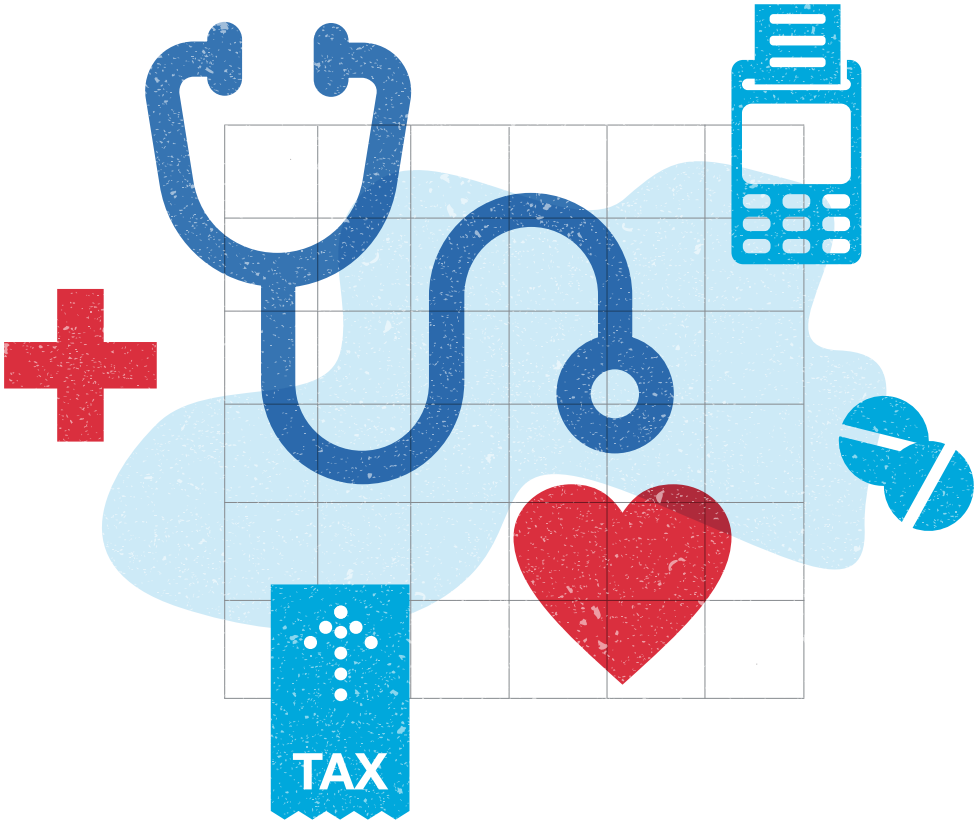
Health care

GP Finance Update

PKF FRANCIS CLARK
Shared Ambition

NEWSLETTER
ISSUE 2



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Welcome

I recall writing in a previous newsletter that the General Practice landscape was extremely challenging (mind you, when is it not), due to the worldwide pandemic that ensued in early 2020. It seems that despite being more than two years on, the challenges are as great as ever. Patient demands seem to be ever increasing and with the changes in technology and the way in which communication has evolved over the previous two years, patients now expect instant solutions and responses. There's also the backlog of patients on hospital waiting lists, which are at an all-time high.

Over the past 15 months or so, General Practice has provided an astounding number of Covid vaccinations, and this has been the backbone of the vaccination campaign. Our whole-hearted thanks goes out to you all, as without you we would not be protected in the way that we are now, and the country would almost certainly be in a much worse state.

As we head further into 2022, now needs to be the time to focus on the year ahead and concentrate on the financials, as well as the clinical and other admin work. Income for Practices has been protected or supported in some form throughout the pandemic and as we know, this level of support will not continue forever. Over the coming 12 months Practices will be entering a period where costs are rising and income could be reducing.

Our newsletter covers a variety of topics that we hope you find useful, including looking at the upcoming changes to the rates of national insurance and pension contributions, dealing with topical frequently asked questions, considering how software can assist practices to become more profitable and finally, reviewing the impending changes to the taxation of trading profits.

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A year of change

National Insurance

As part of the Autumn Statement in 2021, the Chancellor highlighted the rising costs of Social Care and to deal with this, proposed to raise more revenue by increasing National Insurance. From April 2022, National Insurance rates across the board will increase by 1.25% - this is for both employer and employee, as well as the self-employed.

A 1.25% increase may not see an awful lot, but it will impact on take-home pay for most of the country. This is the first year in many, where taxpayers will be worse off due to a Budget change - see worked example in section below.

