

Limited companies – How do I set one up?

Introduction

The first article in this series introduced you to the concept of incorporating your dental practice and the associated advantages and disadvantages, soon to be a possibility in the UK dental market.

As you now know, incorporation is a process that will change your status from a sole trader or partner to that of a director of a limited company in which you will be the only or main shareholder.

The main advantage of converting your practice into a limited company is to reduce your tax bills compared to a sole trader or partner, something that all dentists wish to achieve!

In this article I would like to explain the process involved in converting your sole trader or partnership into a limited liability company.

The process

In short, incorporation is a process of transferring your business and its assets to a limited company. In doing so, careful planning is necessary to avoid any unnecessary taxes such as capital gains taxes and to maximise tax planning opportunities.

The good news is stamp duty on intangible assets such as goodwill is no longer levied; nevertheless stamp duty land tax may be applicable on land & buildings transferred to the new business.

There are two alternative approaches to incorporation with each having its own tax advantages and disadvantages. In any case, the first step is to establish a limited company. Then, the second step is to transfer your existing business assets into this new business in the most tax efficient manner.

Establishment of a limited company has its own requirements, but it is a very straight forward and quick process. Therefore, I won't go into details in this article.

Unless you are an associate who wants to establish a limited company and start from scratch, the main concern of most businesses, in my experience, is how to convert the existing practice into a limited company, which is what I shall focus on in this article.

Option 1 - Transfer your dental practice in exchange of shares

The first option is to transfer your sole trader or partnership dental practice in exchange for shares in the new incorporated company. In the case of a two practitioner partnership this will result in a limited company with two directors holding an equivalent amount of shares, provided both had an equivalent amount in the capital account.

In order to qualify for tax relief, owner/s should transfer all business assets, such as land, buildings, and equipment, into the business, except cash. Unfortunately, you cannot choose which assets should be transferred. The assets will be transferred at the

current market values and in exchange, owner or partners will receive shares in the new entity.

Even if these assets have become more valuable since the original purchase date, you will not be liable for capital gains tax on the assets transferred to the business.

From a company's point of view its future capital gains on disposal of transferred assets will be minimised since the cost to the company of these assets acquired is the full market value.

However, this relief can become limited if the business asset transfer was made partly in exchange of shares and partly for some other consideration.

Since the owner can not choose what assets are to be transferred, you have to transfer any land and buildings too which will attract stamp duty land tax. As a result, this alternative can be attractive for dentists who operate from rented premises.

Option 2 -Transfer your dental practice by way of a gift or sale at under-value

The second option is to transfer your sole trader or partnership dental practice's assets by way of a gift or sale at under-value to the new company.

Under this alternative, a sole trader or partnership can form a limited company and the required level of capital in the new company would be subscribed for in cash in exchange of its shares. The amount paid for shares can be a nominal amount.

Then business assets owned by the sole trader or partners can be transferred to the new company either as gift or at a value which will not result in a gain for tax purposes. However, assets should qualify as "business assets" in order to satisfy the relevant tax laws.

A business asset is defined as an asset used for the purpose of a trade, profession or vocation carried out by the transferor. Therefore, almost all the assets at your practice will qualify as business assets.

The main advantages of this alternative are there is no capital gains tax to pay on the incorporation. In addition owners have the discretion of which assets are to be transferred to the business and which to be retained for personal use. Often you can make these assets available to the business and draw funds from the company. For example, by retaining land and buildings, in addition to saving stamp duty land tax, you can also withdraw funds from the company as rent.

However as with anything there are disadvantages too. One of them is the potential of the company incurring more capital gains tax on disposal since the assets were acquired at a very low cost.

Also, capital gains tax can be high for directors when disposing of the shares since these were acquired for a nominal fee. This is especially true if these shares were to be disposed of soon after the incorporation, since the market value of the shares will represent the market values of the assets transferred, not the nominal values at which

they were transferred. However, over time these assets will drop in value and lead to a drop in share value, as compared to just after incorporation, in the long run.

So what's the best alternative for you?

It is hard to give a direct answer to which is the best option for you as individual circumstances need to be taken into consideration.

You must consider tax planning opportunities and other aspects such as purchase details of the assets, which must be taken into account in order to ascertain the impact of incorporation on capital allowances. Therefore, once you have decided that incorporation is good for you, the approach that best suits you is again a matter of judgment after taking into account your specific circumstances.

I hope by now you must have gained a fair amount of understanding of the concept of incorporation and the process involved. In my next article I'll be discussing the day to day aspects of the incorporated body including further opportunities to save tax.