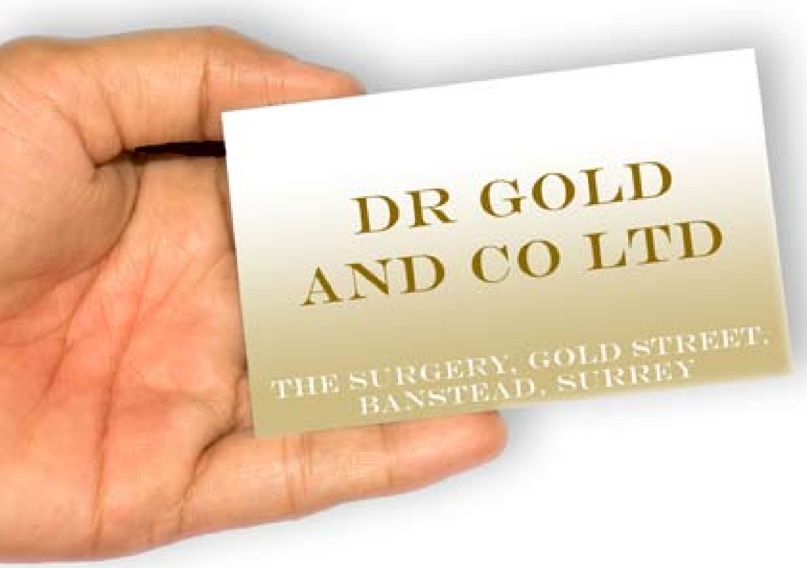
STARTING A PRIVATE PRACTICE

Firm grip needed to become a company

Trading through a limited company can often be a tax-efficient way of structuring your private practice business. But Ian Tongue (right) warns that it can be a more cumbersome structure in practice and therefore it is important that you take the time to understand how it should be run



A LIMITED COMPANY is a separate legal entity and therefore you have responsibilities as a director to run things in accordance with company law.

Due to the tax efficiency of a company, HM Revenue and Customs (HMRC) is keen to challenge any arrangement that it feels is not commercial or is not run in an appropriate manner.

If you have previously been a sole trader, the biggest change will be the concept that the money belongs to the company. There are strict procedures to extract it to avoid problems later on.

As a sole trader, personal expenditure is classed as drawings and irrelevant for tax. But this is not the case for the company and can lead to problems with director's loans which, in turn, can result in corporation tax issues and benefits in kind for the director(s).

Practicalities

- Set up a current account and savings account in the name of the company.
- Use a credit card in the name of the company for purchases not paid through the bank.
- Use adequate accounting software, as the required standard of record-keeping is higher and HMRC could fine the business if not adequate.
- Take the time to understand how you can extract profit from the company.
- Personal guarantees may be required for assets financed through the company.
- Consider the transitional impact of changing to a company for personal tax.

Income

It is very important that the income is not only paid into the company but it is clear that it is the company trading rather than the individual.

Therefore, the paperwork associated with the business must always be in the name of the company and show the relevant minimum requirements.

If you have previously been a sole trader, you may encounter difficulties with payments being received into the limited company relating to the old practice and vice versa. It is vital that records are maintained to minimise this happening and take action when it does happen.

Expenses

It is important to pay all business expenditure through the limited company rather than personally. Where you do pay personally, the company can repay the money, but it should be avoided.

It is common in many businesses for directors or employees to receive benefits other than salary. However, as you will own the company, it is vital that you understand the overall impact on your disposable income from entering into such arrangements.

For example, the income tax payable personally and National Insurance by the company on a 'benefit in kind' can frequently outweigh the corporation tax relief gained in the company.

If you are considering receiving 'benefits in kind', always ask your accountant to do the sums to show you how much disposable income is available before and after, rather than focusing on one aspect of the arrangement, such as corporation tax relief.

Your medical defence cover will continue to be one of, if not your most, significant expense. To ensure that you are adequately covered, it is vital that your provider is made aware of your trading structure.

In relation to motor and travel claims, assuming that you do not have a company vehicle, the most appropriate method of being reimbursed is through the HMRC's approved scheme.

This allows the company to pay up to 45p per mile tax-free to the employee/director for the first 10,000 miles and 25p thereafter. Care must be exercised here in relation to what constitutes business related travel, as has been well publicised in this magazine.

You may have employees paid through the company and it is important that the company maintains its own PAYE (pay as you earn) scheme. You can also receive a salary as a director and you should discuss this further with your accountant.

Extraction of profit

The normal method of extracting the bulk of profits earned for personally owned companies is by way of dividend. A dividend is an appropriation of profit and therefore should not be as regular as you would perhaps take drawings or a salary.

Public companies often declare dividends twice a year, but a private company can declare more frequently than this.

You may have introduced capital or perhaps sold your practice to your company. If this is the case, you would usually repay any loans arising from this before taking dividends, but, depending on your circumstances, this may not be the case. If you are in this position, you should discuss your profit extraction strategy with your accountant.

When voting dividends, there are procedures to follow and the correct paperwork should be issued. This paperwork is important for demonstrating that the company is being run properly and also for your personal tax position.

Depending on the shareholder's tax position, further income tax may be due on the dividend. It is important that you understand your position here to ensure that you do not get caught out later on.

Corporation tax

For small companies, corporation tax is paid through the company 9 months and a day after the financial year-end. For example, a 31 March 2012 year-end would require payment by 1 January 2013.

The current corporation tax rate for small companies (profits less than £300,000) is 20%. If you save somewhere in the region of 15-18% of gross fee income, you should have sufficient savings within the company to meet its ongoing liabilities.

For those companies with earnings in excess of £300,000 or have associated companies, the rate can be as high as 25% (from 1 April 2012).

Therefore, if you are in this position, you should discuss your own savings requirements with your accountant.

Key areas to avoid

- Using dividends as a substitute for a salary;
- Not completing the paperwork and administration associated with running a company;
- Paying personal or household expenditure through the firm;
- Paying personal tax liabilities through the company;
- Paying car expenses – for example, fuel;
- Being a significant shareholder of multiple private companies without discussing the implications of this with an accountant.

A company can often be the most tax-efficient way of trading, so it is only to be expected that HMRC likes to challenge arrangements that are not commercial, properly run or contrived.

Provided that you run things properly and take advice from the outset, you should find that the company is a beneficial structure to operate.

■ **Next month: Preparing for my first tax return**

Ian Tongue is a partner at Sandison Easson & Co, specialist medical chartered accountants