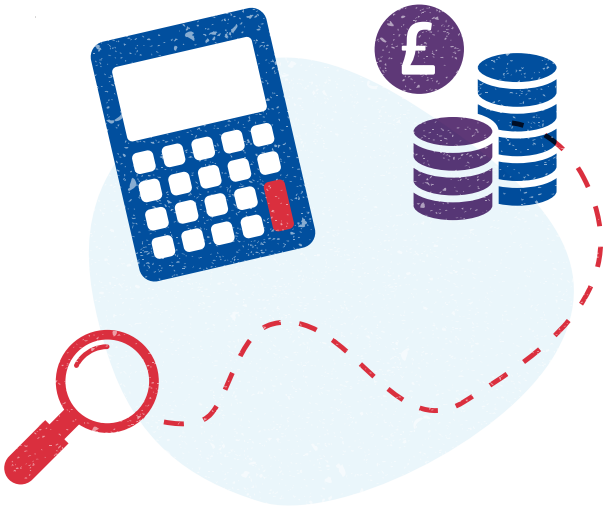
With the recent increases in the Energy Price cap, those on modest incomes are really going to struggle this year. Of course, the Government has announced some support towards the increase in energy costs but given the 54% increase in April and a likely further 20% in October this really won't prevent many people getting into difficulty.

From a Practice point of view, with many staff paid around the living wage, there could be a great deal of concern among employees. Practices may be considering support that they can provide and whether the Practice can afford any pay rises to try to maintain a balance with take-home pay. From a review of the announced NHS contract changes for the 2022/23 year, it does not appear as though any additional funding has been provided to support with this, although the BMA has not yet agreed the changes and negotiations continue.

To combat the rate increase, in the 2022 Spring Statement, the Chancellor announced an increase in the primary earnings threshold/lower profits limit for National Insurance. This sees the planned threshold of £9,880 for 2022/23 increasing to £12,570 from July 2022. The increase will be welcome news for many, as this will bring about an uplift in take-home pay of just under £30 a month (compared to where they would have been had the threshold not been increased) and mean anyone under that level of earnings will not pay any tax or National Insurance. Of course, there will be three months of pain until the change is implemented from July.

As well as levying additional National Insurance on employees and employers, the Government will also increase the dividend tax rates - the current rates of 7.5%, 32.5% and 38.1% will all increase by the same 1.25% and become 8.75%, 33.75% and 39.35% from 6 April 2022.

From April 2023, the 1.25% increase in National Insurance will become a deduction in its own right, where it will be rebadged as the 'Social Care Levy'.



Pension contributions

Following the outcome of the McCloud and Sargeant cases concerning age discrimination in public sector pension schemes and notably the 2015 section of the NHS pension scheme, the Government published a consultation document in late 2021, proposing a change to the rates and bands for NHS pension contributions.

From 1 April 2022 all active NHS pension scheme members will be moved to the 2015 section of the NHS pensions scheme. Historically, members of the 1995/2008 sections (other than GPs) built benefits with a final salary link. For the 2015 section, benefits are calculated based on a Career Average Revalued Earnings model. This means that pension benefits are built at the same rate for all members, so contributions could be altered to allow for this change. Ideally, each member would pay the same rate. Tier rates are currently weighted more heavily towards higher earners, given the final salary link.

The Government states that they require an average contribution of 9.8% on pensionable earnings to fund the scheme. Tier rates have historically varied between 5% and 14.5%, increasing through the scale as members' pensionable earnings increase and are based on Whole Time Equivalent pay e.g. if you work 3 days a week, your tier-rate would be based on 5/3 of your salary. Under the proposed changes, contributions would be based on actual pay, which seems sensible, and range between 5.1% and 13.5% in year 1 then 5.2% and 12.5% in year two. There is a two-year period which contributions are transitioned to the new rates. An employee earning £25,000 will see their contribution rate increase from 7.1% now to 8.3% in the second year. This is a huge increase - see worked example below.

As well as a change to the required contributions, there will also be annual changes to the tier threshold, based on Agenda for Change (AfC) annual pay awards.

In February 2022, the Government updated its proposal and confirmed the intended changes. The original consultation document proposed changing contribution rates from 1 April 2022, however, given the additional costs of living that many will be facing, the implementation has been pushed back to 1 October 2022.

The delayed implementation date clearly gives some reprieve, but you have to question whether this will be administered correctly for GPs. Primary Care Support England (PCSE) have historically struggled to process changes within a reasonable timeframe, so introducing a further mid-year change may well cause lead to duplicated or erroneous contributions.

