Raising taxes

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01 August 2015

Bill Dodwell considers the main points of the Conservative government's first Budget for 18 years

Slowly the word crept out that there would be a great deal in the summer Budget – although details of the content remained closely guarded until 8 July. The Chancellor's speech was longer than many, as he outlined tax increases, welfare cuts and the parameters for public spending cuts in the autumn spending review. Perhaps most surprising was the plan for a national living wage, which will apply from April 2016 to those aged 25 and older – and is an 11% increase on the national minimum wage. The Chancellor envisages that the living wage will increase to 60% of median earnings – expected to be £9.35 an hour by 2020.

The net tax increases are huge – more than £33 billion over the parliament, according to the red book. They lift the tax burden from 35.9% of GDP now to 36.8% of GDP in 2020/21, with the biggest year-on-year increase from this year to next. Public sector net debt is forecast to reduce to 68% of GDP by 2020/21 as the Budget moves into a small surplus.

Insurance premium tax

There are three large tax-raising measures. Insurance premium tax rises from 6% to 9.5% – which will pull in £8 billion over the parliament. It's true, as the Chancellor noted, that the UK level is below the EU average, but the increase will cost the average two-car family about £37 a year. Unsurprisingly, insurers immediately said they would pass on the costs to consumers and businesses.

Corporate focus

The second major increase comes from the simple expedient of asking some companies to pay their corporation tax wholly during the accounting year, rather than half during the year and half afterwards. The measure will apply from 1 April 2017 to companies with profits of £20 million or more – with the limit split between group companies. Since red book accounts follow the cash basis, this acceleration should bring in £8 billion in 2017/19. Companies, of course, have to finance the earlier payments, but their accounting follows the accruals basis – so it's not a tax increase to them, but a rather more modest financing cost. Details of exactly how the measure will operate will have to await the draft clauses for Finance Bill 2016, no doubt due in December.

Companies will probably have been surprised by the announcement of new reductions in the rate of corporation tax. It drops to 19% from 1 April 2017 and then to 18% from 2020. The legislation for this is in the summer Finance Bill, so it will be enacted in the autumn.

The timetable for the Finance Bill isn’t yet known, but there have been suggestions that it might receive royal assent by the end of October. This will affect the 2015 financial statements for calendar year companies, potentially reducing deferred tax assets and liabilities. No doubt the government will use the rate cut to repeat the message that the UK is ‘open for business’ as we reach conclusions in the G20/OECD Base Erosion and Profit Shifting project and some multinationals start to consider possible relocation of some of their activities. It is an expensive policy, though, costing some £6.5 billion over the parliament. The figures certified by the Office for Budget Responsibility make a pretty modest allowance for additional business in the UK; no doubt the government will have more significant ambitions in attracting investment.

There were no announcements on the BEPS project, presumably because we are about to enter the final intergovernmental negotiations on the outcomes before public release at the G20 meeting in Lima on 8 October. The OECD secretariat’s webcast in June alluded to the possibility of changes to the closure of existing patent box regimes. The forum on harmful tax practices has not released any updates, which suggests that the group continues to work through the open issues.

There are a few other corporate tax changes, though. First, the government has decided to abolish allowances for purchased goodwill and customer-related intangibles. The measure applies to new acquisitions from 8 July; existing amortisation is unaffected. It’s not obvious why the relief introduced in 2002 is now considered unnecessary, but its abolition is predicted to raise £200 million a year. The change does still leave goodwill as an income asset, rather than a capital gains asset, which is an unhelpful complexity. It would surely be best to return goodwill to the class of capital gains assets so that we no longer need to worry about when pre-2002 goodwill and customer intangibles magically mutate into new goodwill.

The second change is to provide that profits apportioned to UK companies under the controlled foreign companies rules can no longer be offset by UK losses and reliefs. Again, there seems no point of principle here beyond raising some £150 million a year. Perhaps the change will support the retention of the UK's partial finance company regime, since it will be clear that it raises UK tax.

The other obvious case where profits are apportioned is from captive insurance companies. They are commonly used to access third party reinsurance and many are based outside the UK since insurance regulation here is not designed to accommodate captives. It is unfortunate that something intended for commercial reasons may now trigger tax charges without the benefit of using existing losses. The change applies to profits accruing from 8 July and there are apportionment provisions for straddling accounting periods.

The corporation tax cut was facilitated by the third major tax increase – an unexpected change to the taxation of dividends.

From 6 April 2016, the dividend tax credit is abolished. In its place, an individual will receive a £5,000 exempt allowance and dividends above this amount will be taxed at new, higher rates. These are 7.5% for basic rate taxpayers; 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers.

The main target must be owner-managed companies which typically pay dividends to their owner-managers in place of salary. This has meant that a self-employed individual pays more tax and national insurance if the services are provided as a sole trader or partnership rather than through a company. The change will narrow the gap. A self-employed person with net income of £40,000 will in future pay an extra £1,300 if a company is used – but the effective tax/NIC rate will still be just 19.2% compared with 21.7% for a sole trader. The breakeven point is quite high, at £140,000, where both routes carry a 39% tax burden. At higher income levels, the company route costs more. The estimated yield is £8.5 billion, plus a further £2 billion through discouraging further incorporations. Some people will benefit from the change – after all, the dividend yield on quoted shares is about 2.5%, implying that investors would need a share portfolio worth more than £200,000 to trigger any additional tax.

Inheritance changes

Older individuals may welcome the forthcoming inheritance changes, although these will not take effect until 2017. Currently about 5% of estates are liable to inheritance tax but this is expected to increase substantially due to rising property prices. The new relief is targeted, in that it applies only to residential property left to children and grandchildren. There are provisions to protect the value of the relief where the house is sold (downsizing relief) which naturally adds to complexity. The relief is expensive – costing £940 million in the final year of the parliament but it is being phased in over four years to manage cost.

Pensions

Pension changes finance the inheritance tax cut. Additional rate taxpayers will find their annual pension contributions limited to £10,000 if income exceeds £210,000. There's yet another high marginal rate, as relief is gradually cut from £40,000 when income exceeds £150,000. Pension tax relief is costly, so cutting the benefit for the wealthiest 1% is understandable but we are left with a less coherent and more complicated system.

Perhaps we should welcome the 'blue-sky' consultation on pension tax relief, which asks whether contributions should become more like ISAs by removing tax relief for contributions in return for tax exemption on payout. The unnecessary complexity of the pension input period finally disappears when the period aligns with the tax year, after a transitional year in 2015/16.

Other announcements

Other changes included withdrawal of non-domiciled status after 15 years of UK residence and the forthcoming basic rate limit for buy-to-let interest expense. While private equity specialists will note the changes to carried interest where concessional rules introduced in 1987 have been withdrawn, increasing the tax charge on disposal.

This summer Budget sets the tax framework for the 2015/20 parliament.