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Important Variables

Finance	Practice capital Practice income – what is included Profit shares Expenses and their allocation Superannuation	**Leave**	Holidays Incapacity Maternity leave
Management	Decisions requiring unanimity/majority Decision-making process Mediation and arbitration	**Departure**	Expulsion Restrictive covenant?

Essential Clauses

Identifiers	Date of document Name and title of practice The nature of the business List of partners Practice address Date of commencement and the duration	**Leave Arrangements**	Holidays Incapacity Study leave Maternity leave Paternity leave Sabbaticals
Finance	The capital Practice premises Practice income Division of receipts – profit shares Expenses and their allocation Superannuation Tax liability Accounts Banking	**Departure**	Resignation Expulsion Lengthy incapacity Retirement on age grounds Restrictive covenant?
Management & Decision-Making	Attention to the affairs of the firm Decisions requiring unanimity/majority Decision-making process Engaging and dismissing staff Mediation Arbitration Defence body membership		

Successful Partnerships - Plan For Succession

If you are a member of a partnership, you will know how important the individual partners are to the practice. Each partner brings his or her own skills and viewpoints together with responsibilities within which the practice operates. Remove one partner from the picture and the nature of the practice changes and could become destabilised.

It is important with all such business arrangements, particularly partnerships, to have a regulated Partnership Agreement. This forms the basis upon which the partnership can be operated.

Within the Agreement it will set out the position in the event of a partner leaving the partnership, retiring, on the grounds of ill health or indeed in the event of premature death.

We are all aware of the need to provide locum insurance, which provides an income to pay a locum in the event of the illness of a partner. The position does however differ if the partner is diagnosed with a critical illness or should die prematurely.

It would make good commercial sense in most practices to have a simple partnership protection arrangement, which would provide the surviving partners with funds to cushion the practice against possible future loss. Furthermore, if a partner dies, the surviving partners would receive a lump sum that could help finance the purchase of the deceased partner's interest, be it business loans, buying their share of the surgery premises, or paying out their partner's current account.

If a partner has to retire through serious ill health then a lump sum payment is made to the other partners. The ill partner then has the choice of selling their interest or retaining it, (which can have inheritance tax advantages by way of business property relief).

The cost of providing this peace of mind is less than you would imagine, it is however important to seek expert advice on this subject, as many individuals may disregard the Partnership Agreement and undertake cover of this type without consulting it.

It is therefore important to take legal, financial and accountancy advice before establishing this cover.

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News and Information from Hillier Hopkins LLP
Leading medical accountants and practice advisers
Summer 2007

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The Next Horror Story

As we mentioned in our last newsletter, each issue will contain a true horror story with names omitted to protect the innocent. This issue involves a situation where one of our members was asked to present their services to a six-partnered urban practice in the north of England who had hitherto used the services of a non-specialist accountant. Our member was successful in securing the appointment, but at the outset the senior partner asked the new accountant if he would review the capital account balances of the partners over the last few years as they had clearly got severely out of line and were nowhere near representing profit sharing ratio. The senior partner could not understand the differentials at all as he was responsible for calculating the partners' drawings and took great care in ensuring that drawings were equitable.

The new accountant agreed to the above task on the basis of no fee if nothing was found but an agreed "deal" if something came out of the woodwork. He asked for the practice accounts for the last ten years up to 31 March 2001. The accountant, true to his promise, undertook the review and found nothing of major importance in the first seven years to 31 March 1998. He then noticed that on 1 April 1998 three of six partners took out added years' contracts, which obviously meant that their superannuation contributions were going to be significantly higher than the other three partners. As the partnership shared "profits" equally it was agreed that the three partners with added years' contracts would pay to the practice the differential in superannuation contributions so that equality would be maintained and the capital accounts would not get unfairly out of balance. The accountant noticed that the balances on partners' capital accounts at 31 March 1998 were quite close and that the imbalance occurred during the three years ended 31 March 2001. The picture was beginning to form and "hey presto" a discovery was made.