Following the impending increase in National Insurance, as well as the pension contribution changes, an employee earning £25,000 a year will see reduction of £5* in monthly take-home pay. For the employer, this will also mean an additional annual cost of £185.

On the face of it, £5 a month is hopefully not the end of the world, but Practices needs to consider the strains on their employees already, which coupled with perhaps a further £70-80 per month payable on energy bills, this could start to become a struggle for many.

**based on comparing old and new National Insurance rates with the increase in National Insurance thresholds, as well as pension contributions from October 2023 and assuming other rates and allowances remain the same.*

Your questions answered

Why are my taxable profits much higher than my drawings?

Drawings are essentially an advance on anticipated profits. Drawings are not taxed. An individual is taxed based on their share of taxable profits - taxable profits are the profits allocated within the Partnership accounts after adjustments for items such as the add-back of depreciation but deduction of capital allowances. A figure will be arrived at, and this will flow through to the individual's personal tax return and tax will be calculated from there.

Drawings are quite a loose term. Most Partners/GPs will feel that their drawings are the amounts that are paid to them monthly. However, drawings contain many other different forms - examples of these will be pension contributions, or personal accountancy fees e.g. the Practice may pay something on behalf of the GP, they just haven't paid the funds directly to them.

Expanding on this further, Partners who are members of the NHS pension scheme will be aware that contributions need to be made to fund their pension. At Practice level, contributions are taken (hopefully!) from the monthly GMS/PMS statement, based on estimated pensionable profits for the year. These payments belong to an individual GP and the payment is recorded within their overall drawings total. As well as these monthly contributions, estimates for future adjustments to be collected/repaid based on estimated pensionable profits for the accounts in question are included. This is to ensure Partners' do not stumble across unexpected liabilities in the future and that funds are reserved 'now' to meet those liabilities.

As Partners will be aware (and hope), there is usually an annual balancing exercise that is carried out as part of the accounts process. This exercise compares profits generated during the year against drawings paid out. Surplus profits (the excess of profits generated over drawings) are then usually able to be paid out to Partners after the accounts have been approved, subject to Practice cash flow.

Often, Partners may be entitled to large sums and these sums may go a good way to supporting upcoming tax liabilities. Due to their nature, they will be paid in the following accounting period and will not show in the annual accounts for the year in question. Bear this in mind, as it is these payments that also need to be considered when comparing 'drawings' to taxable profits.

Where there have been post year-end changes to Partnership sessions, continuing Partners may be obliged to buy-out those sessions or pay-in more if they've increased their own sessions. These numbers can be substantial and can eat into some or all of any intended pay-out. This can have a large impact as tax liabilities will be due based on taxable profits actually generated, but the Partner may not have received all of the surplus to help towards these. In situations like this, it may be worth a discussion with the Practice – is the amount being kept in to fund an additional buy-in affordable. If not, the additional amount/or the tax shortfall could be funded by loan. It may be an idea to view this as a loan taken out to fund investment in the Practice, rather than fund tax liabilities.

Our Practice cash balance looks healthy, can we pay something to the Partners?

Reviewing the Practice bank account on a regular basis is good practice. This allows the Practice to ensure cashflow is retained and the Practice can operate smoothly and efficiently. There can often be points throughout the year where cash may look high and the Partners, or Practice Manager may consider making ad-hoc distributions to the Partners.

A high cash balance may well be a positive sign and could be due to increased or retained profits. Partners often draw out a relatively modest sum each month, to ensure they avoid over-drawing and needing to pay monies back into the Practice, once the accounts have been prepared and the balancing exercise has been completed. Those profits which aren't drawn would of course sit within the Practice bank account throughout the year and cash could quickly increase.

Having said this, a high cash balance may be a sign of outstanding liabilities. Whenever the cash balance is reviewed, liabilities must be considered, and the available cash must be reduced to factor this in. Liabilities are largely known, such as the previous months' drug invoices, PAYE and NIC, pension payments and other supplier invoices. However, there can often be hidden (or less visible) liabilities such as pension contributions for the Partners and salaried GPs. As we know pension contributions for GPs are usually taken monthly but these are a) based on estimated profits and b) may not always be taken regularly or correctly. If Practice profits increase substantially for a year, then around 25% or so of those additional profits will need to be retained, as they will need to be paid over to PCSE at some-point in the future. As well as contributions for the current year, there may be historic liabilities due to unprocessed pension certificates for the Partners or salaried GPs. As we know, these can be many thousands of pounds and so it is vital to ensure that surplus cash is also adjusted for these, otherwise the Practice runs the risk of struggling to meet future liabilities, as well as the possibility of asking Partners to pay back into the Practice - not an ideal situation.

