How Medical Professionals Can Use Excess Capital More Efficiently

Medical professionals who operate their own limited company for their private practice are often accumulating high levels of cash within their business. While this may not be a problem for younger medics, as they get closer toward retirement age and are thinking about their exit strategy, there can be serious tax implications. Medical professionals who are holding high levels of surplus cash may not always be aware of these.

The Dangers of Excess Cash

Holding significant surplus cash can in their business can mean that medical professionals don't get the full range of tax reliefs that other business owners would normally benefit from. These include Business Relief (BR) for inheritance tax purposes and Business Asset Disposal Relief (BADR - formerly known as Entrepreneurs' Relief) for capital gains tax purposes. BR can have a big impact on medical professionals when they exit their business:

- HMRC may deem the surplus cash to be an 'excepted asset' meaning that BR would not be applicable to that cash.
- If most of the company's assets are held in cash (or other investments) there's a risk that the whole company will no longer qualify for BR.
- If the firm is deemed to be an 'investment company' by HMRC, then when it's wound up / liquidated the director may not be entitled to BADR

A Potential Tax-Efficient Solution

One option would be for the director to withdraw the surplus profits in the form of extra dividends. However, the director may not wish to incur the dividend income tax liability. Another option would be to fund pensions, although the level of contributions that can be made is restricted.

By deploying the company's excess cash into a BR qualifying trading activity, the director can restore the full availability of BR to mitigate inheritance tax and also BADR to mitigate capital gains tax.

The simplest way for a firm to obtain these tax reliefs is to put the excess cash to work in a BR qualifying trading activity such as secure asset-backed lending, via a Corporate Cash Management Service.

An Effective Way for Medical Professionals to Use Excess Capital More Tax Efficiently

Medical Company

- If the medical company is holding more than 20% in cash, then the cash element will be liable to inheritance tax
- If the cash element represents more than 50% of the business' value, as is often the case, then the entire business may be subject to inheritance tax
- On exit/disposal of the business, BADR may be lost, leading to an increase in capital gains tax
- Cash held on deposit can receive poor returns

Corporate Cash Management

- The excess cash is deployed into BR qualifying trading activities, such as secure asset-backed lending (remains on the company's balance sheet as a lending activity)
- Obtains BR (after 2 years) for inheritance tax purposes
- Obtains BADR for capital gains tax purposes
- Targets a return of 4% to 6% per annum
- Liquidity provides access and control if the needs of the business change

Using BR to Exit A Medical Company Tax-Efficiently

Company:	London Medical
Established:	2003
Value:	£950,000
Unused cash within the business:	£800,000
Owner:	Michael Robinson
Age:	66
Goals:	To retire at age 70 and exit the company with a capital distribution

Background

Michael is a busy medical professional working for the NHS and is also running his own private practice through a limited company. His NHS salary is sufficient to provide him with a comfortable lifestyle and therefore Michael's earnings from his private practice have been building up over the years. He has already maximised his pension contributions through his company and has accumulated £800,000 in surplus cash within his limited company.

As an Additional Rate Taxpayer, he's reluctant to draw dividends from his company as he doesn't want to have to pay the dividend tax. Looking ahead, he's also concerned about the level of tax he may have to pay when he retires and closes the company down.

The problem

As the excess cash is not actively trading, the business would not qualify for Business Asset Disposal Relief (BADR), so when Michael winds the company up, capital gains tax would be payable on the excess cash, currently at a rate of 20% (£160,000).

Similarly, the surplus cash would not qualify for Business Relief (BR) in the event of Michael's death. As the value of Michael's other assets (including property, investments etc.) is above the threshold, inheritance tax would become payable on the excess cash, currently at a rate of 40% (£320,000).

The solution

After talking the situation through with his accountant and financial adviser, Michael decides to deploy £700,000 into a Corporate Cash Management Service. This is comprised of BR qualifying, asset-backed lending activities and is expected to generate an annual return of 4% - 6%.

With the majority of the business' assets now trading, when he retires, Michael can wind his company up with a capital distribution and a capital gains tax liability of just 10% (instead of 20%). In addition, Michael will be able to pass on the full value of his business to his beneficiaries free of inheritance tax.

Further Information & Support

If you have any questions or would like further information, please contact John Castle of Tax Planning Solutions:

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