Do new NHS UK pension scheme rules signify end of associate incorporations?

Penny Bowen details changes in NHSPS

I
have written this article because I want you to think about this now, and take action if you need to. When you retire you will have the time to sit and think about the money you have lost, but then it will be too late to do anything about it.

Dentists have been allowed to run their businesses as limited companies since July 2006, and over the years a significant minority of dentists have taken advantage of the opportunity to incorporate, and so taken control over their personal tax liabilities.

The introduction on 6 April 2010 of a 60 per cent income tax band for incomes between £100,000 and approximately £112,950, rising to £114,950 on 6 April 2011, and a new top rate of income tax at 50 per cent for incomes in excess of £150,000 has stimulated the demand for incorporation amongst the professional minority of dentists.

The new tax rates have made incorporation a viable proposal for associate dentists, however, there are two drawbacks:
• associates cannot capitalise goodwill because they don’t own any, and
• associates with NHS activity will lose their right to be part of the NHS Pension Scheme after 7 November 2011.

The second point is of particular concern to us as specialist dental accountants. All too often we meet associates with NHS activity whose accountants have recommended incorporation. When we point out to them that they will lose the benefits of the very generous NHS Pension Scheme, we are told their accountant says that there is no problem. But this is simply untrue. The truth is that the non-specialist accountant does not know that there is a problem, never mind how significant it is.

So, what is at stake? Well, the NHS Pension scheme (NHSPS) is a statutory occupational pension scheme. Providers’ (principals) and performers’ (associates) pensions are broadly based on their career pensionable pay rather than their final salary. NHSPS benefits are paid for by the contributions made by members and their employing authorities - the primary care trusts (PCTs) and local health boards (LHBs).

The NHSPS offers considerable benefits which it would be foolish to give up:
• An annual (index linked) pension and tax-free lump sum at retirement
• Life Assurance benefits including pensions and allowances for a member’s spouse/civil partner (or nominated partner) and dependent children in the event of the member’s death.

From a tax point of view incorporation is attractive because it gives you an opportunity to base your tax on what you earn rather than on what you draw. Earnings are still taxed of course, but these are subject to corporation tax at substantially lower rates (20 per cent on profits of less than £500,000). Once the corporation tax is paid, any further tax will be based on what you draw – to take the extreme case if you don’t draw anything then you won’t pay any personal tax.

The methods of drawing money from a company for personal use are many and most practitioners use a combination of salary and bonus, benefits in kind, dividends, rent (although this would have an impact on a subsequent claim for entrepreneur’s relief), drawings from the director’s loan account and interest thereon.

Until 7 November 2011, you must draw all the NHS income from the business in the form of salary and/or dividends in order for this to count as pensionable earnings. Any NHS income that is not taken but left in the business cannot be pensioned now or in future years. Dividends are pensionable however they must only be in respect of NHS work, so technically the private element of a dividend must be stripped out leaving only pensionable NHS dividend income.

Incorporation remains increasingly attractive to associates working in purely private practices, but things are not so good for those with NHS income.

According to A Guide to the NHS Pension Scheme published in September 2011, because the NHSPS regulations to not recognise the sub-contracting relationship between the associate and the limited company,

‘A Performer [associate] who sets them self up as a limited company cannot be a member of the NHSPS with effect from the 7th of November 2011. This is subject to Parliamentary approval however (pensionable) Performers are advised to put arrangements in place by this date to ensure they can comply.’

It is reassuring to note that NHSPS membership will continue until 6 November 2011, however, you need to take action now to make sure you remain in the NHS Pension Scheme and so retain for yourself and your family, its generous benefits.

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