INCORPORATION
IS IT RIGHT FOR YOU?

IF YOU ARE A DENTIST OR DENTAL PRACTICE WHO HAS CONSIDERED INCORPORATION (MOVING TO A 'LIMITED COMPANY' STATUS), YOU ARE LIKELY TO BE AWARE OF THE COMPLEXITIES INVOLVED. THIS IS MOST CHALLENGING FOR PRACTICES WITH NHS CONTRACTS (ESPECIALLY PERSONAL DENTAL SERVICES CONTRACTS) OR THOSE WITH LOCAL AREA TEAMS WHO ARE RESISTANT TO HELPING – THIS CREATES A POSTCODE LOTTERY FOR DENTAL INCORPORATION.

Private practices have had an easier time, but even they have suffered a setback as a result of the recent changes to tax rules. For those who are interested in the subject of dental incorporation, Alan Suggett, NASDAL member and a partner in specialist dental accountants UNW LLP, sets out the challenges and includes flow charts to help you.

Where are we now?
Incorporation of dental practices was first allowed for most practices in 2006. Initially there was some confusion as to whether it would be beneficial for practice owners, and this cloud of uncertainty has continued to unhelpfully hover over the heads of practitioners.

Further complications were caused by changes in both personal (income tax) and limited company (corporate tax) rates between 2006 and now. In 2006 the combination of tax rates made it tax inefficient to incorporate for more profitable practices, and not worthwhile for less profitable ones – an unusual occasion where it was best to be average! Then there was the worsening of attitudes; initially of Primary Care Trusts (PCTs) and subsequently NHS England Local Area Teams. At first, most PCTs were happy to cooperate, and imposed few or no restrictions on incorporation.

Nowadays, even though it can be a postcode lottery, NHS England Incorporate Policy dictates:

1. *That the incorporating principal/provider permanently guarantees the performance of the NHS contract (i.e. even after the practice is sold he or she can still be held accountable for a clawback!)*

2. *NHS England have to approve a future sale of the limited company shares (i.e. on sale of the practice)*

3. *Ownership of shares in the company/practice is subject to NHS England approval.*

4. *An efficiency review must be performed on incorporation (e.g. the UDA or UOA rate can be reduced!)*

All of the above has led to a situation where incorporation of an NHS contract is usually inadvisable (unless you are lucky in the postcode lottery of course). The next important changes occurred in December 2014 by way of George Osborne's Autumn Statement and his more recent 2015 Budget. Mr. Osborne must have had an unfortunate dental experience, as his changes have impacted on dental incorporations more heavily than any other business sector.

The main impacts of the 2014 Autumn Statement and 2015 Budget were:

1. *Full Capital Gains Tax (CGT) (28%) payable on sale of goodwill to the limited company (rather than 10% under Entrepreneurs Relief). Capital Gains Tax is a tax levied on the gain on sale of goodwill.*

2. *Abolition of Corporation Tax relief on 'amortisation' of goodwill in the limited company. Amortisation is an accountancy term that refers to a form of depreciation on intangible capital assets such as goodwill, copyrights and intellectual property.*
   The idea behind it is that it allows the cost of an asset to be spread over the period of its 'useful life'. The legislation changes effectively mean additional corporation tax payable of up to 20% of the goodwill value.

3. *Abolition of the tax credit on dividends. This leads to an extra income tax charge of 7.5% on dividend income taken from limited companies (other than the first £5,000).*

As a consequence of the conflict between a greater understanding of the potential tax benefits of incorporating, and the increasing obstacles in the way of incorporations, various planning schemes have been devised. Some of these planning schemes are entirely legitimate and safe, some less so, and some not at all!

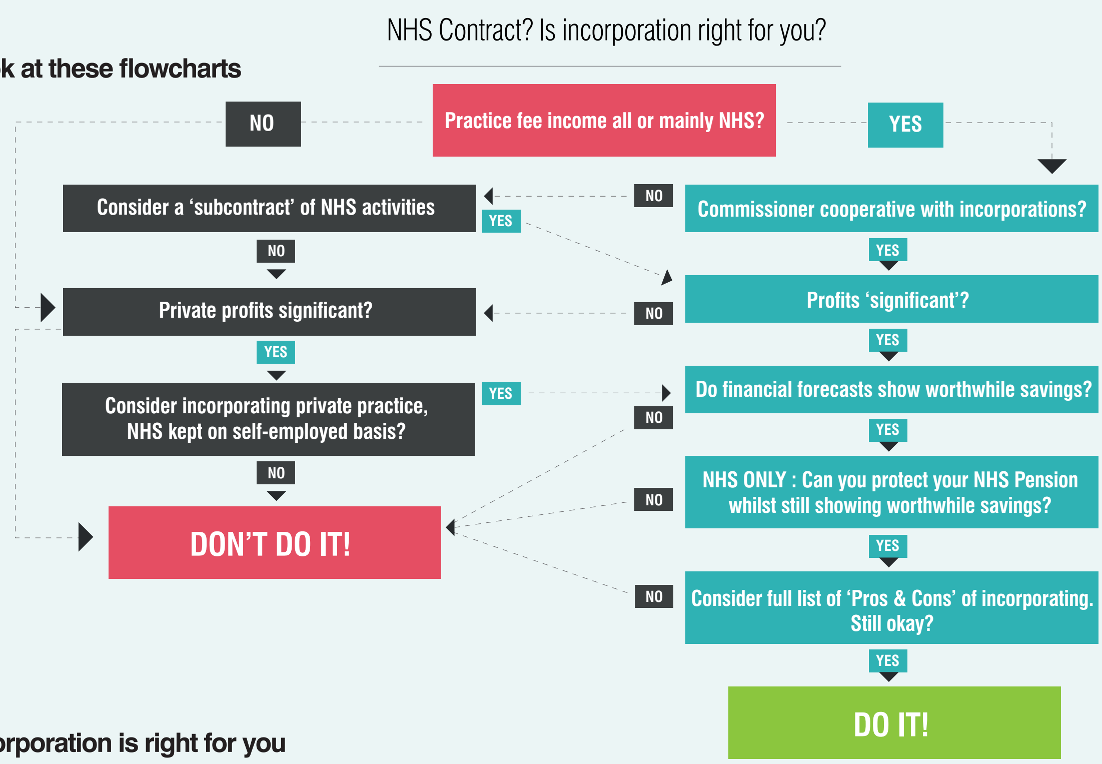
Brief details about some of these planning schemes are as follows:

