

Incorporation advice in 2023/24 (Lecture B1349 - 8.54 minutes)

Corporation tax rate increase

The announcement that we are to press ahead with the increase in corporation tax – main rate increasing to 25% - as legislated for in Schedule 1, Finance Act 2021 means that advice regarding incorporation of small businesses – and indeed advice regarding remaining a small company is changing from April 2023.

Small profits rate of corporation tax

Section 7 and Schedule 1 set out the details of the small profits rate and related marginal relief. The rate of corporation tax applying profits in a company subject to the small profits rate will be 19% from 1 April 2023. The legislation also specifies a standard 'marginal relief fraction' of 3/200ths.

The small profits rate will apply to the chargeable profits of a company where:

- The company is UK resident;
- The company is not a close investment holding company, and
- The company's 'augmented profits' do not exceed the lower profit limit which is set at £50,000.

Augmented profits

The adjustment for augmented profits arises because UK dividends are not part of chargeable profits, but a company in receipt of substantial amounts of UK dividends would not be regarded as one with 'small profits'. The augmented profits are arrived by taking the chargeable profits of the company for the accounting period and adding any exempt distributions of a qualifying kind (exempt from corporation tax under Chapter 9A CTA 2009) received by the company that are not excluded.

Dividends that are excluded for this purpose are those paid by 51% subsidiaries or fellow subsidiaries in a group.

Marginal relief

Marginal relief is available if:

- The company is UK resident;
- The company is not a close investment holding company;
- The company's 'augmented profits' exceed the lower profit limit; and
- The company's augmented profits do not exceed the profit upper limit which is set at £250,000.

In this case, the corporation tax charge on the profits is calculated as the chargeable profits multiplied by the main rate less marginal relief, where the marginal relief is calculated using the following formula:

Marginal relief fraction x (Upper profit limit – augmented profits) x total taxable profits / augmented profits.

A company with taxable profits of £75,000 in receipt of £5,000 of UK dividends and with no associated companies would be liable to:

$$75,000 \times 25\% - 3/200 \times (250,000 - 80,000) \times 75,000/80,000 = £16,359.38 \text{ or } 21.81\%$$

The effective marginal rate for a company with no dividend income and profits between the relevant upper and lower limits will be 26.5%.

Profit limits

The lower limit is £50,000 for the 2023 financial year and the upper limit £250,000. However, these are annual limits and should therefore be time apportioned if used in an accounting period of less than 12 months.

The limits are also adjusted for the number of associated companies – the limits are divided by 1 + N where N is the number of associated companies.

Close investment holding company

A close company is a close investment holding company unless throughout the accounting period it exists wholly or mainly for on the following permitted purposes:

- for the purpose of carrying on a trade or trades on a commercial basis;
- for the purpose of making investments in land, or estates or interests in land, in cases where the land is, or is intended to be, let commercially (not to connected persons);
- for the purpose of holding shares in and securities of, or making loans to, one or more companies each of which—
 - (i) is a qualifying company (controlled by candidate company or parent thereof), or
 - (ii) falls within subsection (4)*,
- for the purpose of co-ordinating the administration of two or more qualifying companies;
- for the purpose of the making of investments as mentioned above:
 - (i) by one or more qualifying companies, or
 - (ii) by a company which has control of the candidate company, or
- for the purpose of a trade or trades carried on on a commercial basis—
 - (i) by one or more qualifying companies, or
 - (ii) by a company which has control of the candidate company.

Dividend taxation

The rates applying to dividends increased in April 2022 at the same time as the NIC rates were increased. However, it is not now intended to reduce the rates of dividend tax, so these will remain at 1.25% over those for 2021-22.

The rates are:

- Basic rate 8.75%
- Higher rate 33.75%
- Additional rate 39.35%

In addition, as announced in the 2022 Autumn Statement, the dividend nil rate band is to reduce from £2,000 to £1,000 in April 2023, and to £500 in April 2024.

Incorporation comparison

The table below considers the relative tax burden on various levels of profit based on the following assumptions.

For a sole trader, the tax, Class 2 and Class 4 National Insurance contributions are calculated.

For the limited company, a salary of £12,570 (the tax and primary NIC threshold) is assumed, and the profits then taxed at the relevant rate of corporation tax. There will be secondary NIC on earnings in excess of £9,100 at a rate of 13.8%. I have assumed that no Employment Allowance is available as it is a single director company. There is tax relief on the employer NIC paid.

All of the post tax profits are extracted by way of dividend, by a director shareholder who has no other sources of income.

| <u>Profit</u> | <u>Self Employed</u> | <u>Ltd company</u> | <u>Tax Saved</u> |
|---------------|----------------------|--------------------|------------------|
| 20,000 | 2,334 | 2,205 | 129 |
| 30,000 | 5,234 | 4,814 | 420 |
| 40,000 | 8,134 | 7,423 | 711 |
| 50,000 | 11,034 | 10,032 | 1,002 |
| 60,000 | 15,199 | 12,669 | 2,530 |
| 70,000 | 19,399 | 17,239 | 2,159 |
| 80,000 | 23,599 | 22,370 | 1,228 |
| 90,000 | 27,799 | 27,501 | 297 |
| 100,000 | 31,999 | 32,632 | - 634 |

Marginal rates on dividends

When corporation tax is 19%, the marginal rate of tax on dividends distributed is 26.09%.

Dividends reach the higher rate bracket when the profits reach £59,592. While the corporation tax rate remains 19% the marginal rate is 32.93%, but the small profits marginal rate is reached at £63,049 at which point the marginal rate becomes 51.31% (as against 42% for the sole trader).

For the limited company, taper of personal allowance starts at profits of £126,899 and the marginal rate is then 63.71%. The sole trader has moved to 47% marginal rate.

Contributed by Rebecca Benneyworth