The Association of Independent Professionals and the Self Employed

IPSE Budget Analysis

March 2017

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Introduction

Self-employment has been dominating the airwaves and TV bulletins following the Budget, with IPSE featuring on BBC and Sky News, and the broadsheet and tabloid press. The Government is facing criticism for its plan to increase Class 4 National Insurance Contributions (NICs) for the self-employed, and this briefing summarises this announcement as well as the changes to the Dividend Allowance. We also discuss the tweak to Government's Making Tax Digital plans, and the consultation announced into parental benefits for the self-employed.

The planned increases to the personal allowance and timeline for corporation tax cuts are also explained. This is only an outline of some of the key changes affecting the self-employed – it is not a substitute for taking professional advice from a qualified accountant.

Personal allowance & Income Tax

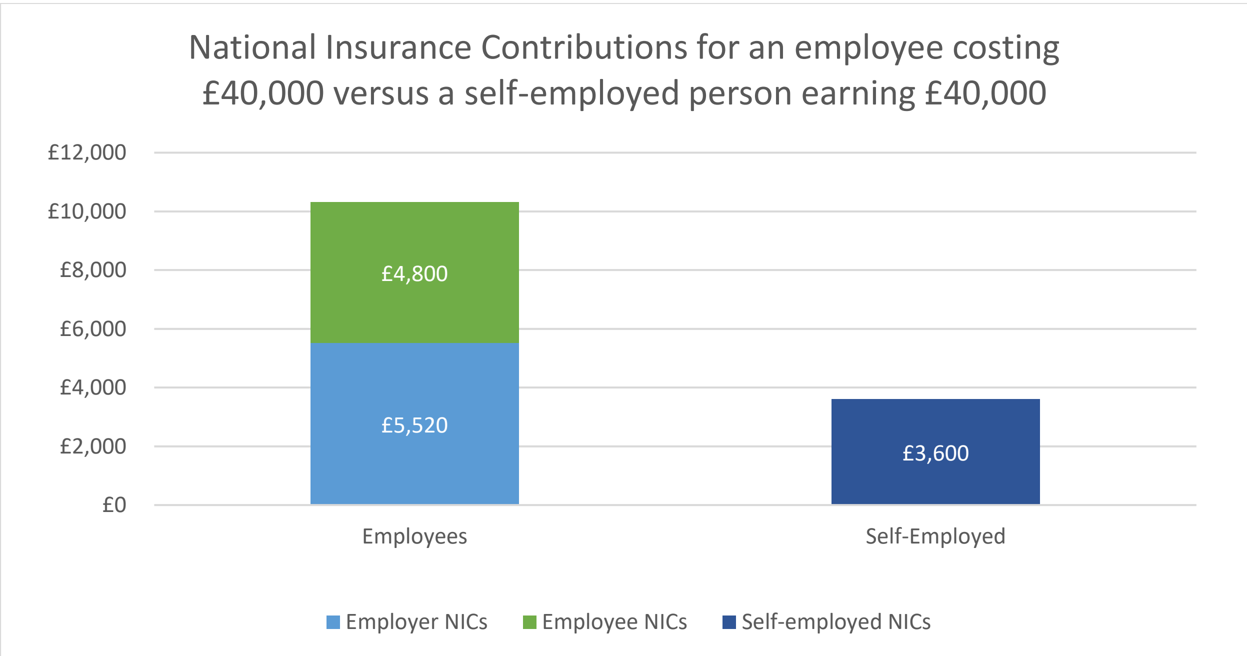
The Government confirmed they will increase the personal allowance by more than inflation for the seventh consecutive year, raising it by £500 to £11,500 in 2017/18. Also from April this year, the 40% threshold will rise from £43,000 to £45,000.

In addition, the Government reaffirmed their commitment to increasing both the personal allowance and higher rate threshold for Income Tax to £12,500 and £50,000 respectively by the end of this Parliament.

Changes to NICs for the self-employed

The Chancellor announced the rate of Class 4 NICs will increase from 9% to 10% in 2018-19 and then to 11% in 2019-20. The changes in the rate coincide with the abolition of Class 2 NICs, which is the £2.80 per week paid on self-employed profits over £5,965. These changes will make anyone earning more than £16,250 worse off even with the abolition of Class 2 NICs.

