

Budget review

The key impacts on SMEs

Speed read

The corporation tax rate changes mean that there will be an effective return to the old concept of small and large company rates. The higher tax rates for companies may encourage migration overseas for more mobile businesses and, for others, herald a rise in the popularity of LLPs. The extended period for carrying losses back is welcome, but it is unclear whether HMRC's practice on 'exceptional circumstances' claims will be allowed here. The 130% 'super-deduction' is also welcome, but there is a slight 'catch' relating to disposals. The freezing of income tax rates and allowances amounts to effectively increasing income tax rates. Now that VAT concessions and SDLT reliefs are here for the longer term, businesses should be maximising the opportunities that these present.

**Andrew Marr**

Forbes Dawson

Andrew Marr is a partner at Forbes Dawson.

Andrew's expertise lies in bespoke tax planning for owner-managed businesses. He also has extensive experience of company reconstructions which he advises on and implements. Email: andrew@forbesdawson.co.uk; tel: 0161 927 3854.

As the UK is still very much in 'pandemic mode', with the hospitality industry on its knees, few people were expecting Rishi Sunak to announce many 'in your face' tax hikes. Although there was some speculation about a capital gains tax rise, this tax was barely mentioned. Rather, we have seen a number of measures which do not look too bad at first glance but look more serious when considered in greater depth.

In this article, I seek to highlight the main points of the Budget which will be of interest to SMEs and provide preliminary comments about their implications. I do not attempt to provide a comprehensive summary of all the tax points in the Budget which are well-covered elsewhere.

The death of the company?

The biggest news in the Budget is that corporation tax will increase from 19% to 25% from 1 April 2023. In fact, there will be an effective return to the old concept of small and large company rates. Companies with profits up to £50,000 will continue to pay tax at 19% and then there will be a marginal rate of 26.5% between £50,000 and £250,000 with a 25% rate thereafter.

It is worth recapping that shareholders were hit with extra tax when the dividend rates were increased in 2016/17 to their current rates. Before 6 April 2016, a top rate taxpayer would pay an effective rate of 43.75% on profits extracted from his company (19% corporation tax and then an effective dividend tax rate of 30.56%). After the 2016/17 increase, this effective rate became 49.86%. For a company that is taxed at 25%, this effective rate jumps to 53.58%! It gets worse if we consider the effective rate on the 26.5% marginal band of profits because this has a 54.5% effective rate.

It remains to be seen how entrepreneurs will react to these increases. One risk must be that the more mobile ones will look to leave the UK for more favourable tax jurisdictions.

Importantly, at top rates, profits are now taxed at higher rates in a company than in a sole trader business or partnership (assuming that all profits are extracted as dividends). This may herald a rise in the popularity of LLPs which is already a more flexible structure which can more easily accommodate changes in equity shares. Of course, the company still has the advantage of acting as a fairly low tax (even at 25%) deferral vehicle for those profits that a shareholder does not need access to immediately. Also (at least for the moment) there is the prospect of extracting reserves in the company at lower capital gains tax rates (see below).

Loss reliefs

After announcing the corporation tax rate rise, the chancellor then sweetened the pill by introducing an extension to the period over which company trading losses can be carried back to offset earlier years' profits. This period will now be three years, as compared to the current one year. The extension also applies to unincorporated trading businesses.

This will apply to trading losses made by companies in accounting periods ending between 1 April 2020 and 31 March 2022 and by unincorporated businesses in tax years ending 5 April 2021 and 2022.

I assume that HMRC's practice of allowing provisional loss relief claims for 'exceptional circumstances' will extend to these new loss provisions. Many companies will already have carried back losses for one year but should now be seeking to carry back any remaining losses to the earlier years. Although accounts will not have been finalised for the year ended 30 June 2021 (say), covid-affected businesses should be successful in making a claim assuming they have decent records.

There will be certain capital-intensive businesses that will welcome this enhanced loss relief particularly when combined with the 'super deduction' below. This will allow them to enjoy a relief which may have otherwise been restricted by profits. It remains to be seen whether HMRC will allow the 'exceptional circumstances' claims here.

130% 'super deduction'

A temporary allowance has been introduced for companies in respect of qualifying capital expenditure incurred between 1 April 2021 and 31 March 2023. The 'super-deduction' of 130% can be claimed in respect of most plant and machinery investment. In the absence of the annual investment allowance (AIA), this would typically have only attracted 18% writing down allowances.

These measures will sit alongside the existing capital allowances regime meaning companies will be able to choose whether to claim capital allowances, the super-deduction, or a combination of the two. Unlike the AIA, there are no limits to the amount of capital expenditure that can qualify for the super-deduction. This will be of particular assistance to capital intensive businesses that routinely exceed their AIA entitlement.

There is a slight 'catch' in this legislation relating to disposals. Any disposal will have to be recorded in the tax pool using 130% of proceeds received. If we combine this fact with the 32% increase in corporation tax rates, then it is clear that some companies could face significant balancing

charges on disposal. If an asset is bought for £100 in February 2023 and then sold a year later for £80, its tax relief would be worth £24.70 and yet the balancing charge would be subject to £26 of tax. In this way, especially for slowly depreciating assets, this relief is not quite as good as it sounds.

