

“Limited companies – Should I practise as one?”

I often get asked the question “Should I run my practice as a limited company?” and my standard response is one that usually ends with “It’s not currently possible to run a dental practice as a limited company, with the exception of a few body corporates!”

However, changes are afoot, and hopefully some time during 2005 the GDC will give the go-ahead for dentists to run their businesses through limited companies, rather than as sole traders or partnerships.

In light of these proposed changes in statute our next four articles intend to discuss the various aspects of incorporation, including the short and long term advantages and disadvantages.

We want to draw your attention to the background of the changes in legislation, the distinction between a sole trader/partnership and a limited company, and the general advantages and disadvantages of incorporation for a dentist. Later in the series of articles, we will detail, once approval has been granted by the GDC, how you can run your practice as a limited company and enjoy the benefits of incorporation.

Why the changes?

Currently the vast majority of dental practices are set up as sole traders or partnerships, with the exception of a few dental body corporates which are limited companies.

As sole traders and partnerships, a dentist typically draws an income from the business, on a monthly basis.

Some partnerships may operate according to a pre-set agreement between the partners, especially on routine operational and profit sharing aspects of the practice. Generally though, most dentists have a rather casual administrative approach, especially with regards to drawing money from the business, record keeping and so on. From the owner’s point of view this creates flexibility but in reality it often results in the full potential of the practice not being reached.

Under a limited company a practice will be compelled to operate in a regulated environment, especially in terms of administrative aspects. The company will be subject to Companies Act criteria, and the director’s held responsible for their actions.

We believe this administrative regulation will lead to better financial disciplines and systems & procedures, and, if these procedures are implemented correctly, an increase in growth and profitability.

The impetus for the changes comes from the Government’s decision to reform the Dentist’s Act. Part of a major overhaul of the Dentist’s Act, once the reforms are approved at the Government level, the GDC will have the power to reform the Dentist’s Act and hence allow practices to incorporate (become a limited company).

So what are the differences between a sole trader/partnership and a limited company?

The primary distinction between a sole trader/partnership and limited company is that the incorporated organisation is a separate entity in the eyes of law. It is treated as independent of its owners and shareholders.

In addition, the limited company has only a limited liability to the extent of its share holders' funds, whereas a sole trader's or individual partners' "liability" is much wider in scope. Therefore, as a limited company, a dental practice and its principal dentist has greater protection against any prospective legal claims. The legal claim can only be made against the company and NOT the individual principal dentist.

Advantages and disadvantages of incorporation

Before deciding whether a limited company is the right choice for you, you need to consider the advantages and disadvantages of incorporation with particular reference to your practice's unique circumstances.

Advantages

The following are the main advantages of incorporation:

- In a business with more than one owner, it is far more comfortable to run the business through the medium of a limited company with the rules and regulations this will entail. This way the rights and duties of each owner are clearly set out and leave no room for "misunderstandings."
- The business becomes much easier to transfer in the case of a business interest represented by shares. This is particularly useful if the owner wants to transfer the business to a family member or to an outsider.
- Some may prefer to trade as a limited company due to the perceived status as compared to trading under his or her own name. Being a limited company may potentially reassure patients, suppliers, the general public, banks and other lending institutions as to the credibility of the organisation.
- In the modern commercial world, where litigation is common, sole traders and partners may find themselves increasingly vulnerable. This is particularly true when your practice grows, since your commercial risks grow with the practice. By incorporating, commercial risk can be limited.
- One of the major benefits of incorporation is the possibility of saving tax and national insurance contributions, especially in the long run. This is especially true when your practice has grown and has pushed you into a higher income tax bracket.
- In a limited company scenario, the possibility of extracting a combination of a salary and dividends can reduce the tax and NI contributions, as explained in more detail in a later article in this series.

Disadvantages

Although the list of advantages may look convincing, you should also bear in mind the potential disadvantages:

- A PAYE (Pay As You Earn) system is usually required and the owners (now directors) are prevented from drawing money from the company on an ad hoc basis, except as loans given to directors.
- As directors of the limited company you are liable to file the annual accounts and tax return at the Companies House, in addition to the maintenance of minutes on board meetings etc.
- As in the case of personal income tax returns, there'll be automatic fines for late filing of returns with the Inland Revenue and Companies House.
- There are likely to be taxable "benefits in kind" giving rise to tax liabilities on the directors e.g. company cars, and fuel etc of which proper records should be kept.
- There'll be an element of bureaucracy involved in the form of systems and controls since a company is a separate legal entity and its former owners now become employees as well as shareholders.
- It may not be easy to end a company since it has a separate legal entity, however owners (shareholders) can always relinquish their shares for a consideration as an exit strategy from the business.
- Set up costs and an increase in annual accountancy fees due to greater administration requirements.

Of course most of the disadvantages can be attributed to the tightly regulated procedures inherent in operating a limited company, which in turn will encourage greater financial controls and systems leading to better practice management techniques and therefore more profit!

So what should you do?

In this article we intended to draw your attention to the preliminary aspects of incorporation and its main advantages and disadvantages. Incorporation may not be for everyone. It is important to weigh the advantages and disadvantages of incorporation in light of the particular circumstances of your practice, its growth objectives, and your exit strategies and retirement options etc.

However, if the Chancellor does not change the current small company tax rules, in our opinion, for many practices, the advantages will outweigh the disadvantages of turning your practice into a limited company.

Let's now just hope the Government does not do a u-turn in policy and change its mind about allowing you, the dentist, to benefit from turning your practice into a limited company.