

Planning for the 25% corporation tax rate (Lecture B1319 – 19.27 minutes)

Companies will be keen to mitigate the effects of the 25% tax rate which starts from 1 April 2023.

The small profit rate of 19% will continue to apply where the small profits limit is not exceeded.

This is where augmented profits (including non-group distributions received) are at or below £50,000 pa. The £50,000 limit is divided by the number of companies who were associated with the relevant company at any point in the accounting period.

We are concerned where augmented profits will exceed the small profit limit. Above this, profits are taxed at a marginal rate of 26.5% until they exceed the upper profit limit of £250,000 pa (divided by the number of associated companies) when they are taxed at 25%.

Associated companies

Two companies are associated where one controls the other (i.e. like 51% groups today), or both are controlled by the same person or group of persons.

Dormant companies are ignored as are pure holding companies that just receive dividends and pay them on to shareholders.

Control

Control is where a person can exercise or acquire direct or indirect control over the company's affairs. This will definitely be the case if they own or can acquire:

- More than 50% of the share capital or issued share capital, or
- The majority of the voting rights, or
- Entitlement to majority of distributable profits, or
- Entitlement to > 50% of assets available to participators.

It includes where two or more persons satisfy these conditions.

But when attributing rights of others (e.g. associates such as spouse, siblings etc.) companies are only associated if there is substantial commercial interdependence between them (e.g. economic links, financial links and organisational links).

Husband and wife scenarios

If H&W each own (say) 50% of A Ltd and of B Ltd, the two companies are associated.

But if H owns 100% of A Ltd and W owns 100% of B Ltd, normally we would attribute H's interest to W and W's interest to H so the companies would be treated as under common control, but for this purpose A Ltd and B Ltd will only be associated if there is substantial commercial interdependence between them. If they operate separately, they will not be associated.

Timing of revenue and expenses

If augmented profits are likely to exceed the lower profit limit and can any profit be accelerated into earlier year?

For example, trying to complete long-term contract work before 1 April 2023 (or the accounting period that straddles this date).

Or can allowable expenditure be delayed until after 1 April 2023 to get tax relief at higher level? This might be possible for discretionary expenditure such as directors pension contributions.

If the company is planning to acquire an electric car for employees or directors, it might be worth considering leasing the car rather than purchasing it, if it would be purchased when the rate of corporation tax is still 19%.

Leasing the car would spread the expense over the lease term. Typically, an electric car is leased for 48 months, so, assuming it could be delivered to the company in, say, November 2022, the vast majority of the expense would be recognised in periods after the corporation tax rate has increased.

Buying the car in November 2022 would result in a 100% first-year allowance but would only save tax at 19%.

An additional feature of car leasing is that if the car is used for some business purposes, 50% of the VAT on the rentals can be reclaimed. No VAT is recoverable if a car is purchased (or hire-purchased) unless the car is used 100% for business use which is extremely rare.

Ultimately, whether to purchase or lease a car is a commercial decision based on which minimises the overall cost to the company, but tax can play a large part in this analysis.

Use of losses

Losses arising in recent accounting periods might be better carried forward than used in the current and previous period(s) to save tax at higher rates than 19%.

This depends on the probability that the company will make taxable profits in excess of the small profit threshold in future years.

Consideration can be given, where relevant to tailoring the use of brought forward losses to reduce future profits to the small profit limit and carry forward the remainder. This would ensure that the losses save tax at more than 19% but would delay loss relief. It is also dependent on the company achieving profits in excess of the small profit rate in later periods.

Possible restructuring to save some tax?

Consideration should be given to the impact of associated companies and considering if restructuring is worthwhile to reduce the number of associates to save some corporation tax.

Additionally, restructuring might mitigate the impact of dividing the quarterly instalment payment limits by the number of associates from 2023.

Example 1

Individual client owns 2 companies, each with profits of £800,000. At present, they do not have to pay tax by instalments.

The first accounting period beginning from 1 April 2023 will be within the instalment regime, but QIPs will not apply in that period, but from the following accounting period.

Example 2

If one company has profits of £800,000 and the other has profits of £600,000, it might be advantageous to merge them. The first company would then avoid the need to pay QIPs going forward.

Example 3

Two companies in a group. A Ltd has losses of £120,000 and B Ltd has profits of £300,000. Maximum group relief claims are made where possible.

At present, both pay corporation tax at 19%.

From April 2023 the LPL = £25,000 and the UPL = £125,000.

A pays no corporation tax, B pays tax of $(25\% \times [300 - 120])$, total = £45,000.

If they merge into one company, LPL = £50,000, UPL = £250,000. Profits = £180,000, tax = $(50k @ 19\% \text{ plus } 130k @ 26.5\%)$ £43,950. This saves £1,050, in theory annually if results are similar in future years.

The costs of restructuring need to be balanced against the tax saving.

Example 4

2 companies owned by 1 individual. A Ltd has profits of £10,000 and B Ltd has profits of £130,000.

At present, both pay corporation tax at 19%.

From April 2023, the LPL = £25,000 and the UPL = £125,000.

A would pay tax of $(19\% \times 10k)$ £1,900, B would pay tax of $(25\% \times £130k)$ £32,500, at total of £34,400.

If they merge into one company, the LPL = £50,000 and the UPL = £250,000. Merged profits = £140,000, and the corporation tax payable is $(50k @ 19\% \text{ plus } 90k @ 26.5\%)$ £33,350.

This again saves £1,050, possibly annually if profits are similar in future years.

Change of accounting date

Depending on seasonality of profits it might be worth moving the company's year-end either to, or from 31 March.

For example, if a company currently has a year-end of 30 September and does not change this, its profits will be taxed at 22% for the year ended 30 September 2023.

If it changes its year end to 31 March:

1. 6 months to 31 March 2023 will be taxed at 19% (with plant & machinery effectively getting relief at 24.7% with super-deduction);
2. 6 months to 30 September 2023 will be taxed at 25%/26.5% if above the lower profit limits (as part of the year ended 31 March 2024).

If the company's profits are generated more in the period October to March than in the period April to September, it might be worth changing the year end.

Example

A company with year ended 30 September is anticipating a taxable profit ignoring capital allowances of £560,000 in its year ended 30 September 2023 and this is expected to be stable going forward.

The company has historically earned 35% of its annual profits in the period April – September and 65% in the period October – March.

If the company retains its current year end, it will have a tax liability (ignoring capital allowances) of $22\% \times £560,000$, i.e. £123,200 for its year ended 30 September 2023.

If it changes its reporting date to 31 March from 2023, then it will have a tax liability of

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| 1. 6 months to 31 March 2023 ($560,000 \times 65\% \times 19\%$) | £69,160 |
| 2. 6 months to 30 Sep 2023 (part of y/e 31 Mar 2024) ($560,000 \times 35\% \times 25\%$) | <u>£49,000</u> |
| | <u>£118,160</u> |

Changing the reporting date would save £5,040 of corporation tax. This is $£560,000 \times 15\%$ seasonal bias* $\times (25\% - 19\%)$.

*The seasonal bias is the 65% of profit earned in the first 6 months minus 50% if there was no seasonality.

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