THE BUDGET SUMMARY
JULY 2015

Prepared by Accord Accountants

Contents

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1 – LIMITED COMPANIES

1.1 Corporation Tax

The current main rate of corporation tax is 20% and will remain for the current and next financial tax year. The Chancellor announced some good news for all of our clients that own a limited company with a plan to reduce corporation tax down to 18% by 2020. Of course there may be further updates but the planned rates of corporation tax are shown below.

Tax Year	Corporation Tax
2015/16	20%
2016/17	19%
2017/18	19%
2018/19	19%
2019/20	18%

1.2 Director Salaries

A company director can decide what salary is best for them and with our help and advice we can discuss your individual needs at any time. Where possible we shall continue to file most company director salaries annually to save on administrative costs for you.

Although the income tax allowance has increased marginally the amount when employees and employers National Insurance becomes due on the directors salary remains around £8,000 and now at £8,060 for the 2015/16 tax year. We believe this is the right salary choice for most company directors as there are no tax deductions to calculate and pay on the salary but yet it is still deemed a contributory salary and therefore counts towards your state pension.

1.3 Shareholder Dividends

Currently company dividends are paid tax free up to the higher rate income level. This is due to a tax credit that applies to dividends at 10%. In the budget it was announced this tax credit is to be scrapped and instead replaced with a £5,000 tax free dividend allowance and a new tax on dividends over the allowance of 7.5%. This new dividend tax increases to 32.5% on dividends paid to higher rate tax payers and up to 38.1% on those earning more than £150,000.

The result is going to be a personal tax liability for most company owners of between £500 and £2,000 depending upon the amount of dividends paid. However the new reduced rate of corporation tax will go some way to off-set this personal tax liability overall but we recommend further consideration to ensure legitimate income shifting has been applied where possible between company owners and their immediate family.

1.4 Employment Allowance

Employers National Insurance is a tax paid by businesses that employ staff. Where an employee's salary is over £8,000 a 13.8% national insurance liability is due on the employee's gross salary. Employers currently have an allowance of up to £2,000 per year and the chancellor has agreed to increase this from April 2016 to £3,000. The employers national insurance allowance is restricted so that it only applies to actual staff so company directors won't be able to take advantage of this allowance unless they are contracted, which means directors who are employed by the company on employment contracts such as typically the case with much larger companies with a board of directors for example. This restriction is the main reason why we suggest the optimum tax efficient salary for company directors is currently £8,060 per year and not the same as the tax free allowance amount.

1.5 Goodwill

Tax relief available from purchasing goodwill has now been abolished. So this also means a business that incorporates after the 8th July 2015 from a self-employed business will no longer be able to benefit from the tax relief on the transfer of goodwill as previously available relief. However tax relief on the acquisition cost of goodwill remains available upon disposal of business in relation to capital gains tax including when entrepreneurs relief is being claimed.

In Summary

With these new rules to the company dividend tax and goodwill the financial advantages of incorporating a limited company from a self-employed business has been reduced significantly. In most cases there will always be some tax saving advantage to running a company compared to being self-employed but with the additional administrative costs the level when this should become a financially motivated decision based specifically upon the fees charge by us is when a business has taxable profit of £20,000 or over. In the following illustration prepared by Rebecca Bennyworth it is suggested a profit level of £40,000 and over but this is based upon an average accountancy fee for a small owner managed company being about £2,500 and as our clients know Accord's commitment to charging the lowest possible fees means our fees are typically less than half of this London average.

The other benefits of running a limited company such as the advantages of having limited liability, the potential enhanced business image and the additional ease of legitimate income shifting still results in a company being the preferred choice for most. We shall of course remain objective with our advice to new and existing clients on the overall and financial benefits of companies and should you wish to discuss this please do not hesitate to contact us.

DIVIDEND TAXATION

The bombshell announcement was regarding the taxation of dividends. For many investors this will not pose any issues, but for the owner manager of a small company, major changes are in store. The basic information about the taxation of dividends is as follows. Inevitably, before the release of the Finance Bill, some details are a little sketchy – this is indicated where important.

- Abolition of the tax credit – dividend income will no longer be grossed up in the personal tax computation
- A Dividend Tax Allowance of £5,000. It is not clear whether this will then reduce the available basic rate band or whether it is a full exemption from tax. The policy driver is likely to be to exclude the vast majority of ordinary investors from having to complete tax returns in respect of dividend income (even basic rate taxpayers), so logic tends to suggest that it will be ***in addition to*** the basic rate band to keep things simple for those not in SA.
- Dividends will then be liable to tax at 7.5% in the basic rate band, 32.5% in the higher rate band and 38.1% in the additional rate band.
- This compares with existing rates of 0%, 25% and 30.56% on the net income.
- The new savings allowance of £5,000 introduced this year (2015) **is not** available against dividend income – only interest and similar.
- The new personal savings allowance of £1,000 for basic rate taxpayers and £500 for higher rate taxpayers which is due to commence in 2016 will **probably not be available** against dividends; it is likely to be restricted to savings income only. This will also be in the Finance Bill to be issued shortly.

