2023 CHANGES TO CORPORATION TAX … EXPLAINED

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From 1st April 2023, the current 19% flat-rate of corporation tax for all companies will be replaced by a new regime with variable rates up to 25% of profits. This article looks at how the new regime works, and what tax planning can be done now to mitigate some of the impact of the changes.

Increase in main rate of corporation tax from 19% to 25% from 1st April 2023

The current corporation tax (CT) rate of 19% is to be increased to 25% as follows:

- **New "small profits" CT rate of 19% for companies with profits of £50,000 or less**
- **New "main" CT rate of 25% for companies with profits of £250,000+**

This change for many companies will mean an increased CT bill of around a third!

Companies with profits between £50,000 (the 'Lower Limit') and £250,000 (the 'Upper Limit') will pay a reduced rate somewhere between 19% and 25% by claiming 'marginal relief', which acts to reduce the CT rate payable on profits between £50,000 and £250,000.

What exactly is 'marginal relief'?

Marginal relief (MR) is a reduction in the tax bill which is applied to the main CT rate, and acts to lower the CT between the £50,000 Lower Limit and £250,000 Upper Limit. It is given as a fraction of 3/200 of the profit amount and the £250,000 Upper Limit.

For example, Company A makes a profit of £150,000 in the year ended 31st March 2024 (its profit is therefore £100,000 below the £250,000 Upper Limit). The CT bill is as follows:

£150,000 @ 25% = £37,500

Minus: **Marginal relief @ 3/200 x £100,000 = £1,500**

Tax bill: **£36,000**

Effective CT % rate = £36,000 / £150,000 = 24%

If Company A had made different profits in the same year, its CT bill would have been as follows:

£250,000 profit = £62,500 tax = 25%

£100,000 profit = £22,750 tax = 22.75%

£50,000 profit = £9,500 tax = 19%

The above figures show how the effective tax rate rises from 19% up to 25% as profits increase through the range £50,000 to £250,000.

For companies with short or long accounts periods, the Upper and Lower Limit is pro-rata'd, eg if a new company wanted to shorten its first year-end to align with the tax year, it would have a reduced threshold (9/12 of the Upper and Lower Limit for that year).

HOWEVER – the effective tax rate is not the marginal tax rate!

This may sound like gobbledygook … but bear with me!

The 'effective' tax rate on the above example £100,000 profits is 22.75% (as the tax bill is £22,750, and the profit is £100,000, the effective tax rate is 22.75%). This is simply the average tax rate paid on the entire profit.

However, as the new CT regime will have two CT rates (Lower Limit = 19%, Upper Limit 25%), the marginal tax rate on profits between these limits is higher … **26.5%.**

To illustrate, imagine profits of £50,000 for Company A, and £51,000 for Company B, under the new CT regime:

Company A tax bill is £9,500 … simply, £50,000 @19%

Company B tax bill is 25% of £51,000, minus 3/200 of £199,000 (the difference between the £51,000 profit and the £250,000 Upper Limit) – so:

£51,000 @25% = £12,750

Minus: Marginal relief @ 3/200 x £199,000 = £2,985

Tax bill: £9,765

This means that the difference in tax bill is £265 on a £1,000 extra profit … illustrating that the 'marginal' tax rate between £50,000 and £250,000 of profits is actually 26.5% (£265 / £1,000 = 26.5%).

Someone mentioned 'associated companies' – will this affect me?

Many company owners operate more than one company … in which case the Upper and Lower Limits are reduced by one plus the number of associated companies, eg if a company has three associated companies, the limits would be divided by four, to become £12,500 and £62,500 (rather than £50,000 and £250,000).

Although this may appear at first glance as unfair, the rationale is to stop the obvious 'abuse' that would otherwise follow, if company owners could simply set up lots of companies and ensure that each has profits of no more than £50,000.

An 'associated company' is one which controls another, usually because it owns 51%+ of the shares, or as the same person(s) has control over both companies in some other way (eg voting rights, rights to income distributions, etc).

In practice, it's usually obvious where companies are associated, though dormant or non-trading companies are excluded. But parents, children, spouses, business partners, siblings and grandchildren/parents are all deemed to be 'associated' and so included in the associated company assessment.

TAX-PLANNING – POINTS TO CONSIDER

1 Defer expenditure until after 1st April 2023

Simply deferring costs into the future, when the higher CT rates will apply, will mean more tax relief on the same cost. For property investment companies this could mean delaying non-essential repairs (assuming such repairs are actually required!).

Many costs can't realistically be deferred but as most business owners – including corporate landlords – know, there is often flexibility in the timing of when to spend money. For example:

- **Director's pension contributions – 'saving' up 2022 and 2023 pension contribution allowances to make a much larger 2024-onwards pension contribution (up to a £160,000 maximum if the previous three years' contributions weren't made)**
- **Purchase of business assets / equipment / vehicles**
- **Training costs – either actual expenditure or committing to the training contractually (allowing the cost to be accrued when the contract is signed)**
- **Timing of writing off bad debts, and being stricter with prepayments and accruals to try to 'push' cost into the future (beyond 1st April 2023) – within reason – as many smaller companies don't bother too much with this aspect of accounts and tax returns!**

2 Bringing income 'forward'

It's generally difficult to bring income from the future 'forward' into an earlier year, as income (and expenses for that matter) have to be accounted for on the 'accruals' basis (rather than 'cash received' basis). So, for example, it wouldn't be possible to ask tenants to pay all their 2024 rent before 1st April 2023 to avoid the new CT regime!

But, for example, the timing of a property sale to before 1st April 2023 would mean the resulting corporation tax bill would be at the current 19% CT rate, so this could be worth considering (note that exchange of contracts is the 'trigger' for the tax bill to arise). It could even be worth offering buyers a modest incentive to exchange contracts prior to 1st April 2023, to ensure that the 19% CT rate applies!

Similarly a contractor may choose to work continually via their company until 1st April 2023 and then take a break, to have more company profits taxed at the current 19% rate.

3 Check for any 'unnecessary' companies

Associated companies act to reduce the Upper and Lower CT limits, dragging more profits into the >£50,000 range and so leading to more tax payable. So, it makes sense to check that additional companies really are worth retaining, either for risk management purposes or because the activities of each company wouldn't work within a single company (eg mixing a VATable trade with VAT-exempt residential property rental).

4 Don't run out of cash – or at least agree a HMRC 'Time to Pay' arrangement

Obviously, if profits are increased in earlier years to benefit from paying tax at the current CT rate of 19%, this will in turn lead to an increase in tax payable now, so a company would need to ensure it has the cash to pay the earlier tax bill.

Or, the company could apply to HMRC to operate the 'Time to Pay' scheme, which allows for a tax payment plan to be agreed with HMRC – often HMRC are surprisingly supportive!

SUMMARY

The new corporation tax regime, with the main rate increasing from 19% to 25%, will hit corporate landlords hard potentially … and will affect far more landlords than would have been the case if Section 24 hadn't been introduced, as there are now far more property companies around …

Many smaller companies with modest profits may only be mildly affected by the changes, but it's nonetheless an unwelcome tax increase, negating some of the benefit of owning a company.

But, although any tax rise is unwelcome, the UK will still have the lowest main corporation tax rate within the G7 – USA, Canada, France, Italy, Japan, Germany … to try to end on a positive!

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