If you've considered the above and are happy that there is still a surplus, then additional payments could well be made. Consider how these will be split between Partners before doing so.

If you are unclear what may be owed to PCSE or would like assistance in identifying if ad-hoc payments can be made, please contact your usual PKF Francis Clark contact.

Efficient system, efficient Practice

Given the impending changes in pension contributions and NICs, as well as the forthcoming implementation of Making Tax Digital for self-assessment, now appears as good a time as any to get on top of Practice finances and review whether your current system gives what you need.

Many Practices continue to keep their records using IRIS software, or perhaps manual spreadsheets. Whilst these serve a purpose and there may never have been complaints about the information provided or produced, technology is moving on and there is now software that can reduce record keeping time, while allowing Practices to keep a better handle on their finances in real time.

So how can the software help?

Modern accounting software, such as Xero or Quickbooks are cloud based. This means that they are 'live' and financial data can be accessed in real time and at the click of a button - if it took your fancy, you could check practice profits, review accounts receivable and payable and even do some of the bookkeeping, all whilst sat in your front room of an evening. Clearly, completing the record keeping outside of working hours is not ideal, but the reality is that many Practice Managers do just this. They are needed to run the Practice, but also deal with the finances. The latter is often left to be completed in evenings or weekends and if that's required, making it quick, easy and as accurate as possible clearly makes sense.

Software such as Xero or Quickbooks allows for Practice bank statements to be imported directly in to the software, by a 'bank feed'. Essentially this results in the transactions from bank statements automatically appearing in the software and this should help end the onerous task of manually entering bank statement lines - not the most enjoyed task in the world. Once the transactions appear, the software then provides suggestions (based on past practices) as to what the income or expense may relate to and where it should be posted. These can be accepted, or easily changed if there's a better classification. Removing the need to manually enter statements should be a huge time saver.

Once the data has been entered and reconciled, you are able to pull off reports at the click of a button should you wish to review aged receivables, payables, or even look at drawings payments to Partners over a period of time.

As well as this, it's easy to view an up-to-date profit and loss account or balance sheet, so that you can review the profitability and stability of the Practice. As we know, GP Partnerships are not the simplest of businesses and so a great deal of care is needed when reviewing a profit and loss account - for instance, profits for a period may seem high, but that could be because there have been additions to the Partnership group, resulting in reduced salaried or locum GP costs. A higher profit is usually positive, but it's the impact on the underlying Partners that counts. As the data is there (and live), reports can be built and tailored to compare profits with previous periods, analyse income lines to ensure there's nothing missing, review expenses to keep a handle on costs and monitor cashflow to ensure upcoming liabilities can be met. Regularly reviewing the data will help lead to a more efficient and profitable practice.

Moving forward, ensuring software is compliant with Making Tax Digital is clearly important. Manual spreadsheets won't be compliant and it's likely, that software such as IRIS may not be able to introduce the required links to report to HMRC on a regular basis. Clearly, changing software when forced to isn't ideal, so planning ahead and making the changes now, should allow for a relatively seamless and stress-free transition.

How do I get the software in place?

It's relatively straightforward. Clearly there are some initial costs to get this in place and we can assist in the creation of a Xero account, tailored 'chart of accounts' to allow for a coding structure that suits your preferences and training to get the most out of the software.

The set-up and implementation are relatively quick and once the training has been provided the records can start to be kept. There will then be a monthly subscription cost, incurred by us and disbursed to you throughout the year. On average, this should be no more, but is often cheaper than current software subscriptions, but is dependent on requirements.

Should changing to a cloud-based software be of interest to you, please let your usual PKF Francis Clark contact know.

Tax basis - Forewarned is forearmed

Individuals are currently taxed on a 'current year' basis, other than opening and closing years of trade. That is, profits are taxed from a twelve-month period of accounts that falls within a tax year. For the many practices with 31 March year-ends, HMRC accepts that as a proxy for the 5 April UK tax year end, so they are relatively straightforward. Practices with non-March year ends however suffer from complicated and confusing rules when partners join or leave.

For instance, take a 30 June 2023 year-end with a new partner joining on 1 July 2021. HMRC requires them to be assessed, in their first (2021/22) tax year on profits arising from 1 July 2021 to 5 April 2022. For the second (2022/23) tax year, profits are assessed on the full year to 30 June 2022. As you can see, profits arising between 1 July 2021 and 5 April 2022 are taxed twice. These are called 'overlap profits'. Overlap profits are then relieved when the Partner leaves or retires from the Partnership - but that may be many years later and when profit levels are fundamentaly different.

