GARBETTS
Chartered Certified Accountants

PRE BUDGET REPORT 2005
CHANGES TO CORPORATION TAX RATES

A change in Corporation Tax rates was announced in the pre budget report, with effect from April 2006.

These changes mark the final demise of the Corporation Tax nil rate band.

Tax rates – now and April 2006 onwards

Band of profit PA	Current	From April 2006
Up to £10k	0% note 1	19%
£10k to £50k	23.75%	19%
£50k to £300k	19%	19%
£300k to £1.5m	32.75%	32.75%
£1.5m and over	30%	30%

Note 1 - Non Corporate Distribution Tax regime imposes a minimum 19% on profits taken as dividend, even if the rate would other wise have been nil

A bit of history…

In April 2000 a 10% tax band was introduced on company profits between £0 and £10k. This was tapered out over profits between £10k and £50k.

In April 2002 the 10% tax band was reduced to 0%, again with a taper clawing it back on profits between £10k and £50k. The taper is why the tax rate in the above table jumps from 0% to 23.75% (£10k x 0% + £40k x 23.75% = £50k x 19%).

The lower Corporation Tax rates led many sole trader / partnership businesses down the route of incorporation during 2002 to 2004. Its not hard to see why – take a business with profits of £15k pa. Current (04/05) Income Tax rules would have the business paying £2,941 in tax and NI (sole trader) – but properly structured with a limited company the tax and NI would have been £nil. If the business was making £25k pa, then the tax as a sole trader would have been £5,941 against £1,900 as a limited company.

When the Corporation Tax rate was lowered to 0% representatives of business and the accountancy/tax profession, as well as the opposition, asked the Government to explain their objectives – did they want to push all businesses towards becoming companies? The Governments reply was a rather naïve "We don't think that businesses will become limited companies just to save tax". Of course, the Government was wrong and there was a rush towards incorporation by small business.

…and a right old bodge up…

Realising the tax revenue they were losing, in the December 2003 pre pudget report we were treated to "IR591", which spoke darkly of *"the Government is concerned that the longstanding differences in tax treatment between earned income and dividend income should not distort business strategies, or enable reductions by tax planning of individuals' tax liability, and that support should continue to be focused on growth."* and went on to promise *"The Government will therefore bring forward specific proposals for action in Budget 2004, to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company, and so protect the benefits of low tax rates for the majority of small businesses."*

Basically, "we got it wrong but we cannot admit it".

So, in the spring 2004 budget IR591 gave birth to the so called “non corporate distribution rate” of Corporation Tax – the 0% rate was left in place, but a minimum 19% tax was imposed on monies drawn as dividends by individuals (as opposed corporate shareholders).

Basically this was a face saving exercise by the Government to remove the 0% band without being seen to have got it wrong in the first place. The problem was the NCD rate was not properly thought through and created various anomalies and pitfalls, not in the least that the minimum 19% tax rate was, in fact, nearer 16%. All in all a bit of a rushed bodge up.

…and we’re back at square one

So what we’ve seen in the recent December 2005 pre budget report is complete abolition of both the 0% band and IR591.

Basically we’re back to where we were in 2000, but with many small businesses having saved a good few bob on the way.

What does this mean in practice to a small company?

Should I go back to being a sole trader? Well, probably not as there are still cracking tax savings by being a limited company, plus the benefits of limited liability, but you need to set these against the extra bureaucracy involved, a less generous regime for cars/motoring costs and increased accounting costs. If you are a contractor working via an agency, you probably cannot be a sole trader anyway.

So, just how much tax will I now pay?

Profit PA £	Tax as sole trader £	Tax as company £
5,000	110	-
10,000	1,301	950
15,000	2,701	1,900
20,000	4,101	2,850
30,000	6,901	4,750
40,000	9,715	6,650
50,000	13,815	9,271
60,000	17,915	13,196
100,000	34,315	28,896

(05/06 tax rates Income Tax/Ni rates, assuming new April 06 onwards Corporation Tax rates. Assume company salary £5k pa)

So, its clear the savings from being a company are worthwhile still.

Conclusion

For most businesses the conclusion is that limited company status still makes sense financially. However, if you are currently running as a limited company and feel that sole trader / partnership may be better for you, then please make contact with us so we can discuss your options. In most cases a shift back to sole trader / partnership is fairly straight forward to do.

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