Accountancy and bookkeeping
- Taxation planning
- Management accounts
- Strategic planning
- Audit
- Raising finance
- Acquisition searches and advice
- Financial and taxation due diligence
- Confidential business disposals
- Sage advice and training
- Financial planning
- Payroll assistance to include bureau service
- Benchmarking and profitability advice
- Incorporation

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