

Don't make your accountant rich!

Incorporation easy? NASDA member John Minford separates the facts from the hype and warns that incorporation is not a clever loophole to confound the taxman.

"My old accountant told me that if my practice is a limited company I will pay tax at less than half rate! And I might not pay any tax at all for the first two years!"

My heart sinks every time I hear this from a new client. Perhaps it's time to consider the facts, rather than the hype. Let's be clear from the outset: Incorporation is no better for a dentist than it is for any other business. There are no "special rules" or tax breaks which are available to dental practices and not to others. And all the same anti-avoidance legislation applies equally across the board. So if it doesn't make sense for a "regular" business, it won't make sense for you.

Sure, a limited company pays tax at 19% on its profits and this is undoubtedly advantageous. So far, so good. But these profits belong to the Company, not to the dentist or to the shareholders, or to the directors. You can't spend the company's profits at the supermarket. You can't pay university tuition fees with them. You can't go on holiday with them. It's not your money. It's the company's.

It only becomes your money when you take it out of the company, and subject it to your own top rate of tax (40%). Plus a deduction for Employees' National Insurance of course, if it is by way of salary. And don't forget Employer's NI which the company must pay on top together these can add up to almost 24% of salary.

What about dividends? Isn't that the big secret? Well, your marginal net tax rate will indeed be less, essentially a further 25% of the net dividend drawn will go in tax. But remember the company will still be subject to corporation tax at 19%. Add them together? Sure, there is a bit of mathematical jiggerypokery with net versus gross and effective rates manipulation which shows the difference narrowed to a negligible amount compared to the 40% you pay now. But then, what was the point?

You should also be aware that after a profit level of £300,000, the Corporation Tax rates go up to 30% from 19%. For a high earner or groups of practitioners, what might be marginally sensible at 19% is blown out of the water at 30%.

So, if you want to get your hands on the money your company has earned, you might well end up paying more in tax and NI than you do at the moment. Turning that around, to receive the same take-home or after-tax remuneration, you will have to gross more if working through a Company.

So are there any benefits? Undoubtedly, yes in certain circumstances.

The advantages of incorporation become evident when profits are not withdrawn but remain within the company, where they can be used for improvements or expansion of the practice or upgrading equipment, or simply retained and used by the shareholders as a savings account. The company may invest retained funds in property or shares, for example, in much the same way as an individual. However, this course of action still runs up against the age-old problem facing limited companies everywhere ---- how do you get the money out in the end? It is critical to ensure a strategy is in place which enables tax-efficient access to these funds at some future date. Undoubtedly for some, retirement can be arranged in such a way that UK Higher Rate tax is not payable. However for most, this will not be the case.

The benefit which has had recent headline attraction is the ability to "sell" your practice and its goodwill to a limited company for a large capital gain, on which you only pay an effective tax rate of 10% (in simplistic terms). The money owed to you, the seller, by the company, the purchaser, can then be drawn off over a couple of years with no further tax payable. The company will plough on, making its profits to be taxed at 19%, and you will only have paid an upfront 10% exposure until you have drawn out all the value of the goodwill.

But then what?

You will find yourself back at Point A, being faced with the same problems of how you get your accumulating profits out without heavier deduction than currently.

And how do you value your goodwill? Can we just say 30% of Gross? Why not 35%? If it is so tax-favourable, why not 80%? Because the taxman will be well aware of what is going on, and you may rest assured that challenges will be made. It might be an idea to get an arm's length professional valuation up front and enclose details with your submissions, so that at least one reason for an enquiry by Her Majesty's Revenue and Customs might be eliminated.

You may also need formal legal transfer documents, particularly where there are several principals. At the very least, your PCT Contract (if you are working within the NHS) will need to be transferred into the company name; otherwise HMRC will without doubt unravel the process on the grounds that it's only purpose is to save tax (perish the thought). Some practitioners are finding that their PCTs are taking this opportunity of Contract change to renegotiate their terms, which they perfectly able to do. You may be lucky with your PCT ----- or not.

The trade press features many other "clever" uses of a limited company to "confound" the taxman, but the reality is that most of these schemes have already been attempted by other businesses over the years, and a wealth of precedent and anti-avoidance legislation is already in place to curtail their advantages.

One thing is for sure: the lawyers, the accountants, the valuers..... all are going to make money out of this..... fairly so, as the process is fraught with long-term consequences with which the advisors as well as you, the dentists, will have to live. Anyone who tells you that it's easy, that it's straightforward, that there will be little effect on the value of your practice or re-sale, or your retirement, is a cowboy.

It would be wrong to imply that turning a practice into a limited company would never be of benefit. The solutions are, however, a little more complex than you may have heard, and are certainly not for everyone. Don't be fooled into thinking that incorporation is some sort of cunning loophole exploitation through which the taxman is going to give you money.

It isn't.

Take some proper specialist and considered advice to enable an informed decision. Avoid the cowboys -- they may well turn out to be bandits.

John Minford of Minford Associates can be contacted on 01904 658865