

Business Taxes

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Why the focus on individuals running their own businesses?

Backdrop: self-employed & company owner-managers account for 40% of growth in workforce since 2008

Lower taxes for these groups imply impact on government revenues

- HMRC estimates that in 2016–17:
 - £5.1 billion forgone through lower self-employed NICs
 - £6.0 billion forgone through lower taxes on company owner-managers
- Revenues losses increasing as business population grows

Raises issues of fairness ...

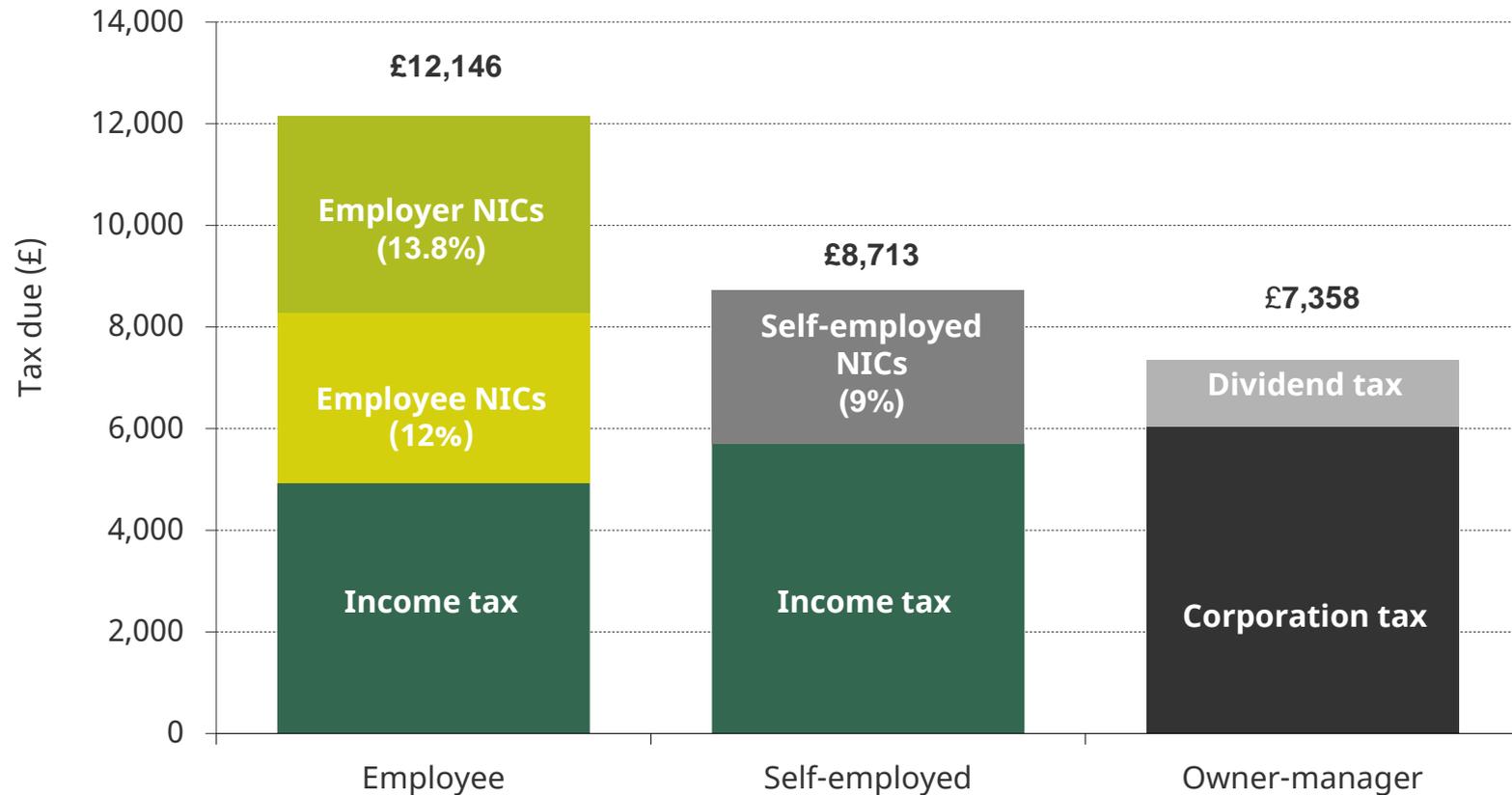
- Similar individuals get very different tax rates

... and economic efficiency

- Tax differences distort choices

The tax system penalizes employment

Tax due on a job generating £40,000, 2017–18



Other ways to reduce taxes if running your own business

Split income with a spouse

More scope to deduct work-related expenses from income

Tax avoidance (legal) or evasion (illegal)

