

Problems with incorporation

Ajit Thakrar highlights some of the pitfalls practices could face.



The key incentive for incorporation is usually the potential tax saving to the dentist and the protection of personal assets. However, incorporating can lead to some unexpected costs or even unforeseen advantages. In this article I propose to highlight some of them:



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Sickness cover

Once incorporation takes place, the amount drawn out by the dentist will be in one of the following forms, or a combination:

- salary
- dividends
- by withdrawal from the director's loan account (created after transferring the goodwill and other assets into the company on incorporation)

By drawing money out from the director's loan account, the dentist's overall taxable income will be reduced but this could have a drastic effect on the amount of permanent health insurance cover available, usually based on salary plus dividends.

The potential reduction in insurance cover is an important consideration to bear in mind when deciding whether to incorporate or not and advice should

be sought from a qualified independent financial advisers.

Mortgages

Once you incorporate, your choice of mortgage lender is considerably reduced because you can no longer demonstrate a high level of personal income. Lenders work on 'taxable income' and any amounts drawn out through the directors' loan account are excluded. It is not always easy to persuade the lender that the dentist and his company are one and the same and that it is the profitability of the company, including the salary and dividends that should determine 'income' for the purposes of obtaining a mortgage.

It's not uncommon for high earning dentists to use the extra cash generated by the business to reduce the

• mortgage interest they pay, especially where they have offset mortgages. If a business is incorporated, this will not be possible as the funds belong to the limited company and if they are drawn out this could have tax consequences.

It has become fairly common for loans taken out to acquire the goodwill and/or property not to be transferred to the limited company on incorporation.

The reason for this is that they were often taken out years ago at very favourable rates and transferring them now would result in a much higher interest rate being paid as well as an arrangement fee.

In such a case, the interest paid would not be relieved for tax purposes and if this is substantial then this would be an added cost of incorporation as long as the loan continues.

Superannuation

The amount of NHS pension a dentist will receive in the future maybe impacted if a practice with an NHS contract is incorporated. For superannuation purposes, a dentist would need to draw out sufficient income from the company, either in the form of salary or dividends, to enable him to have his appropriate entitlement to superannuation. This may increase the income tax liability and thus defeat the reason for incorporating in the first place.

Information

Once a dentist incorporates, a lot more of his or her information will be in the public domain as the accounts will need to be filed (albeit abbreviated with limited information) at Companies House. When he/she is a sole practitioner or in a partnership, the accounts are not in the public domain.

Compliance costs

If the dentist incorporates their business there will invariably be additional compliance costs. Limited company accounts are different to those prepared for a sole trader as they have to comply not only with generally accepted accounting principles but also company law. Also, formal

minutes and board resolutions are required, dividend vouchers need to be prepared and returns for benefits and expenses received need to be prepared and submitted.

Cars

In view of the penal regime for taxing company cars, it is inevitable that cars owned by the dentist are not brought into the limited company on incorporation. Usually the only amount a dentist can claim would be based on business mileage.

Property

If a property is involved which is not transferred to the limited company (for tax and other reasons) and if rent is charged, then there will be a loss of Entrepreneurs Relief on disposal of the property in the future. This would increase the capital gains tax considerably, from 10 per cent to 28 per cent.

Tax acceleration

When a dentist incorporates his practice he may save income tax in the future. But in the first year there may be unanticipated costs. For instance, on incorporation, capital gains tax will need to be paid to HM Revenue & Customs - despite no physical cash or consideration having been received. The timing of this will depend on the tax year.

If the year-end of the sole practitioner or partnership is not March 31, then additional income tax may need to be paid as more than two accounting periods will be taxed in one tax year. Incorporation results in cessation of the old business for tax purposes.

As you will see, there are a lot of factors which need to be considered in deciding whether to incorporate one's business or not. It is important that any dentist considering incorporation takes appropriate professional advice and to have a financial forecast prepared by a specialist dental accountant. A detailed due diligence report should also be prepared by a competent and qualified practitioner. In this way the picture is clear, and a decision can be taken based on information not guess work. Disincorporation can be costly.