MOVING THE TAX GOAL POSTS FOR SMEs

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We are often reminded that large international companies look for stability in a tax system when deciding where to locate their operations. The argument is that a stable tax regime will provide the certainty these companies need in planning for the future. But what of SMEs, often family businesses, who equally have to decide on structures and plan for the future?

In determining the structure for a family business for a number of years there have been tax considerations that point towards incorporation. Back in 2005 and 2006 there was a starting corporation tax rate of 0% on taxable profits up to £10,000 and then a reduced rate on taxable profits up to £50,000.

More recently there has been Capital Gains Tax Entrepreneurs' Relief with scope to sell goodwill to newly incorporated companies and pay tax at 10% and in some cases also to achieve the added benefit of corporation tax relief on the write off of the goodwill by the new company.

Not least among the tax attractions of incorporation was the ability to take dividends from the new company. Tax advisers produced detailed calculations comparing the tax efficiency of bonuses and dividends and taking into account the need to avoid corporation tax at the expensive marginal rate. This has gone now and the decision to take dividends had become easier with falling corporation tax rates and rising employer's national insurance rates on salary/bonus. We even have a single corporation tax rate now.

So far so good but the 0% starting rate did not last for long. Also, with effect from 3 December 2014 there were changes to the tax position on incorporation so that CGT Entrepreneurs' Relief was no longer available to the proprietors of the former unincorporated business and also tax relief was not available on the write off of the goodwill in the new company. We then had the recent Summer Budget, which amongst other significant measures, announced changes to the taxation of dividends with effect from the start of the next fiscal year, 6 April 2016.

Marginal (top) rate of income tax

Tax band	Basic rate	Higher rate	Additional rate
Effective dividend tax rate now	0%	25%	30.55%
Post 5 April 2016	7.5%	32.5%	38.1%

The current position is that all UK dividends are paid with a notional 10% tax credit so for every £1,000 of dividend income received it is assumed that £111 in tax has already been paid (the total dividend is therefore £1,111). For this reason basic rate taxpayers had no further tax liability on dividends received. This tax credit will be scrapped with effect from April 2016 so that in future all dividends will be treated as gross (i.e. untaxed) income.

The one piece of good news is that a £5,000 tax free dividend allowance will be introduced.

These changes do seem to be aimed at SMEs, often family companies, who pay a small salary which is intended to preserve the entitlement to state pension and a larger dividend.

Whilst it is likely that dividends will remain advantageous, companies in this position will need to review their remuneration strategy prior to the end of the current fiscal year. It will also be interesting to see whether the dividend changes along with changes in the tax treatment of CGT and goodwill slow down the rush to incorporate.

The recent changes will impact family companies significantly.

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