Detailed computations on the impact on small businesses organised through companies is in the next section, but here is a view of the impact on a private investor with substantial dividend income.

Example

Peter is a higher rate taxpayer with a significant inherited portfolio of shares on which he receives dividends of £9,000 a year (net amount).

His tax position in 2015/16 and 2016/17 is as follows:

	2015/16		**2016/17**	
Dividend income received		9,000		9,000
Plus tax credit		1,000		-
Dividend allowance				5,000
Taxable dividend income		10,000		4,000
Tax at	32.5%	3,250	32.5%	1,300
Less tax credit		1,000		
Tax due		2,250		1,300

So for the even above average investor, the change represents a better tax position than currently. For an additional rate taxpayer the number are:

		2015/16		2016/17
Dividend income received		9,000		9,000
Plus tax credit		1,000		-
Dividend allowance				5,000
Taxable dividend income		10,000		4,000
Tax at	37.5%	3,750	38.1%	1,524
Less tax credit		1,000		
Tax due		2,750		1,524

It is only where dividends represent the majority of an individual's income that we shall see the reverse.

INCORPORATION ADVICE

Introduction

The changes to dividend taxation announced in the July Budget impact significantly on the advice about incorporation. Following the changes made in December 2014 affecting goodwill on incorporation, this change makes it even less attractive for some clients to run their business through a limited company.

Numerical examples - assumptions

In all cases the following assumptions apply:

- The comparisons are between a single person operating as a sole trader and a company owned by one person. The tax, and Classes 2 and 4 NIC are included in the current year; thereafter Class 2 NIC is excluded as it will be abolished in 2016.
- Incorporated business assumes that the taxpayer takes the most aggressive view about distribution of profits and draws a salary roughly equal to the NIC threshold (£8,000) and the balance by way of periodic dividend. It is assumed that the tax and NIC limits set for 2016 will continue through to 2020.
- A 100% profit distribution route has been considered, which puts maximum disposable income in the hands of the taxpayer. If profits are retained in a company over and above the personal higher rate threshold, this will produce further tax savings. This way, the figures below show the “worst case scenario”.
- These examples exclude any other differential arising from operating in the particular business structures; in particular, there will be differences in the cost of business motoring arising from the tax treatment, and the administrative costs borne by the business operating through a limited company.

Table 1 : Tax & NIC burden self employed to limited company 2015/16

Profit	Sole trader	Tax %	Company	Tax % in co.	Saving
£20,000	£3,100	15.5%	£2,400	12%	£700
£30,000	£6,000	20%	£4,400	14.7%	£1,600
£40,000	£8,900	22.3%	£6,400	16%	£2,500
£50,000	£12,790	25.6%	£9,063	18.1%	£3,727
£75,000	£23,290	31.0%	£19,063	25.4%	£4,227
£100,000	£33,790	33.8%	£29,063	29.1%	£4,727

1.1.1 Overview

With the tax savings shown above it is unlikely that it is worth incorporating at profits of less than £40,000, given the additional administrative costs.

Changes in 2016

The change to taxation of dividends produce the following results, using the same assumptions.