The graph below shows the current tax gap between the NICs paid by a self-employed individual earning £40,000 and the total NICS paid for an employee job, the salary for which is £34,480 and the total cost to the employer (because of the additional Employer NICs) is £40,000.



HMRC estimates in 2016–17 this disparity will cost the Exchequer £5.1 billion. For this reason, taxation of the self-employed, particularly in terms of NI payments, has been the subject of much attention in recent months.

The below table outlines what a sole trader's NICs will be as the changes come into effect from 2018. The final column shows the change in NICs for those with different earnings – those earning £10,000 will actually be £115.60 better off, with all those earning above £16,250 losing out.

Amount earned	NICs bill in 2017-18	NICs bill in 2018-19	NICs bill in 2019-20	2017-18 - 2019-20
£10,000	£280.60	£150.00	£165.00	**-£115.60**
£20,000	£1,180.60	£1,150.00	£1,265.00	**£84.40**
£30,000	£2,080.60	£2,150.00	£2,365.00	**£284.40**
£40,000	£2,980.60	£3,150.00	£3,465.00	**£484.40**
£50,000	£3,530.60	£3,750.00	£4,115.00	**£584.40**
£75,000	£4,030.60	£4,250.00	£4,615.00	**£584.40**
£100,000	£4,530.60	£4,750.00	£5,115.00	**£584.40**

IPSE verdict: It is disappointing these changes have been brought in without consultation. We share the concerns of many backbench Conservative and backbench MPs that this is an unfair tax on enterprise.

Tax-free Dividend Allowance

Company directors who pay themselves in the form of dividends will see their tax-free allowance more than halved from £5,000 to £2,000.

This reduction in allowance will come into effect in April 2018.

For IPSE members who pay themselves a salary somewhere around the personal allowance, this will result in an additional **£225** of tax liability on their dividends. The example below considers a director drawing down £50,000 of dividends.

In the coming tax year 2017 -18, dividend income above the allowance threshold is taxed at:

- 7.5% for basic-rate taxpayers (the basic rate band is £33,500)
- 32.5% for higher-rate taxpayers (the higher rate band is between £33,500 - £150,000)
- 38.1% for additional-rate taxpayer (the additional rate band is over £150,000)

In 2017-18, the tax free allowance is £5000. Any dividends taken over that amount are taxed. Assuming salary is capped at personal allowance of £11,500, the tax on £50,000 of dividends is £7,500.

This is calculated as follows:

- The £11,500 salary is included within the personal allowance
- The first £5,000 of dividends is tax free (included within the Dividend Allowance)
- The next £28,500 of dividends are taxed at 7.5% = £2,137.50
- The remaining £16,500 dividends are taxed at 32.5% = £5,362.50
- The total tax on the dividends is **£7,500**

In 2018-19, the tax free allowance is reduced to £2000. The personal allowance will probably increase again (and probably by a further £500 if it were to follow the recent trend) but we do not know this for sure. The following example therefore uses the £11,500 salary, as before. Even if it were to increase it would not affect the tax liability on dividends.

The higher rate threshold is also likely to increase. This would reduce the tax liability on the dividends in our example, but we do not know for sure by how much. Again we stick with the £33,500 higher rate.

- The £11,500 salary is included within the personal allowance.
- The first £2,000 of dividends is tax free (included within the Dividend Allowance)
- The next £31,500 of dividends are taxed at 7.5% = £2,362.50
- The remaining £16,500 dividends are taxed at 32.5% = £5,362.50
- The total tax on the dividends is **£7,725**

So the difference between tax payable on dividends between 2017-18 and 2018-19 is **£225.** This will increase to £975 if dividends fall within the higher rate band (in most cases this would mean the salary would need to increase significantly, to the higher rate threshold).

IPSE verdict: This additional tax liability is clearly unwelcome. The allowance also only came in last year, and this tinkering will only undermine business confidence.

Corporation tax

Corporation Tax on company profits will as planned fall from 20% to 19% from April this year. In 2020, the rate will fall again to 17%.

VAT threshold

The VAT registration threshold will increase from £83,000 to £85,000 in April 2017, with the deregistration threshold increasing from £81,000 to £83,000.

Those that use the VAT flat rate scheme should be aware it gets significantly less generous from April. Businesses with limited costs (we imagine many IPSE members will be limited cost traders for the purposes of the scheme) can still use the Flat Rate Scheme, but their percentage will be 16.5%. So if they sell £120 of work, including £20 of VAT, the flat rate amount is £19.80 (£120 x 16.5%).

