Taxation of practice sales

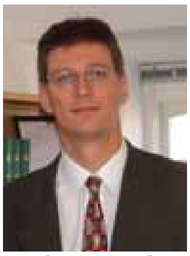
Maximise your profits, says **Andy Hodgetts.**

The last few years have seen some significant changes to the way in which tax is charged on the disposal of dental practices. With the right advice and a strategic approach, it's possible for practice-owners to maximise the profits when they come to sell. This article looks at some of the issues you may have to deal with.

The surplus made on the sale of a practice will be taxed under capital gains tax. In 2008 the previous Chancellor, Alistair Darling, moved away from the existing rules which taxed the gain at the taxpayers marginal rate, (usually 40 per cent), after excluding some portion of the gain under a taper relief calculation. Instead he brought in a flat rate of 18 per cent for capital gains but introduced a new element called Entrepreneurs Relief (ER). This had the effect of reducing the tax rate on gains covered by ER to 10 per cent.

Initially the lifetime limit for ER was set at £1m but in a surprise move Alistair Darling increased it to £2m in his last budget before the election. To further surprise, the Coalition increased the limit to £5m in the emergency budget last year. However they also increased the standard rate of CGT to 28 per cent for all gains except those where the taxpayer remains below the higher rate threshold (including the gain).

This has left us with a situation where there is now an 18 per cent difference between gains which qualify for ER and those which don't. Following a further increase in the recent budget this can cover up to £10m in total, that is, a maximum of £1.8m in tax savings. Now most dentists won't get anywhere near that level, but ensuring that you qualify for ER remains one of the most important items in planning the sale of your practice, and other assets linked to it.



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Practices which are unincorporated are highly likely to qualify for ER and there are two main criteria:
1. The sale must be the disposal of a 'material interest of business assets', or be associated with a material disposal
2. The seller must have been an owner of that interest for at least one year prior to the date of sale

There are more likely to be complications for incorporated dental practices. These need to meet the following, again for one year up to the date of sale:
1. The company has to be a trading company or parent of a trading company
2. The seller has to hold at least five per cent of the equity in the business
3. The seller must be an officer or employee of the company

For a dentist (1) will not normally be a problem unless the business has been mixed with other activities or it has built up meaningful surpluses and applied them in 'investment' activities. HMRC have a guideline of 20 per cent as the level above which these other activities become a problem, although that figure can

Exploit the generosity of the Chancellor by making the most of tax concessions.

be applied to a range of measures so there is no hard and fast rule.

The five per cent holding rule is more likely to be relevant where a principal has chosen to introduce key staff into minority ownership. Such shareholders will not benefit from the relief. This is also an important planning point as, where the opportunity exists with an incorporated practice, shares can be gifted to a spouse to make use of an additional entitlement to ER, as well as another annual personal allowance, but the transfer cannot be left until the last minute.

Where owners wish to withdraw from day-to-day involvement in an incorporated practice but are not ready to sell up, they will need to retain a directorship or employment to keep their qualification for ER. In non-dental family businesses we see this where owners want to retain an interest in the family company, sometimes so it can be passed on to future generations. These situations are not yet common in the dental sector, but there are dentists whose children enter the profession. By retaining a directorship the parent enables their offspring to join the practice-owning business in the future and they retain the ability to claim the ER in the future.

Other areas where vendors should ensure they have taken good professional advice include: non-cash consideration for the sale, that is, shares or loan notes; the treatment of practice premises, particularly when the practice has incorporated; what happens if an incorporated practice sells assets rather than shares in the company?

For some larger sales, and particularly where the buyer is a major corporate, it is not uncommon for part of the consideration to be deferred, (either an earn-out or loan notes of some sort). There have been changes in the way these items are taxed and a vendor is now commonly faced with a decision between minimising the tax liability but paying it all up front, or delaying the payment but probably paying more.

Where a vendor sells the practice premises at the same time as disposing of the practice this can qualify as part of the gain to be covered by ER. However, if the vendor decides they would prefer to hold on to it and have an income stream from the rent, it is unlikely that a later sale will still qualify. There are also implications for tax where the practice premises are held outside a limited company, linked to the level of rent which has been charged. We have seen lenders requiring a lease with the company at a commercial rental, but from the perspective of ER this can impact the level of relief. Sometimes the best answer is not absolutely clear and could depend upon the likely level of gain on the property.

It will normally be in the vendor's interest to sell their shares in the company. However, purchasers will usually prefer to buy assets, as it avoids the risks of them acquiring hidden problems within the company. It will usually depend on who holds the balance of power in the transaction as to which route is taken. If there is an asset sale then the company will probably make a gain on its disposal of the goodwill, equipment, and if relevant the premises. After settling its own tax liability the company will be sitting on a surplus which the owner will want to get hold of, but there will probably be a further tax liability involved in that process. Although in some circumstances dividends could be extracted tax efficiently over a number of years it is more likely that the company will be wound up. However, delays in doing that could impact the amount of tax paid at that point. Again it is important to obtain good quality professional advice to understand your likely tax liabilities and minimise them.

ER at 10 per cent at a time when CGT is 28 per cent is a valuable concession from the Chancellor and I'm sure that any dentist selling their practice wants to exploit this generosity. It may not always be on offer!

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