The accounts were quite well laid out with a reasonable amount of detail. There was a note in the accounts, which broke down the NHS income of the practice over various headings. The accountant noticed that included in this note for each of the three years ended 31 March 2001 appeared an item entitled "added years". He also noticed that nothing appeared in the partners' accounts for capital introduced by the three partners who had taken out added years' contracts to effectively cancel or offset the charge made to those three partners' capital accounts by way of added years' superannuation deducted at source for these three partners.

Furthermore, because added years was charged to the three partners' capital accounts by way of drawings, the past accountant assumed that this related to "income" of these partners and consequently included it as part of their private income.

So what was happening here? The situation can broadly be summarised as follows:-

- The added years' contributions introduced by the three partners to cancel the charge on them was not disclosed as capital introduced but rather disclosed incorrectly as NHS income divided in profit share in error and taxed accordingly.
- The private income of the three partners was erroneously inflated by the added years' contributions and taxed accordingly.
- Of the above two items, only the former affected the partners' capital account balances, but both items affected the tax liabilities of the partners.

So what did the new accountant do? First of all, he calculated what adjustments were required to the partners' capital accounts for the three years ended 31 March 2001 had the profit shares been calculated correctly and the added years' contributions made by the three partners to the practice been properly disclosed as capital introduced. Low and behold the balances on the partners' capital accounts ended up very close to profit sharing ratio, which was originally intended. The new accountant proposed that these adjustments were made to the capital accounts in the year ended 31 March 2002.

But of course this was not the end of the story - there was the thorny issue of taxation to consider. Accordingly, the new accountant proceeded to re-do the Income Tax computations for 1998/1999, 1999/2000 and 2000/2001. Having completed the exercise, he prepared error and mistake claims for these years and set up a meeting with the local District Inspector of Taxes to go through the claims and agree matters. To cut a long story short, the meeting with the District Inspector of Taxes went well and the Inspector appreciated what had gone wrong and agreed to issue revised tax assessments. The amount of tax overpaid by the partners and due to be refunded with interest was broadly calculated as follows: -

Annual added years £4,000 x 3 partners x 3 years x 2 for duplication in practice and private income = £72,000 at 40% tax = £28,800 plus interest. Finally, the new accountant calculated how the £28,800 was to be divided between the partners and advised the practice accordingly.

The practice was of course delighted at the outcome. There just remained one final issue to resolve - what was the new accountant's fee for this special one-off exercise? True to his word, the new accountant proposed a "deal" of a fee of £1,000 plus VAT = £1,175 which was agreed by the practice and duly settled immediately. The final sequel to the story was the new accountant contacting the old accountant to explain what had happened and that the practice was not particularly happy with their work. Accordingly, the previous accountant agreed to meet the fee and VAT of £1,175 and duly reimbursed the practice.

At the end of the day, the practice were happy that matters had been sorted out, their capital accounts were no longer in imbalance, they had received a tax refund of £28,800 plus interest, and this situation had been reached at no cost at all to themselves in terms of professional fees. The moral of the story is again clear - medical practices need to engage accountants who know their way around the specialist area of medical finance.

VAT - Further Pronouncements

Since our last newsletter there have been two significant pronouncements made by HM Revenue & Customs (HMRC), the first on 15 December 2006 which clarified problems being faced by dispensing practices who generally registered for VAT on 1 April 2006, and the second in January 2007 which set out the changes to the exemption for medical services from 1 May 2007 following the European Court of Justice decision in the case of Dr Peter d'Ambrumenil and Dispute Resolution Services.