Capital gains tax

Sunak and the Budget papers were almost ominously quiet about capital gains tax, with the only news being that the annual exemption will be frozen at £12,300 until 2025/26. This is still the subject of an Office of Tax Simplification (OTS) review, and I anticipate seeing changes to the capital gains tax regime over the next year.

In the meantime, prospective sellers should continue to limit dividend payments to basic rates in the hope of finding a buyer who will 'pay for reserves' and therefore limit their tax exposure to 20% (and possibly 10% if business asset disposal relief (BADR) is available). Also, many shareholders will be eager to either exchange on transactions over the next few months or consider putting structures in place to accelerate gains (such as gifts to trusts).

In addition to BADR, it is worth remembering that investment relief is still around, and the lifetime limit is still £10m for this. Although it will only apply in restricted circumstances (broadly where external investors have subscribed for shares), it is worth considering appropriate planning for any qualifying shares which stand at a gain.

Freezing of income tax rates and allowances

We have been told that the personal allowance of £12,570 and the basic rate band of £37,700 are here to stay until 5 April 2026. This is a good way of increasing income tax rates in substance without actually doing it. Interestingly, the Budget notes predict that this freeze will raise more than £19bn, and presumably this will be much more if inflation is greater than expected.

To put some perspective on this measure, the 2020/21 personal allowance and basic rate band are respectively £12,500 and £37,500. If rates had been frozen in 2016/17 (as they have been today) then these would now be £11,000 and £32,000. This means that an individual earning £50,000 would be subject tax on £7,000 at 40% which otherwise would have been taxable at 20%. This is quite a significant result, although the 'fiscal drag' in the present case will be gradual.

This 'drag' will presumably also move more shareholders into the 53.58% effective tax rate (above) over the next few years.

SDLT holiday

The 'full' SDLT holiday has been extended until the end of June after having previously been due to end on 31 March 2021. This involves a 0% SDLT rate on the first £500,000 of a residential property's purchase price with normal rates applying on amounts in excess of this figure. After June, there will be a transitional 0% rate up to £250,000 before normal rates are resumed in October.

This holiday is worth £15,000 to the buyer of a single home costing at least £500,000, but its effect can be magnified when multiple dwellings relief (MDR) is claimed. This has the effect that companies can often buy multiple properties for an effective rate of 3% (even with the 3% surcharge). For example, this would be the case if a company were to buy ten properties for £5m. Furthermore,

based on legislation and new HMRC guidance, in some cases the effective rate can come down to not much more than 1% of the total price if some non-residential property is included in a transaction.

Hospitality industry 5% VAT rate

Unsurprisingly, this 5% rate has now been extended to the end of September with a transitional 12.5% rate then coming into force until 31 March 2022. It strikes me that there may be scope here to structure some kind of voucher initiative whereby customers could buy vouchers before October for use at a later date. All things being equal, a restaurant (say) could sell a £100 voucher for £87.50 and receive the same net VAT proceeds as it would in a 20% VAT environment, not to mention enjoying a much-needed boost to cash-flow. This all depends on the VAT point being the time when the voucher is purchased, which will usually be the case. This could work as a kind of DIY 'eat out to help out' scheme!

How will the Budget announcements affect behaviour?

As most short-term measures are positive, entrepreneurs will probably not feel any immediate impetus to do anything. They can look to relieve any losses that they may have or enjoy favourable tax reliefs in respect of investment. On the other hand, the tax writing is on the wall and many will face effective tax rates of over 50% (above) in just over two years. Perhaps this critical tax watershed will be enough to trigger decisive action.

For those who continue to operate in the UK, their focus may shift to ensuring that maximum use is made of a family's lower tax rates

When coupled with the prospect of rising capital gains tax rates, some shareholders may be attracted to the idea of liquidating and 'calling it a day'. This could be particularly attractive in the case of companies which have built up significant reserves. Although such shareholders will need to be mindful of the 'anti-phoenixing' provisions, they should generally be able to extract assets at no higher than 20% (and 10% if BADR applies). I can envisage cases here where another three years of work followed by liquidation could end up yielding less net cash than winding up now (this would involve a number-crunching exercise and predictions about rising capital gains tax rates).

There are also fairly mobile business owners who like to operate through UK companies because they are attracted to the low 19% tax rate. It remains to be seen if the hike to 25% will be enough to make them look elsewhere, although they would need to consider issues like corporate exit charges. Here, Maltese tax structures (with around 5% effective tax rates) could look very attractive for new ventures.

For those who continue to operate in the UK, their focus may shift to ensuring that maximum use is made of a family's lower tax rates. This could include a greater appetite for things like pension contributions (although scope here is limited) and spreading shareholdings across generations (to allow dividends to be taxed at lower rates). To end on an optimistic note, it may also increase the appetite for making charitable contributions at both the individual and corporate level. ■