Mitigating the effect of VAT increase

Michael Lansdell discusses how dentists can best address the inevitable increase in costs for every type of dental practice, as VAT goes up.

A major weapon in the Government’s armoury to battle the national deficit, announced in the Budget, is a proposed rise in the standard rate of VAT from 17.5 per cent to 20 per cent from January 2011.

Although health services are exempted from Value Added Tax (VAT), the cost of many of the essential materials, equipment and sub-contracted activities which service dental practices are not, and so any rise in this tax will add to the financial burden of running a dental practice. This increase in practice overheads comes at a time when many are already committed to additional expenditure on autoclaves and decontamination facilities to ensure compliance with HTM 01-05.

In recent years, many practices have expanded their activities to include non-health related cosmetic treatments such as tooth whitening or botulinum toxin injections, as well as selling toothbrushes and dental hygiene products, and these procedures and products are not VAT exempt nor zero-rated.

The present threshold for compulsory VAT registration is a turnover of £70,000, and this means that if the gross income from any practice activity not officially recognised as health care exceeds this figure, then the practice must register for and charge VAT on this aspect of its services, and any changes to the rate of VAT will automatically apply.

Dentists who are in any doubt about which activities in relation to dental services qualify for VAT exemption, should consult VAT Notice Number 701/57 for Health Professionals.

Prudent practice owners and sole traders are currently asking what they can do in the short term to take advantage of the lower VAT rate before it rises in January 2011.

The obvious first step is to bring forward any projected major expenditure or purchases, such as refurbishment, new IT, sterilising or other surgery equipment to before the deadline, and so reduce the VAT burden by 2.5 per cent.

However, principals and managers should be aware that the Government has introduced measures to counter business-esses paying in advance, or pre-dating invoices at the old rate, for goods or services to be supplied after the January 2011 when the new rate comes into force.

These measures provide for a supplementary VAT charge of 2.5 per cent to be levied in cases where the customer can-
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not recover all the VAT on goods supplied, and/or where any of the following conditions apply:

- The supplier and customer are connected
- The supplier is funding the purchase
- The payment on the invoice is not due for at least another six months
- The value of the goods or services supplied is £100,000 or more, except in cases where prepayment or advance invoicing are standard commercial practice

Given the recent changes, dentists operating as sole traders might wish to consider incorporating, as this often provides a legitimate means of saving tax in other areas – paying a reduced rate of Corporation Tax, for example. Limited companies comprised one of the few sectors of the economy to benefit from the Coalition’s first budget, when the previous administration’s announced increase in Corporation Tax was reversed, and replaced with a reduction, with further decreases to follow. Corporation Tax is already significantly lower than the top rate of Income Tax, and incorporation could yield substantial fiscal, financial and personal benefits for dentists in the appropriate situation. Owners of small companies (profits under £300,000) will pay almost 10 per cent less corporation tax under the new Government, whilst bigger companies will pay up to 15 per cent less.

Although the latest figures indicate that the economy is improving faster than expected, personal and family spending remains constrained by existing debt, and there is still on-going pressure on wage increases and uncertainty over employment, meaning it may be some time before the amelioration has an impact on retail dentistry. With other tax changes also in the pipeline, this could be a good time to discuss your situation with a professional for some new ideas on business efficiency – monitoring cash flow, for example, planning for the rise in VAT or identifying areas where expenditure could be reduced. When times are hard, experience has proved that intelligent austerity today is always the foundation for greater success tomorrow.

The one piece of unalloyed good news is that Mervyn King and the Bank of England have pledged to keep interest rates at the present historical low for as long as possible, so if you do have to borrow, loans are cheaper than they have ever been. For more information please visit www.lansdellrose.co.uk.

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About the author

Michael Lansdell was brought up in South Africa, receiving his honours degree there in 1991. He completed his training with international accounting firm Deloitte in 1994, and went on to become a founding partner of Lansdell & Rose Chartered Accountants (SA) a year later. Based in Kensington, London, Lansdell & Rose deal only on a long-term retained basis, exclusively with owner managed clients, general dentists and doctors, and specializing in the incorporation of dental practices. As a client focused team, they look for sustainable long-term solutions for their clients that maximise profits, minimise tax and build wealth.