As many may be aware, the Government has for several years been working towards a more modern, real-time tax system. 'Making Tax Digital' (MTD) for VAT was introduced in April 2019 for compulsorily registered businesses and will apply to all VAT registered business from April 2022. The intention is to bring in the same for Self-Assessment (i.e. individuals' income tax) from April 2024, with Partnerships following in April 2025. The premise behind this is that self-assessed taxpayers will need to report (and eventually make tax payments) quarterly, rather than once or twice a year. To get to this point, the way in which individuals are taxed on trading profits needs to change, or the complexities of overlap profits will be even less clear. In addition, GP practices will need financial systems capable of 'real-time' reporting, which for many is a far step from now - details of this were covered in the article on software.

In mid-2021 the Government published a consultation document proposing that individuals be taxed on a 'tax year' basis, rather than the above 'current year' basis; that is, profits will be taxed for the period 6 April to 5 April (or 1 April to 31 March) each year and the year-end accounts date for tax purposes will largely become redundant. Hence the desire to streamline processes and reduce costs will, we expect, mean most or all Practices will change to 31 March financial year-ends in due course.

The changes will accelerate tax liabilities for many individuals, including GP Partners, because of the change in basis and the interaction with overlap profits.

The consultation document, with some slightly tweaks has now been incorporated in to Finance Bill 2022. The changes will take place from 2024/25 with a transition year in 2023/24. The transition year will allow for the re-basing of taxable profits and will be the point in which the overlap profits are relieved. Depending on the date when Partners joined their Practice, this will have a large impact on the additional tax due. Long-standing Partners will likely have relatively low profits overlap profits given the levels of profits that would have been generated when they first joined their Practice. Move this on, say 20 years, and profits at the current date are almost certainly going to be much higher – Of course, there may be some outliers, such as those who have reduced sessions over the years. Compare this to recently admitted Partners where their profits, you would think, are not likely to be materially different in 2023/24 (unless profits increase for reasons other than general inflation or contract changes etc) compared to the year when they joined. For those Partners, this will mean lower accelerated tax liabilities.

As part of the change in basis, taxpayers will be able to spread the tax on the additional profits over a period of 5 years. While this will help, individuals will still need to fund these additional liabilities out of already taxed income.

To demonstrate this, see the worked example below:

30 June year-end, 1 July start date comparing GP 1 (a long-standing Partner) and GP 2 (a newer joiner)

	GP 1 (£)	GP 2 (£)
Annual taxable profits - 30 June 23	120,000	120,000
Additional - 1 July 23 to 31 March 24	90,000	90,000
Total profits	210,000	210,000
Less: Overlap profits	(45,000)	(90,000)
Total taxable profits	165,000	120,000
'Excess profits'	45,000	nil

As you can see, for GP 1 overlap profits are relatively low, because they joined the Practice many years ago when profits were around 50% of current levels. GP 2 joined recently, and profits have remained static, hence overlap profits fully reduce the additional profits and there is no 'spike' in tax liabilities.

For GP 1 (assuming 2022/23 tax rates and allowances) the additional tax is £21,241: being £4,248 of additional tax, per year, over the 5 year period. These calculations ignore any possible catch-up in pension contributions, as it is not yet clear how the NHS pension scheme will deal with this change in basis, but the question has been raised.

Clearly saving almost £400 a month more over an entire 5-year period will be extremely challenging. Usually any catch-up happens on retirement where additional funds are released from the GP's investment in their Partnership and/or a pension lump-sum, but that will not be the case for the majority here.

This tax will not be due until at least January 2025, but over the coming months we will be reviewing the impact on our clients and advising of the tax implications. In the meantime, if you have any immediate concerns, please contact us.

Onwards & upwards

As the end of the tax year has now passed, many of our Practices have 31 March year-ends and this means records will start rolling in ahead of the various planned meetings throughout the year. As we move further into the new financial year, the safety net of Covid funding for Practices will largely come to an end despite some continuing pots of Covid related funding continuing. Despite wanting to get an understanding of the results for the previous year, the impact this has on Partners and upcoming tax and pension liabilities, it's not time to dwell on the past but look to the future.

We are very much looking forward to returning to face-to-face meetings, despite the benefits of technology and video calls, meetings seem to run much more smoothly and be much more interactive when sat around a table (or in a lunchroom).

We hope this has been a useful insight into some notable changes and as always, if you need support or require guidance, please do let your usual PKF Francis Clark contact know.

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