- HMRC estimates 30% of self-employed tax returns understate the amount of tax due

Retaining earnings in a company can bring even more benefits

Self-employed NICs changes

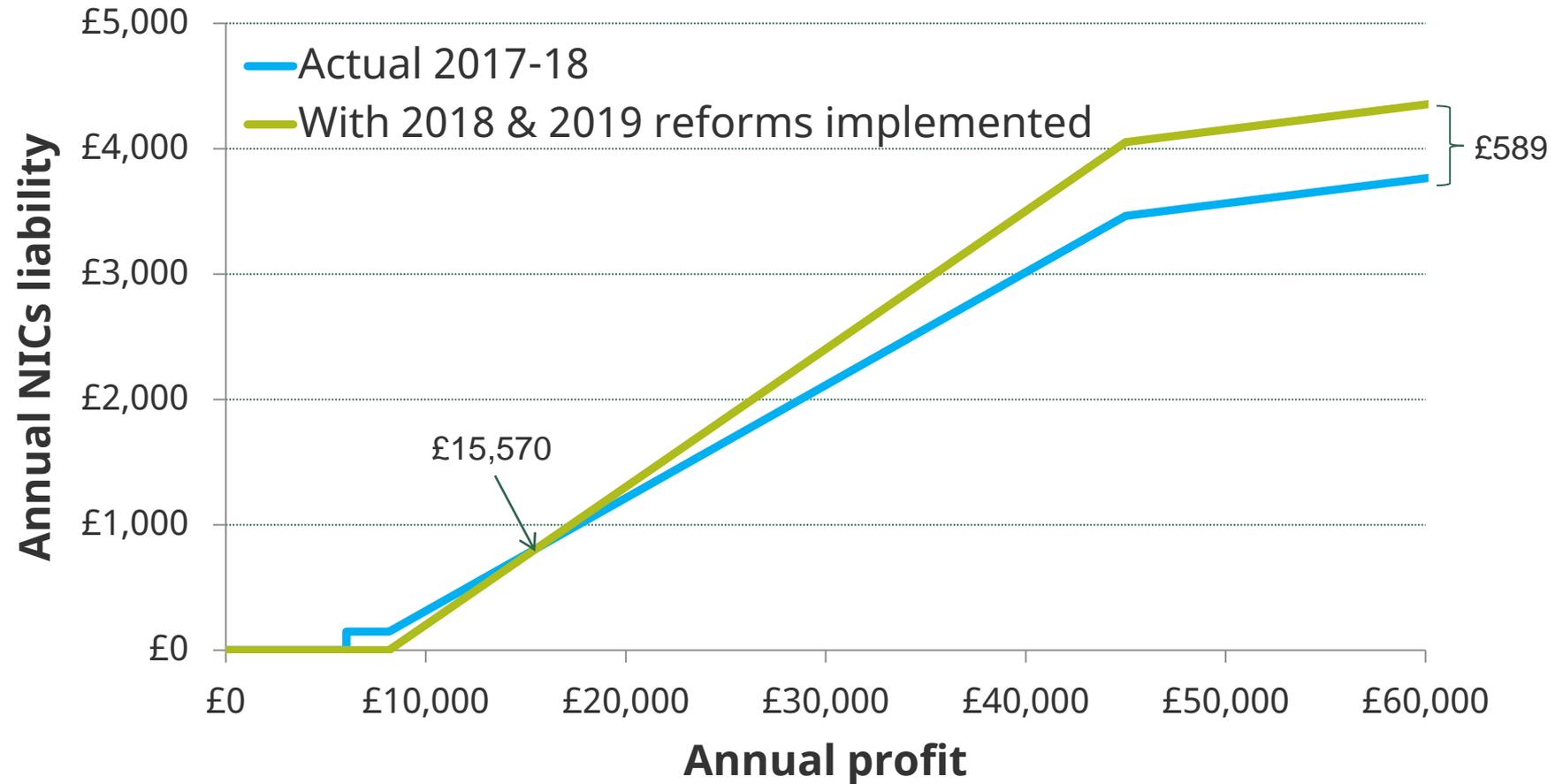
Increase main rate of Class 4 NICs

- Currently main rate of 9% of profit
- Main rate increase to 10% in April 2018, and to 11% in April 2019
 - Raises £600m in 2020-21
- Rate on profits above Upper Profits Limit remains at 2%

