Pharmacy Corporatisation – Now its here what does it mean ?

The New South Wales Government recently passed a new Pharmacy Act, parts of which relate to the corporate ownership of pharmacies. The passing of this legislation was in part delayed due to debate subsequent to Coles' purchase of Pharmacy Direct in March 2006.

Despite this legislation having already received Royal Assent, parts of its operation will be delayed until the Regulations are finalised - possibly 6 to 18 months away. (One senses that the operation of the new provisions are not high on the NSW Guild's agenda if the regs are really going to take this long to finalise - I welcome any commentary confirming otherwise including the expected operational date ?)

One of the most positive changes, is to bring NSW into line with all states and territories (except WA) and allow pharmacists the option to own their business(es) within a private company structure rather than as individuals. This one step alone will deliver improved cashflow to many businesses and as a consequence reduce bank default risk and increase funds available for reinvestment into the business. This is part of the Act that has delayed operation in NSW, other State Acts are currently operational.

It is important to note that the changes are confined to allowing only pharmacists to act as shareholders/directors.

Inevitably the question that should be asked by all owners is, should I own my business in a company? The answer will not always be clear, but here are some of the features you must consider when determining whether a company structure will benefit both you and your business. Paramount for most when considering this question will be assessing eligibility the small business capital gains tax relief rules which were proposed for some positive adjustments in the May 2006 Federal budget.

Advantages

1. The most significant advantage is through gaining access to the company tax rate of 30% compared to the maximum individual rate of 46.5%. This allows for accelerated debt reduction and increased business investment;
2. Consolidating multiple structures which are often unwieldy and prohibit easy monthly reviews of financial performance. As such the need for service entities will be eliminated in many instances;
3. Opportunity to "re-gear" the business and release cash for other purposes by selling into a company;
4. Banks understand and like company structures;
5. Capital gains tax concessions can apply to shares in companies under some circumstances.
6. Employee share plans for pharmacists without the partnership liability risks and without full responsibility of ownership;
7. Better structure than partnerships –shareholders do not have to be directors, therefore limiting liability;
8. Greater ability for passive ownership by pharmacists – will replace limited partnerships as the preferred structure;
9. Share transfers are simpler to deal with than partnership interest transfers – no changes in loan / guarantee documentation / lower stamp duty costs;
10. Securities are simpler to deal with and can also be more easily confined to the company and the business to which they relate without affecting an individual's other assets;

Disadvantages

1. Stamp duty on transfer of business into a company (although irrelevant for initial buyers and minimal in Victoria due to exemption on goodwill);
2. Capital Gains Tax – loss of some of the concessions that attach to owning a business individually on eventual sale;
3. Companies with 2 of the following, over $10m turnover, 50 or more employees, or over $5m in market value of assets (gross not net!) have to apply company reporting standards which are reasonably onerous.

Tax Motives

No doubt the main motivation for utilizing corporate ownership will be to pay tax at 30% rather than 46.5%.

However, with the decrease in the individual tax rates from 1 July 2006 and the increase in thresholds (such that the top marginal rate does not commences until $150,000 of income has been earned), the expected profit (including owner's salary) from the pharmacy needs to be in excess of $150,000 before a company should be considered.

You should also note a federal election is not that far away and there is always the chance of further tax cuts.

In addition, with a restructure (as opposed to an initial purchase) the benefits must cover the costs of transfer (namely stamp duty) to make it worthwhile. As such there must be a payback period that is acceptable. Anything less than two years (providing you intend to own the pharmacy for longer than that) would generally be considered appropriate.

Succession Planning and Small Business CGT Concessions

The recently announced changes to the Capital Gains Tax Small Business Concessions mean that a company can have up to 5 different shareholders with each having access to the concessions providing they own a minimum 20%.

Alternatively a partnership of companies will allow access to the concessions even where the company has less than a 20% interest. Please note the HIC forms are not straight forward when it comes to applying/transferring the number.

This announcement single-handedly reduces the cost of succession planning as stamp duty on shares in private companies is only payable at the rate of 0.6% (except Tasmania and Victoria that have no stamp duty on private company shares). The normal stamp duty on transfers of business assets in most States and Territories (other than Victoria) will be 5 to 6 times more than this on average.

Given the cost of purchasing a pharmacy is now beyond many young pharmacists, company structures will help redress the position. Companies with their reduced tax rate should actually deliver improved cash flow and in turn help fund the high debt levels associated with entering into ownership.

The desirability of incorporation for existing owners however, will vary from case to case but at least should be understood by all. As such, the new legislation provides a timely reminder to review your structure to ensure it is tax and cost efficient while also providing the right platform to assist with business growth and asset protection.