1. **Transfer goodwill into the limited company at cost**
   By doing this no CGT is payable, but the amount of Directors Loan Account created is reduced significantly. There still can be tax savings due to the involvement of a spouse as a shareholder, and greater efficiency on bank loan capital repayments.

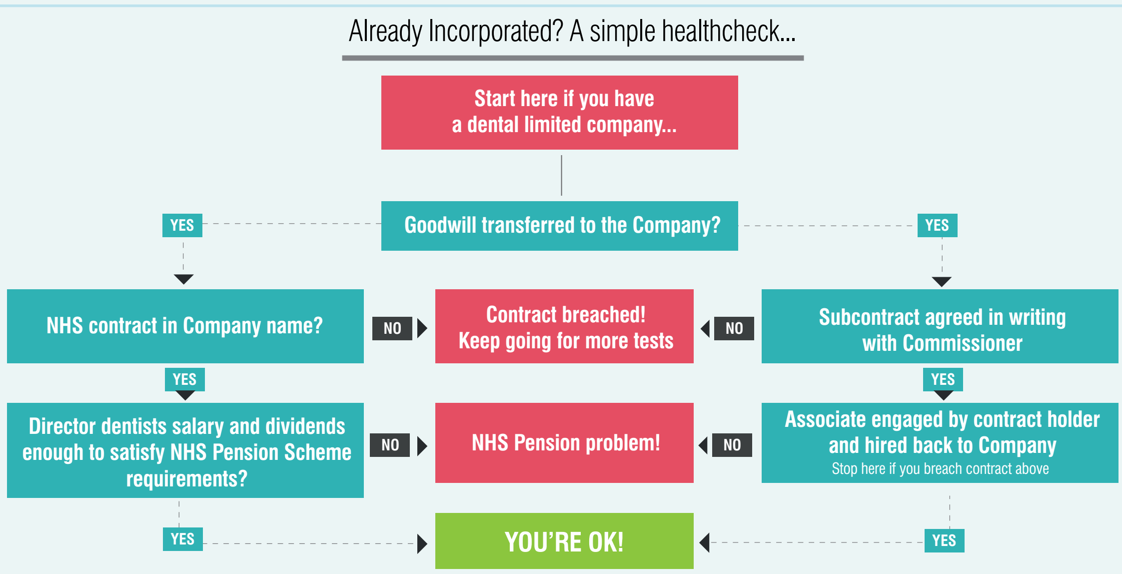
   However, be careful to agree the transfer of bank loans to the limited company with the bank – some banks can be very awkward (and costly) when this is requested.

2. **'Hybrid' arrangements**
   For a mixed practice (NHS & Private) some private owners have incorporated the private practice, but kept the NHS practice as a sole trade or partnership. Half a loaf is better than none? Whilst this arrangement can be made to work, the devil is in the detail. Get it wrong and tax problems can arise, including becoming liable for VAT!

Take a look at these flowcharts



See if incorporation is right for you



3. Create a subcontract practice

If you have an NHS practice and have fallen foul of NHS England policy, it can be possible to set up a limited company which performs the clinical work on a "subcontract" basis.
Once again the devil is in the detail, and problems with VAT and exclusion of dentists from the NHS Pension Scheme can result.

4. Just do it!

This (totally flawed) scheme believe it or not has been utilised by many practice owners. Faced with an unhelpful PCT or NHS England Local Area Teams, many practice owners have simply kept the NHS contract in their own name, yet for accounting and tax purposes transferred the goodwill into the limited company balance sheet – problem solved with an accountant's magic wand!

However, these practices will need to use the magic wand again to solve:

i. Breach of the NHS Contract
ii. Exclusion of all dentists (including the principal) from NHS Pension Scheme
iii. HMRC problems
iv. A practice / limited company which cannot be sold (without painful unravelling)

In conclusion, despite the reduction in the ability to create a Directors Loan Account (with consequent 'income substitution' benefits), NHS England restrictions, abolition of tax relief on goodwill amortisation, potential NHS Pension restrictions, and increased income tax on dividends – incorporation can still be beneficial!

However, I think it is essential for a financial forecast to be prepared to evaluate how much is likely to be saved, and also for full consideration to be given to the non-financial considerations. As always, it is imperative to get specialist advice so that you are aware of all the pros and cons of incorporation in your individual circumstances.

Alan Suggett is a Chartered Accountant and partner in UNW LLP chartered accountants and member of the technical committee of the National Association of Specialist Dental Accountants and Lawyers (NASDAL). If you have any questions, Alan can be contacted at UNW on:
E: alansuggett@unw.co.uk