Making Tax Digital

The Government plans to transform tax administration by 2020 for all businesses so it is more effective, more efficient and simpler for taxpayers through Making Tax Digital (MTD). However, this included mandatory quarterly tax returns through software or apps. IPSE raised a number of serious concerns about the proposal, including compliance costs and increased accounting fees. The Chancellor indicated that some of these concerns had been considered, and the rollout of MTD to unicorporated businesses and landlords with turnover below the VAT threshold (£85,000 as of April 2017) has been delayed a year until April 2019.

IPSE verdict: We welcome the fact that Government has acknowledged MTD presents problems for small businesses, and has delayed rollout by a year. However we are still very concerned that these businesses (and their accountants) will still struggle to deal with the changes.

Fuel Duty

The Chancellor confirmed Fuel Duty would be frozen for the eighth year in a row. Some motorists had also been expecting the announcement of a diesel scrappage scheme, but this did not materialise.

Parental benefits

The Government has announced a review into bringing greater parity between parental benefits for the self-employed and employed, to take place this summer. Currently, if you are an employee you are eligible for “Statutory Maternity Pay” (SMP). This is set at 90% of average weekly earnings for six weeks, and then drops to £138.18 for 33 weeks. In contrast, the self-employed may be eligible for “Maternity Allowance” and receive £138.18 for 39 weeks.

This means in the current system there is a six week period in which the self-employed will receive much less than an employee. In addition, eligibility for paternity benefits is also very unclear for the self-employed.

IPSE verdict: IPSE has long called for action to level the playing field when it comes to support for new parents, so this upcoming review is welcome. However it should be noted that the Government commissioned Deane Review in February 2016 already made clear recommendations on these issues, so the need for another review is puzzling.

Savings:

Lifetime ISA

The Chancellor confirmed the Lifetime ISA (LISA) will be launched in April this year. LISAs will be available to those between the ages of 18 and 40, who will be able to deposit up to £4,000 a year until the age of 50. Those with a LISA will receive a 25% Government bonus on top of savings when withdrawn tax-free at 60.

NS&I Investment Bond final rate

The Budget confirms the rate on the NS&I Investment Bond announced at Autumn Statement 2016. The Investment Bond will offer a rate of 2.2% over a term of 3 years and will be available for 12 months from April 2017. The Bond will be open to everyone aged 16 and over, subject to a minimum investment limit of £100 and a maximum investment limit of £3,000.

Tax avoidance/evasion

From July 2017, financial penalties for tax avoidance arrangements later defeated by HMRC will be introduced. The Government will legislate to ensure the promoters of tax avoidance schemes (POTAS) cannot circumvent the existing POTAS regime through the sharing control of a promoting business, or through putting a person between themselves and the promoting business.

A new penalty will be introduced for a person that has enabled another person, or business, to use a tax avoidance arrangement that is later defeated by HMRC. The Government will also remove the defense of having relied on non-independent advice when considering penalties.

Broadband

In order to support the next generation of fast mobile and broadband communications, the 5G Strategy fund announced in the Budget includes:

- a new National 5G Innovation Network to trial and demonstrate 5G applications
- the Government's response to the National Infrastructure Commission's Connected Future report and recommendations on 5G. This will include developing commercial options for improving coverage on roads and rail

Starting in 2017, the Government will invest £200 million to fund a programme of local projects to test ways to accelerate market delivery of new full-fibre broadband networks. Also in 2017, a new Digital Infrastructure Investment Fund will be launched. Government investment of £400 million will be at least matched by private sector investors, and will accelerate the deployment of full-fibre networks by providing developers with greater access to commercial finance.

Skills

The Budget sets out further steps to achieve Government's ambition that individuals should have the opportunity to retrain and upskill at all points in their life, and to develop skills at the highest level:

- Lifelong learning pilots – up to £40 million by 2018-19 to test different approaches to help people to retrain and upskill throughout their working lives
- Return to work support – £5 million of new funding to identify how best to increase the number of returnships. Returnships offer people who have taken lengthy career breaks a clear route back to employment. Further support for this group was the focus of the APPG for Women and Work annual report, contributed to by IPSE, and this funding was initially announced by the Prime Minister