Most dentists are not primarily business people, so it’s not surprising that since the General Dental Council (GDC) altered the regulations to allow dental practices to operate as limited companies from 2006, there has been much speculation and misinformation circulating within the profession about whether to take this step.

Limited Liability
The use of the word ‘limited’ in the title ‘limited company’ refers to limited liability. While even in these parlous times, few dental practices are in danger of closing, the shareholders in a limited company have the security of knowing that their exposure to liabilities to creditors will never exceed their original share capital, usually between £100 and £1,000.

Another advantage of trading as a limited company is the higher level of credibility in many commercial negotiations or inter-business relations accorded to a company compared with a sole trader.

Selling to a third party
It is often easier to transfer the ownership of a practice trading as a limited company. This is because the company remains in existence unless it is dissolved or liquidated.

The existing business arrangements, bank accounts and supply contracts, for example, all stay the same under the new ownership, while the new owner of a sole-trader practice would need to re-establish these relationships under his/her own name. This is especially important with PCT contracts, which should be unaffected, provided the PCT has been properly approached at the time of incorporation and the PCT contract has been transferred into the limited company without restriction.

Experience shows that incorporated practices with PCT contracts are realising higher selling values than unincorporated practices, partly for this reason.

The process of incorporation and the resulting altered tax regime enables converting sole traders to use tax savings arising from incorporation to substantially increase their pension contributions without affecting their current quality of life, subject to the new rules on pension contributions for high earners.

Tax benefits
Other taxation benefits, related to the differences between how individuals and companies pay tax and National Insurance, depend on the individual’s income, which is effectively the practice’s profit in any given year.
For example, a sole trader making a profit of around £100,000pa, and drawing out of the practice all of the profit, would expect to be about £4,000pa better off after incorporation, just based on the rate differences alone (09/10 tax tables), before any other planning is done to significantly increase the amount of the total tax savings.

Cash flow benefits

Converting to a limited company also has cash flow benefits. Sole traders normally pay tax on their profits (income) in two instalments, with about half becoming due two months before the end of tax year and the other about half payable four months after the end of the tax year. Limited companies of this size do not make payments on account, and their Corporation Tax, as opposed to Income Tax, is not payable until nine months after the end of the tax year. When the practice is transferred to the newly formed company, it can often borrow to pay for the goodwill, which can amount to 100 per cent of the annual turnover of the practice.

The interest on this loan qualifies for tax relief, and the capital sum borrowed by the limited company can be used by the dentist to reduce non-tax deductible payments, for example on his/her home mortgage. In some cases, the home mortgage can be paid off in its entirety, depending on the goodwill value.

Even if the company does not need to borrow to complete the purchase of the practice, it is possible for the dentist as both shareholder and company director (employee) to draw from the company a combination of salary, dividends, and loan repayment, to reduce his/her personal tax liability to zero, for a number of years after incorporation. Corporation Tax on the practice’s (now the company,) profits is of course still paid, currently at a rate of 21 per cent on profits up to £300,000.

A family business

Legislation to curb “income splitting” due to be implemented on 6 April 2009 has been deferred for now. However, other family members, often a spouse employed to manage appointments or other aspects of administration, assist many dentists acting as sole traders in the running of their businesses.

If these family members also become shareholders in the new company, advantage can be taken of other allowable tax mechanisms to further reduce the overall tax liability.

Offshore structures

For higher earners not domiciled in the UK for tax purposes, there are more sophisticated tax-planning techniques that make use of offshore structures. If you fall into this category, (and your domicile in this context is not necessarily the country in which you live or hold a passport from!), you need to take specialist advice to optimise your tax position. It’s evident that all dentist sole traders and dental partnerships, whether or not they are currently considering incorporation, would benefit from a review of their status which compares their present position with that after the formation of a limited company. There is, quite literally, nothing to lose.

At the same time, incorporation is not necessarily appropriate for every practice. The ultimate decision, after considering specialist, professional advice, must take into account the individual dentist’s present business circumstances, personal position and preferences and also, where relevant, his or her future plans.

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 specialising 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 9333.