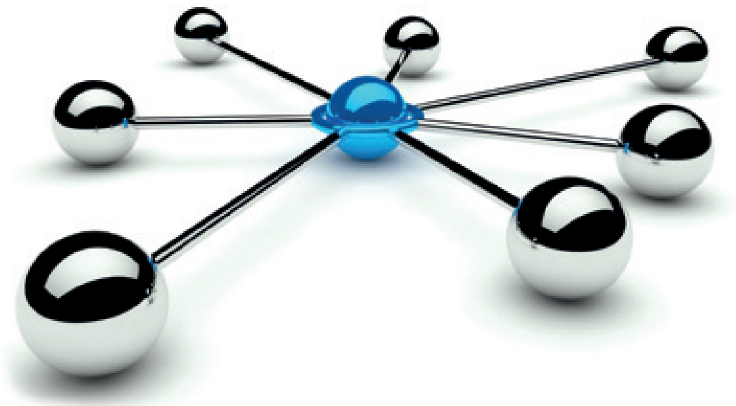
Autumn 2013

Veterinary Matters

Guiding you to lifelong prosperity

Incorporation



If you run your practice as a sole trader, partnership or LLP (generally known as unincorporated businesses), then perhaps at some stage you have considered whether incorporation would be right for you. Even if you are already a company, some of this article will still be relevant to you.

Setting the scene

Company corporation tax rates have continued to reduce, as summarised below for a standalone company:

	Taxable profits < £300K	Taxable profits £300K - £1.5m	Taxable profits above £1.5m
Current	20%	25%	24%
From April 2013	20%	23.75%	23%
From April 2014	20%	21.25%	21%
From April 2015	20%	20%	20%

This contrasts with comparatively higher rates of personal Income Tax and National Insurance (NI):

Income Tax Rates	£000
0% personal allowance	9
20% basic	32
40% higher	59
	100
60% income tax between £100k and £119K due to loss of personal allowance	19
	119
40% higher rate – on income to £150K	31
45% top rate – income over	150

NI (Class 4) is 9% on profit shares between approximately £8K and £41K and 2% above £41K.

Tax Savings – Real Life Examples

At Hazlewoods, we have undertaken well over 100 veterinary incorporations. Here are a few examples of the tax savings achieved:

Type of practice £000	Annual profits £000	Tax savings first 3 years after Capital Gains Tax & costs £000	Ongoing total annual tax savings - with Directors' Loan Accounts £000	Ongoing total annual tax savings - once Directors' Loan Accounts depleted £000
Husband & wife partnership	£400K	£168K	£94K	£15K
2 partner	£120K	£64K	£23K	£15K
3 partner	£725K	£193K	£101K	£73K
7 partner	£575K	£215K	£69K	£27K

Continued overleaf...

Is Incorporation Just About Tax Savings?

Commercial Aspects

It important to dispel one myth, this being that if there are tax savings to be had from incorporating, that it is a "no brainer".

The commerciality of incorporation, in particular the issue of goodwill, is also extremely important.

With an unincorporated business, there is no requirement to recognise goodwill. This is not to say that goodwill cannot be recognised - indeed many unincorporated practices do.

For the sale and purchase of company shares and for incorporations, HMRC require a valuation for shares that is commercial. This includes goodwill, i.e. goodwill has to be taken into account.

If you are currently a practice that does not recognise goodwill, then for any ownership changes post incorporation, goodwill would need to be taken into account. This would affect the value of the practice, probably significantly.

It may also be that having a company within your existing structure is more appropriate than a complete incorporation. This is likely to be more relevant to large partnerships.

Borrowings

It is worthwhile getting your banker on board at an early stage, ensuring that there will be no alteration to the terms of any existing loans and that new company bank accounts are setup in good time.

Properties owned by the practice

Thought should be given to how best property should be dealt with, i.e. go in to the company or remain outside.

It may be that leases need to be considered. Care should be taken to minimise any potential Stamp Duty Land Tax.

Limited liability

With a sole trader or partnership, the owners have unlimited personal liability. With a limited company (which is similar to a LLP in this regard), the owners' liability is limited to the amount they have personally invested, of course subject to any personal guarantees that may be given, e.g. to a bank.

Cars

How owners cars are dealt with should be considered, especially in Large Animals and Equine situations.

Remuneration Plan

A remuneration plan needs to be put in place, potentially involving spouses. This might include salary via the payroll, rent and dividends to the shareholders.

It is worth mentioning that an advantage of paying dividends is that they are not subject to NI, whatever their level and have an effective rate of 0% tax whilst within basic rate band (25% effective rate when in higher rate).

If remuneration remains within the basic rate band, it is often possible to avoid paying any Income Tax and NI all together (other than a small amount of Class 2 NI).

If further cash is needed by the Directors, then this can be drawn from the Directors' Loan Accounts, tax free, assuming they have not yet been fully drawn down.

Once the Directors' Loan Accounts are depleted, additional cash is often extracted by way of dividends.

The company will pay corporation tax on its profits at the appropriate rate (see earlier).

Get The Timing Right!

The timing of incorporation is very important. If the timing of incorporation is not planned carefully, unexpectedly high tax bills can result which could otherwise have been avoided.

Let's consider a partnership with a 30 April 2013 year end, the profits of which fall into the 13/14 tax year. If this practice incorporated on 31 March 2014 (also in 13/14), then 23 months of profits (less any overlap profits) would be taxed in 13/14 being those from 1 May 2012 to 31 March 2014! A potentially preferable incorporation date in this example may be 30 April 2014 to spread when profits are taxed across two tax years. This might also result in exposure to lower tax rates overall.

The timing is also important from a Capital Gains Tax (CGT) perspective. Using the above example:

- Incorporation takes place on 31 March 2014 – CGT payable by 31 January 2015
- Incorporation takes place on 30 April 2014 (i.e. after the start of the 14/15 tax year) – CGT payable by 31 January 2016, i.e. a whole year later, just by moving the incorporation date by one month.

Capital allowances (tax relief on plant and machinery, e.g. equipment) are not available in the final period of the unincorporated business.

How Do I Know For Certain If Incorporation Is Right For Me?

On the face of it, incorporation can sound complex. However, with the right expert advice, it need not be a minefield.

You should ensure that the advice you take is tailored to your specific circumstances. It is important that you understand not only the pros and cons and the potential tax savings, but also the commercial and practical aspects of incorporating.

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