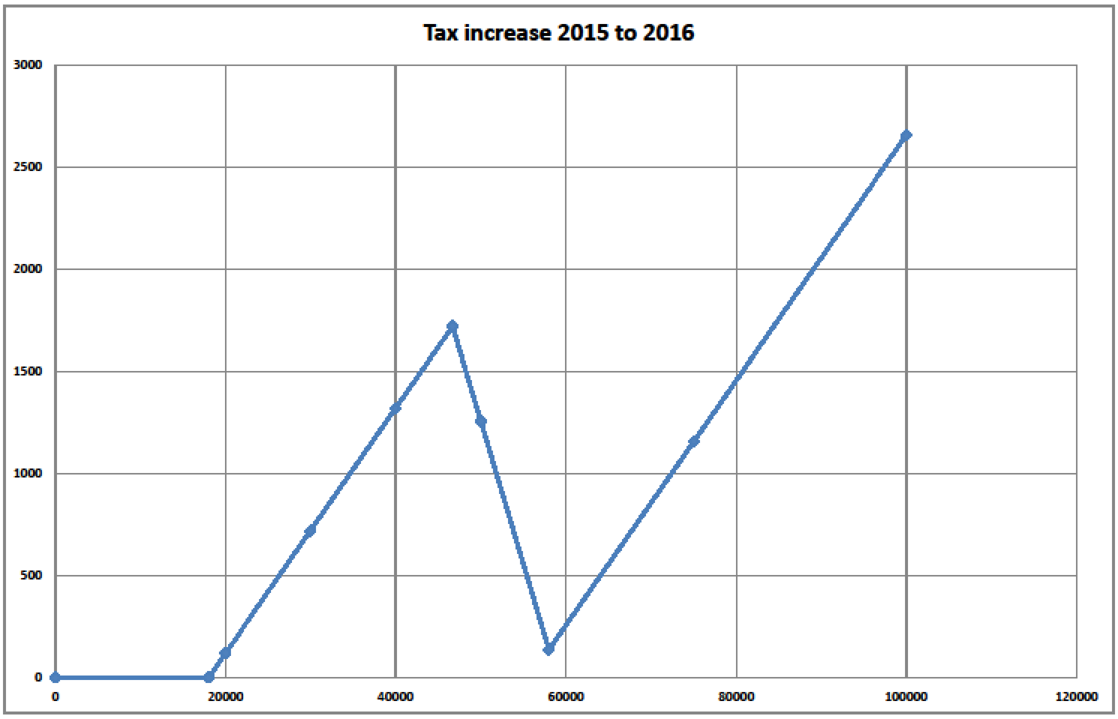
Table 2 : Tax & NIC burden self employed to limited company 2016/17

Profit	Sole trader	Company	Tax % in co.	Saving
£20,000	£2,875	£2,520	12.6%	£355
£30,000	£5,775	£5,120	17.1%	£655
£40,000	£8,675	£7,720	19.3%	£955
£50,000	£12,485	£10,320	20.6%	£2,165
£75,000	£22,985	£20,220	27.0%	£2,765
£100,000	£33,485	£31,720	31.7%	£1,765

Table 3 : additional tax under corporate structure 2015/16 to 2016/17

Profit	Tax increase
£20,000	£120
£30,000	£720
£40,000	£1,320
£50,000	£1,257
£75,000	£1,157
£100,000	£2,657

The increase in tax from 2015/16 to 2016/17 is a complex curve. It commences at profit of £18,000 – below this level there is no tax increase from 2015 to 2016. The tax increase rises in absolute terms until it reaches £1,720 at profits of £46,690. The increase then starts reduce, due to the effect of the higher rate liability on the grossed up dividends in 2015. It turns once again, having reached a low point of £137 increase at profits of £58,000. It is at that point the higher rate in 2016 comes in and produces a rising tax increase. The following graph illustrates the change



1.1.2 Marginal rates on dividends

The combined marginal rate on dividends payable in each band are as follows:

	Basic	Higher	Additional
Profit	100	100	100
Corporation tax	20	20	20
Net profit	80	80	80
Dividend tax	6	26	30
Net retained	74	54	50
Tax rate %	26.0%	46%	50%

1.1.3 Impact of goodwill

The increased tax burden at each level of profit erodes the benefit of incorporation still further, but taking a substantial value of goodwill into the company can still produce a benefit, in spite of the changes made in December 2014.

A large value of goodwill would be taxed on the disposal at 28%, but would then produce a loan account balance to draw on, and on which the trader can also charge interest, which would be covered by the savings income nil rate band. This would enable him to reduce the dividends he draws, reducing the overall tax burden. Although this presents a better picture than above, it would also have been possible before these changes were proposed, so in essence many taxpayers are looking at an increase in their tax liability over the next few years.

Change to corporation tax rate in 2017

Assuming that all other factors remain the same, the one per cent reduction in the corporation tax rate in 2017 will reduce the impact of this, and the further reduction in 2020 will help still further.

Table 4 : Corporate structure tax burden 2016 to 2020

Profit	2015	2016	2017	2020
£20,000	£2,400	£2,520	£2,409	£2,298
£30,000	£4,400	£5,120	£4,917	£4,713
£40,000	£6,400	£7,720	£7,424	£7,128
£50,000	£9,063	£10,320	£9,932	£9,543
£75,000	£19,063	£20,220	£19,768	£19,316
£100,000	£29,063	£31,720	£31,099	£30,478

Table 5 : additional tax under corporate structure 2015/16 to 2020/21

Profit	Tax increase
£20,000	£(102)
£30,000	£313
£40,000	£728
£50,000	£480
£75,000	£253
£100,000	£1,415

Health warning!