VAT Information Sheet 15 December 2006

Since 1 April 2006 dispensing practices have been concerned as to the timing of VAT Return declarations, in particular when supplies to the NHS should be declared given that the value of the supplies made in any month may not be known for up to 3 months until the statement of fees is received. In Information Sheet 12/2006, HMRC have confirmed the following points:-

- Dispensing practices with an annual VAT exclusive taxable (ie standard rated and zero rated) turnover not exceeding £660,000 may use the cash accounting scheme under which VAT Return declarations are based on payment dates - thereby permitting a practice to declare the supplies made when payment is received rather than in the month in which the supply was made. Using the cash accounting scheme therefore solves the problem.

- For practices unable (or unwilling) to use the cash accounting scheme, HMRC have confirmed that the supplies made to the NHS can be declared on the VAT Return based on the date of the statement of fees/drug dispensing statement. Therefore, for example, if a practice supplies goods and services to the NHS in month 1, but does not receive the statements showing the value of those goods/services until month 3, the supplies should be declared on the VAT return for month 3 (or, if quarterly VAT Returns are submitted, the VAT Return that includes month 3).

In the Information Sheet, HMRC have also given advice in relation to the VAT treatment of income shown on the statement of fees. They have confirmed that none of the income is subject to VAT at the standard rate and that, where the income relates to supplies of medical services that income is exempt from VAT. However, in paragraph 2 of the Information Sheet, HMRC goes on to say that general payments and reimbursement of practice costs (for example GMS global sum, MPIG correction factor, computer costs and notional rent) are payment partly for the exempt medical services and also partly for the zero rated supplies of dispensed drugs and therefore those amounts need to be apportioned so that part is treated as exempt and part is treated as zero rated. Frankly, the effect of this is likely to be minimal particularly bearing in mind the complexity of the calculation. Thus, if practices are looking to keep their VAT accounting as simple as possible, they should continue to treat the statement of fees as exempt rather than make the above apportionment. However, if practices wish to make the apportionment they should refer to VAT Notice 700 to get the appropriate guidance.

The final point within the Information Sheet worthy of mention relates to the Dispensing Drugs Statement. The payments received on this statement relate in part to the zero rated drugs dispensed under NHS prescriptions and also to the exempt personally administered drugs. A calculation needs to be made to determine how much is zero rated and how much is exempt. HMRC have now confirmed that instead of undertaking the detailed calculation set out in their manual, a simplified calculation can be undertaken which avoids the need to refer to the drugs tariff and actual purchase invoices.

An example of the simplified calculation is as follows:-

Basic price	£4,216.60	=	A
On cost	£442.74	=	B
Additions	£nil	=	C
Discount	£(304.03)	=	D
Dispensing fees	£733.00	=	E
Container Allowance	£21.15	=	F
Vat Allowance	£88.40	=	G

Total payment received for zero rated dispensed drugs and exempt personally administered drugs is:-

A (£4,216.60) + B (£442.74) + C (£0) - D (£304.03) = £4,355.31
Value of exempt drugs within £4,355.31 is:-
VAT figure G $\frac{£88.40}{17.5}$ x 100 = £505.14

Therefore, zero rated drugs value is £4,355.51 - £505.14 = £3,850.37 (88.40% of total). Apportionment of dispensing fees and container allowance:-
E (£733.00) + F (£21.15) = £754.15 x 88.4% = £666.66 zero rated amount.
Exempt amount is therefore £754.15 - £666.66 = £87.48.

VAT Notice 701/57 Health Professionals January 2007

This Notice refers to the changes to the exemption for medical services from 1 May 2007 which affects all dispensing practices (who have already registered for VAT) and could potentially affect a few of the larger non-dispensing practices. The changes at the time of writing remain subject to House of Commons approval.