Abolish Class 2 NICs from April 2018

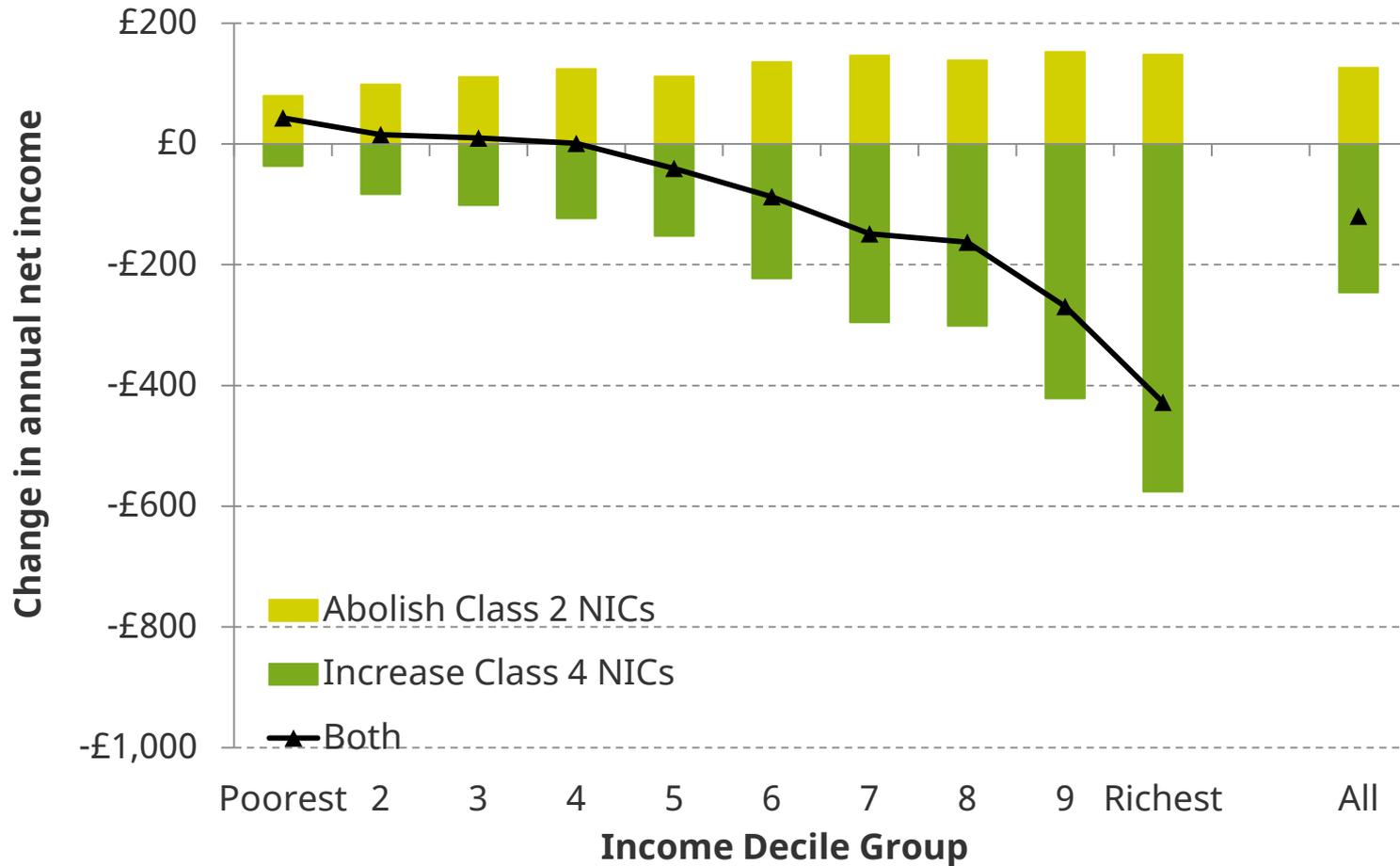
- Flat rate of £2.85 per week in 2017-18
- Abolition announced Budget 2016
 - Costs £400m in 2020-21

Self-employed NICs



Distributional effects of NICs changes

Average gain/loss among households with self-employment income



Note: Decile groups of whole population. Assumes reforms implemented in 2017-18

Self-employed and access to benefits

The self-employed get very similar state benefits to employees

- From April 2016 both accrue same rights to single tier state pension
- Contribution-based JSA & statutory parental benefits are the only differences

