Incorporating change

Michael Lansdell explains how your tax affairs will change if you decide to incorporate your practice

A lot of the confusion and ill-informed comment surrounding the issue of incorporation is centred on the question of tax – how much you may have to pay to incorporate and whether your overall tax liability will be higher or lower after your practice becomes a limited company.

In this article, which sometimes refers to matters already considered in previous articles, analyses in more detail the differences between your liabilities as a sole trader or partnership and your practice’s liabilities after a company is formed.

Types of tax

There are four principal categories of tax to consider when comparing the fiscal liabilities of a sole trader to those of a limited company. Practice partnerships, although they may be legal entities, are not subject to tax; for tax purposes each partner is effectively a sole trader, whose tax liabilities are assessed via his or her personal tax return according to their share of the practice’s profits.

The taxes we need to consider are:

- **Income Tax** (and National Insurance)
- **Corporation Tax**
- **Capital Gains Tax**
- **Inheritance Tax**

Our figures will assume that the dentist(s) has/have no other taxable income, and are based on the Inland Revenue’s tax tables for 2009/2010. We’ll look first at the situation of the sole trader, the dentist who is running their practice as a self-employed person with their own business.

A sole trader pays Income Tax and National Insurance (NI) on all of the business’s profit, which is seen as his/her income in any given year, whether or not the profits are withdrawn from the business. The rate of taxation varies according to the amount of profit, with no tax or NI paid on roughly the first £5,000, a total of 28 per cent being paid on roughly the next £37,000 and about 41 per cent thereafter, so the threshold for the top band of 41 per cent is seen as his/her income on all of the business’s profit, with no tax deductible.

Dividends, being the distribution of after-tax profits to the shareholder(s), are not tax deductible.

Any salary drawn from the limited company by the dentist as a director is subject to personal Income Tax and NI as described above, except that the middle band rate (between about £6,000 and about £57,000) is 51 per cent. If the dentist is paid more than £5,175pa by way of salary, the company also has to pay NI at 12.8 per cent on the excess.

Dividends paid to the dentist as a shareholder may be subject to Income Tax but not to NI. If the dentist’s total income including dividends is less than £45,875, the dividend tax rate is zero per cent. If total income exceeds this figure, excess dividends above this level are taxed at 25 per cent. Any salary paid to the dentist would therefore reduce the amount of dividend, which qualified for the zero per cent rate of tax.

**Tax liabilities**

Although incorporation very often brings significant benefits, it is not a ‘one size fits all’ solution and expert advice should always be sought before any decision is taken.

Many dentists operating as sole traders will have broadly similar financial circumstances, but there will always be factors peculiar to individual situations. Although incorporation very often brings significant benefits, it is not a ‘one size fits all’ solution and expert advice should always be sought before any decision is taken.

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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 at 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, generally 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. For more information, visit www.lansdellrose.co.uk, or call 020 7376 9553.

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