Essentially, VAT exemption is to be restricted to "medical care" which is defined as those services intended principally to protect, maintain or restore the health of an individual. Medical services which are primarily for the purpose of enabling a third party to take a decision become taxable. This means that VAT liability is dependent upon the purpose for which the supply is made, which HMRC refer to as the "purpose test". To qualify for exemption, the purpose must be therapeutic. Full guidance is given in Notice 701/57 which can be obtained from HMRC, but if still in doubt you can contact the National Advice Service on 0845 010 9000. By way of example only, the following services will become liable to VAT at 17.5% from 1 May 2007:-

- witness testimony, reports for litigation, compensation or benefit purposes.
- reports and medicals for the purpose of providing certain fitness certificates.
- some occupational health services.
- medical services provided for the purpose of valuing insurance policies for tax purposes.

The above will clearly affect all practices currently registered (ie all dispensing practices), but it could affect non-dispensing practices if their total taxable income exceeds £64,000 per annum which is the 2007/08 VAT registration threshold. To avoid the need for registration, large non-dispensing practices with taxable services exceeding £64,000 per annum should consider making the income the private income of the individual partners to keep the amount involved below the threshold.

One grey area involves the conducting of a medical to assess the level of insurance premiums. In the case of Morganash Ltd, a ruling was given that medical services which were undertaken for the purpose of enabling a provider of life assurance to decide whether to accept a proposal for a policy fall within the scope of the UK exemption for insurance related services. At the present time HMRC accept that insurance related medical services related to the setting up of contracts, the administration of policies or the handling of claims, will remain exempt from VAT, pending any amendment of the UK exemption for insurance services.

By way of further examples only, the following services will still qualify as exempt:-

- health screening under private medical insurance policies - these are regular check-ups to detect early signs of disease.
- income/credit protection insurance medical services where the policyholder has fallen ill (as opposed to losing their job) which are aimed at assisting the individual in returning to a normal life.
- motor insurance - where medical services are provided under a policy to assist in enabling an injured motorist to return to full health and/or work. (Note - this does not include medicals undertaken for DVLA purposes to ensure initial or continued fitness to drive which are liable to VAT at the standard rate).
- any other medical service provided in connection with an insurance policy where the principal aim is to assist in restoring the health of the individual.

Life certainly does not get any easier. If you think you may be affected by the above changes, contact our VAT partner Robert Twydle on 01923 232938 or email info@hhllp.co.uk.

We acknowledge the valuable assistance of Braim VAT Consultancy in compiling the above article.

Partnerships - The Legal Status

Since 1 April 2004, corporate bodies have been able to negotiate with PCTs to obtain a contract for the provision of medical services, yet medical practices have thus far been reluctant to change their structure from partnerships to limited companies. This is due to a number of valid financial reasons, such as:

- Loss of the benefit of the NHS Superannuation Scheme.
- For accounting year ends other than 31 March, there would be "catch up" tax and "catch up" pension contributions known as the overlap tax and pension time bomb.
- Dividends from limited companies are thus far not pensionable.
- Accounts would be publicly disclosed and in a format not necessarily helpful to the management of a practice.
- The administrative burden of compliance with the Companies Act.
- The potential tax disadvantages of transferring surgery premises into a limited company.
- Higher professional fees.
- Directors' salaries will attract penal employer's national insurance contributions.

It is therefore unlikely that there would be a "rush" to incorporate even if the superannuation issue were to change if the Department of Health were so inclined. Accordingly, a reminder of the legal status of partnerships is considered timely.

There is only one major piece of legislation that governs all partnerships, including those in general practice – the Partnership Act 1890. This Act is unusual in parts in that certain provisions (concerning partners' relations to one another) may be varied by agreement between the partners. Only in the absence of any agreement on these issues will the Act's provisions apply. The Act is divided into four main parts as follows.

- Definition of partnership.
- Relations with non-partners (the outside world).
- Relations of partners between themselves.
- Dissolution and its consequences.

Definition of partnership

The first clause in the Act sets down that

"Partnership is the relation which subsists between persons carrying on a business in common with a view of profit"

The meaning of business in common is important because partners can only be held liable for debts in relation to this "business". For GPs this usually means the provision of general medical services to a list of patients.

