STARTING A PRIVATE PRACTICE

# Should I become a company?

With a steady growth in the number of consultants deciding to incorporate their practices, there is a constant stream of new entrants to private practice wanting to know if this is the best route for them too. **Ian Tongue** (right) gives his views

SHOULD I INCORPORATE? This is one of most common questions I am asked in meetings with new consultants.

Some have heard of incorporation previously, others have discussed matters with their colleagues and are aware that tax savings may be experienced.

It may also be the case that consultants are thinking about it because their tax liability for the year ended 5 April 2011 was much higher than expected, given the 50% income tax rate and loss of personal allowances.

Your individual circumstances will determine whether a company will be the best way forward or if another trading structure would be more appropriate.

### What is a limited company and 'incorporation'?

Incorporation involves the formation of a limited company; in the context of a consultant, this is usually for the purpose of trading for your private practice. It could also mean the switch from another trading structure such as 'sole trader' to limited company later on.

A company is a separate legal entity from you and, as such, a separate 'rule book' of laws and regulations are in place known as the Companies Act. It is your responsibility to ensure that the rules and regulations are followed; this is a legal responsibility for you as a director of the company.

The ownership of the company is referred to as the 'shareholding' and the owners are 'shareholders'. Typically, the greatest tax savings are where you own the company


50:50 with your spouse and they have limited or no other income sources. If they are a higher-rate taxpayer or have significant earnings in their own right, the savings are significantly eroded.

### Corporation tax

A company pays tax, known as corporation tax, which is 20% up to £300,000 profit at current rates, into which the majority of consultants are likely to fit.

Earnings over £1.5m are taxed at the full corporation tax rate, which has just been changed from 25% to 24%. Earnings that fit in between £300,000 and £1.5m are now taxed at a marginal rate of 25%. This is payable nine months after the accounting period.

Once corporation tax has been taken into account, the remaining profit can be paid to the shareholders. Additional income tax may be payable on the receipt of the dividend, depending on your other sources of income.

### Tax savings

A company is more tax-efficient, mainly due to National Insurance. If you are a 'sole trader' or in 'partnership' with your spouse, your profits are subject to income tax and National Insurance.

With a limited company, the dividends are only subject to income tax and only if you exceed the higher-rate tax threshold. So if you have a spouse who is not working, there is a potential 32% combined tax and National Insurance saving until they become a higher rate tax payer, assuming you are a 50% taxpayer.

If you earned £100,000 net profit from your private practice, as a sole trader you would pay £52,000 as a 50% taxpayer on these earnings, including National Insurance. If you traded as a company splitting the shares equally and your spouse was not working, savings of up to £17,000 per year could be experienced before the additional professional fees of trading as a company are factored in.

However, if your spouse is a higher-rate taxpayer or perhaps a consultant themselves, the savings will largely relate to National Insurance, which– at 2% – would limit the savings to around £2,000 per year in the above example before additional professional fees.

For comparison purposes, a 60:40 partnership would generate around £11,500 savings per year and a 60:40 company around £14,500 per year, again before additional professional fees. The above calculations do not take into account the proposed reduction of income tax rate from 50% to 45% in April 2013, the effect of which will be to reduce the savings illustrated.

### Is a company always the best approach?

This will depend on your circumstances. More often than not, it will be the most tax-efficient, but you need to consider the additional burden of administration and the additional steps required to extract your profit from the company.

Unlike a sole trader or partnership, the profit is effectively locked into the company and the usual way of extracting it will be via a dividend, small salary or combination.

Therefore, some changes to your personal finances may be required to ensure that you have sufficient day-to-day cash.

Having had many meetings with new and established consultants, some take the approach of wanting to save tax but are not prepared to deal with the additional work involved in running a limited company.

Therefore, some settle for a partnership with their spouse or pay them a salary if, of course, either can be justified. You should discuss your circumstances further with an accountant and ask them to prepare illustrative examples of tax savings and go through the pros and cons.

### I have heard of goodwill. What is it?

Goodwill is the value of your business over and above its actual tangible assets. If you incorporate from the word go, it is unlikely that you will sell your business on to another company under your control.

So, for a medic, it is mainly discussed in the context of moving from a 'sole trader' to a limited company whereby your sole trader business is 'sold' to the company.

The benefit of recognising goodwill is that the company effectively owes you the value of the goodwill and a loan is created between you and the company. The company then pays the loan off tax-free. But when 'selling' the business to the limited company, you are likely to pay capital gains tax personally, which is usually reduced to 10% due to a relief known as 'Entrepreneurs relief'.

This subject is a hot topic, with accountants having differing views on how much goodwill a medic has. The value attributed to 'personal goodwill' – that is to say, your skills and reputation – cannot be sold to the company and therefore you cannot include this in the selling price.

Therefore, you need something else that would have commercial value in an 'arms-length' transaction: for example, a database of patients on long-term treatment akin to a 'recurrent client base'.

The acid test is to consider what a colleague would potentially be prepared to offer you for your practice, should you cease.

HM Revenue and Customs is increasingly focusing its attention on goodwill valuations for medics incorporating and therefore it is vital that any goodwill valuation can be fully supported under HMRC inquiry.

There are other factors to consider when deciding to trade a limited company, many of which can be easily overcome. The key thing to bear in mind is that the structure has to work for you on a day-to-day basis and the decision is not driven purely by tax.

Your accountant should be able to give you an objective view on your individual circumstances to determine the most appropriate course of action for you.

■ **Next month: An update on property**

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