Given all of the above, you should also factor in the risk that Class 4 NIC will rise when Class 2 contributions are abolished in April 2016. There is a real risk that Class 4 NIC could rise to 12% - note that the triple tax lock specifically applies ONLY to Class 1 primary and secondary rates and not to Class 4. As an illustration, increasing Class 4 to 12% in 2016 would show the following (using the NEW rules for dividend taxation):

Profit	Sole trader	Company	Tax % in co.	Saving
£20,000	£3,233	£2,520	12.6%	£713
£30,000	£6,433	£5,120	17.1%	£1,313
£40,000	£9,633	£7,720	19.3%	£1,913
£50,000	£13,180	£10,320	20.6%	£2,860
£75,000	£23,680	£20,220	27.0%	£3,460
£100,000	£34,180	£31,720	31.7%	£2,460

2 – INDIVIDUALS

2.1 Income Tax Allowance and Rates

The tax free allowance is to increase to £11,000 and the higher income tax threshold to rise to £43,000. These new levels apply from April 2016.

Income tax is to remain at 20% and employees National Insurance and self employed national insurance remains at 9% for the basic income level.

For higher rate earners income tax remains at 40% with national insurance at 2%

The additional 45% rate of income tax on very high salaries and self-employed income has been abolished.

2.2 Dividend Tax Allowance and Rates

As previously mentioned within the company section a new dividend tax and tax free allowance has been introduced. This means for those clients not trading through a limited company and have investments in shares will now receive their dividends tax free up to £5,000 per year.

Dividends	*Tax Rate*
£0 - £5,000	0%
£5,001 - £43,000	7.5%
£43,001 - £150,000	32.5%
£150,001 +	37.1%

2.3 Savings Allowance

Some good news for those with taxable savings. A new tax free allowance on savings interest is to be introduced from April 2016. This means the first £1,000 of interest received from savings will be tax free. Banks are no longer going to automatically deduct tax from their interest payments and most will never have to pay this tax any more. However the allowance is reduced to £500 for higher rate earners and is removed completely for additional rate tax payers.

2.4 Pensions

Paying into a pension continues to be a tax efficient way of investing with straight forward higher rate tax relief available for every pound contribution into a personal scheme. From April 2016 there is going to be a reduction in the pensions annual allowance for those earning over £150,000.

Pension lump sum payments upon death of a pensioner aged 75 and over are currently taxed at 45%, but from April 2016 this is going to be taxed at the marginal rate of the recipient. However the 45% tax rate will continue to apply when the lump sum payment is paid into trusts.

2.5 Inheritance Tax

The Chancellor confirmed an anticipated rise to the inheritance tax threshold and this will mean in most scenarios a home worth up to £850,000 will be exempt from this tax from April 2017 and from April 2020 extended to homes worth up to £1million. The increase only relates to properties that are the main residence of the deceased and a 40% inheritance tax charge would apply to other assets.

The maximum inheritance tax relief is only available when an individual transfers their allowance upon death to their partner so for single parents a property worth only up to £500,000 will be exempt from this tax.

These increases from the current £325,000 per person are very welcome however with property prices being so high in some local areas we still strongly advise consideration of this tax and Accord is always here to help.

For those with a property worth over £2million the additional £175,000 per person allowance will be reduced by £1 for every £2 over £2million.

2.6 ISA's

From April 2016 individuals can withdraw and reinvest ISA funds without the reinvestment counting towards their annual ISA allowance providing the transaction is within the same tax year. However with the new savings allowance being introduced from April 2016 we expect many clients would now simply hunt the best interest rates for their savings as the main tax free benefit of an ISA has will be matched by other saving accounts.

3 - PROPERTY LANDLORDS

3.1 Wear & Tear Allowance

Landlords who own fully furnished properties would be use to claiming the wear and tear allowance equal to 10% of the gross rent charged to the tenant. From April 2016 this allowance will end and instead tax relief will only be available when items at the let property are purchased. We still wait to see if expenditure on replacement furnishings and white goods is to be extended to partially let properties after this was prevented since April 2013.

3.2 Tax Relief on Interest

One of the most significant new policies announced in the budget was the restriction of tax relief on loan interest such as mortgages on let residential properties. Currently if you receive rental income from a domestic property loan interest from a mortgage for example that has been used to purchase, improve or maintain the property provides full tax relief. It is proposed that from April 2017 this unrestricted full relief is going to be gradually restricted so that by 2020 interest will not be an allowable expense when calculating the rental profit and instead the interest will only provide 20% tax relief. This applies to all property let businesses and individual property landlords.

So what that means is that higher rate tax payers will effectively have the mortgage interest restricted to the basic rate of income tax. Those with relatively low incomes or those without a mortgage will not be affected. Those clients with a large amount of rental income and especially if they also have large mortgages will be hit the hardest, exaggerated further if they let fully furnished properties too. We strongly advise all clients affected by this to make an appointment to discuss how this change is going to affect them.