Obligations to the outside world

The Act imposes a joint and several liability on each partner for partnership debts incurred while he or she is a partner. This liability cannot be waived by agreement. For business purposes every partner is an agent of the partnership and anything done in the ordinary course of the business binds the partnership and the other partners. Such a liability may extend to a debt incurred by a person acting, or apparently acting, on behalf of the partnership, if the creditor is unaware that the person does not have the authority of the partners.

The joint liability principle includes the possibility that any partner may be sued individually, for example by a patient, and thereby be forced to settle a claim in full. (He or she may then have grounds to sue the other partners for redress). In some cases a court may require that all the partners be joined in an action. It is also possible that a patient dissatisfied by one partner can sue the whole partnership, hence the vital necessity of all partners having defence body cover. Innocent partners cannot be held liable for crimes committed by a partner, but they may be held liable for any civil damages incurred.

Relation of partners between themselves

The rights and obligations of partners to one another are subject to agreement between themselves. In the absence of any agreement the following will apply.

- All assets acquired by the partnership become partnership property.
- Partners have a right to an equal share of the capital and profits.
- All partners have the right to take part in the management of the partnership.
- No partner may receive "remuneration" for acting in the partnership business.
- The admission of a new partner requires unanimous consent.
- Only a majority of partners is required to decide on "ordinary matters".
- No partner may be expelled unless a power to do so is expressly agreed.
- A partner may dissolve the partnership at any time without notice.

Dissolution and its consequences

Dissolution – the breaking up of a partnership – occurs when the partnership relation terminates, even though the partners may continue to be associated together in a new partnership, or simply to oversee the winding-up of the business. Legally, dissolution will be held to occur because of one of the following.

- By any partner giving notice to the others (subject to agreement).
- By mutual agreement of the partners.
- By fraud or misrepresentation.
- By a repudiatory breach of the partnership agreement by a partner.
- By the death or bankruptcy of any partner (subject to agreement).
- By illegality.
- By the order of a court.

Among the grounds on which a court may order dissolution are: when a partner becomes permanently incapable of performing his or her part of the partnership contract (including because of "unsound mind"); when a partner is in breach of an express or implied term of the partnership agreement; or when the business can only be carried on at a loss.

New partners

It should be noted that the admission of a new partner will as a matter of law constitute a new partnership, therefore his or her liabilities do not extend to those debts incurred before he or she became a partner (and possibly to those after he or she left). However, a new partner may be bound by a pre-existing partnership agreement if he or she is aware of it and behaves as though it was agreed.

Outgoing partners

Generally a partner leaving (for whatever reason) will terminate the partnership unless the agreement stipulates that the others will carry on as before.

Written Agreement

Because of the problems that may arise, it is recommended that the arrangements between partners should be defined in a written agreement prepared by a solicitor. However, such a document may run to 30 or more pages, so the preparatory work should be broken down into manageable blocks. Set out below are the steps to follow.

Partners should first determine amongst themselves what financial and other arrangements will apply to the more variable clauses (see the "Important Variables" box). This will reduce the time spent in arguing in front of a solicitor (who may be paid by the hour).

Next, based on the preliminary discussions, the solicitor should be instructed to prepare a draft agreement. Once this draft is suitably amended it may be signed by all the partners. This may look a simple process but it may take a number of months from start to finish.

Agreements tend to follow a predetermined model and include clauses that are common to all. These "standard" clauses are either taken from the Partnership Act or are implied in all partnerships (e.g. to be just and faithful). For the full agreement, see the "Essential Clauses" box. Some of these, like the identifiers, can be written fairly quickly. Others, such as the finance clauses, may already be in operation, as reference to the practice accounts will show. Yet others may be the subject of verbal agreement, such as holiday arrangements.

Each section, identifiers, finance, etc should be the subject of a separate partnership meeting and a written record kept of what is agreed. Although this process may take some time, it should minimise "agreement fatigue". Only when it is completed should partners start instructing a solicitor.