The NICs advantage is far bigger than differences in benefit entitlements

New consultation on parental benefits for the self-employed

Lower employment rights don't justify lower tax rates

Dividend tax change

Summer Budget 2015: introduce dividend allowance & increase rates

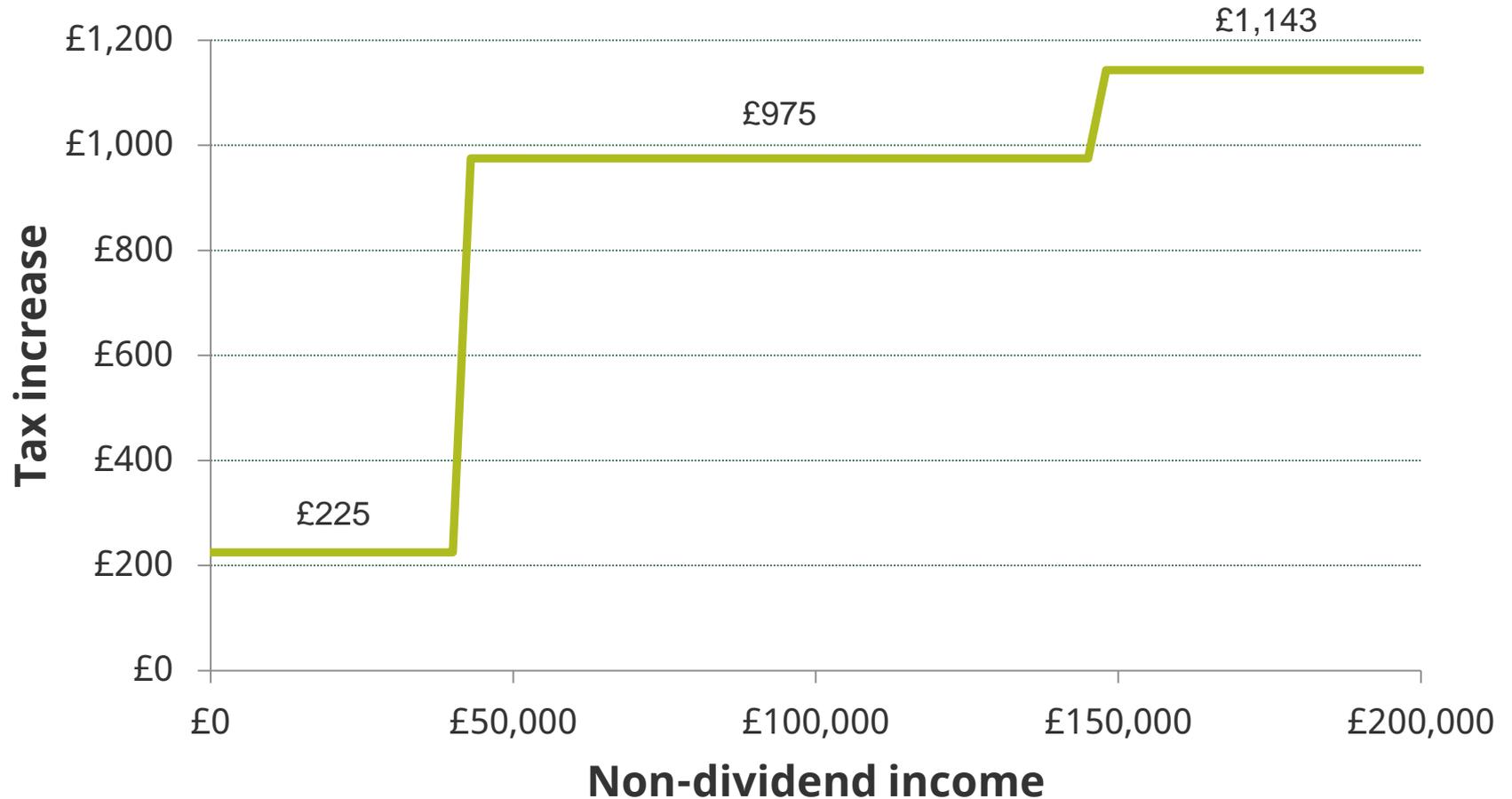
- New dividend allowance of £5,000 introduced in 2016-17
- Alongside increases in marginal dividend tax rates of 7.5ppt
 - Overall tax rise of £2.0bn
- Incentive for many to bring dividends forward
 - Overall, paid £800m less as result
 - HMRC analysis: 1/7th of that saving went to 100 individuals, who, on average, withdrew £30m of dividends from companies

Budget 2017: reduce dividend allowance

- From £5,000 to £2,000 from 2018-19
 - Raises £825m in 2020-21
- Tax rise if dividend income >£2,000 and total income >£13,500

Loss from reducing dividend allowance to £2k

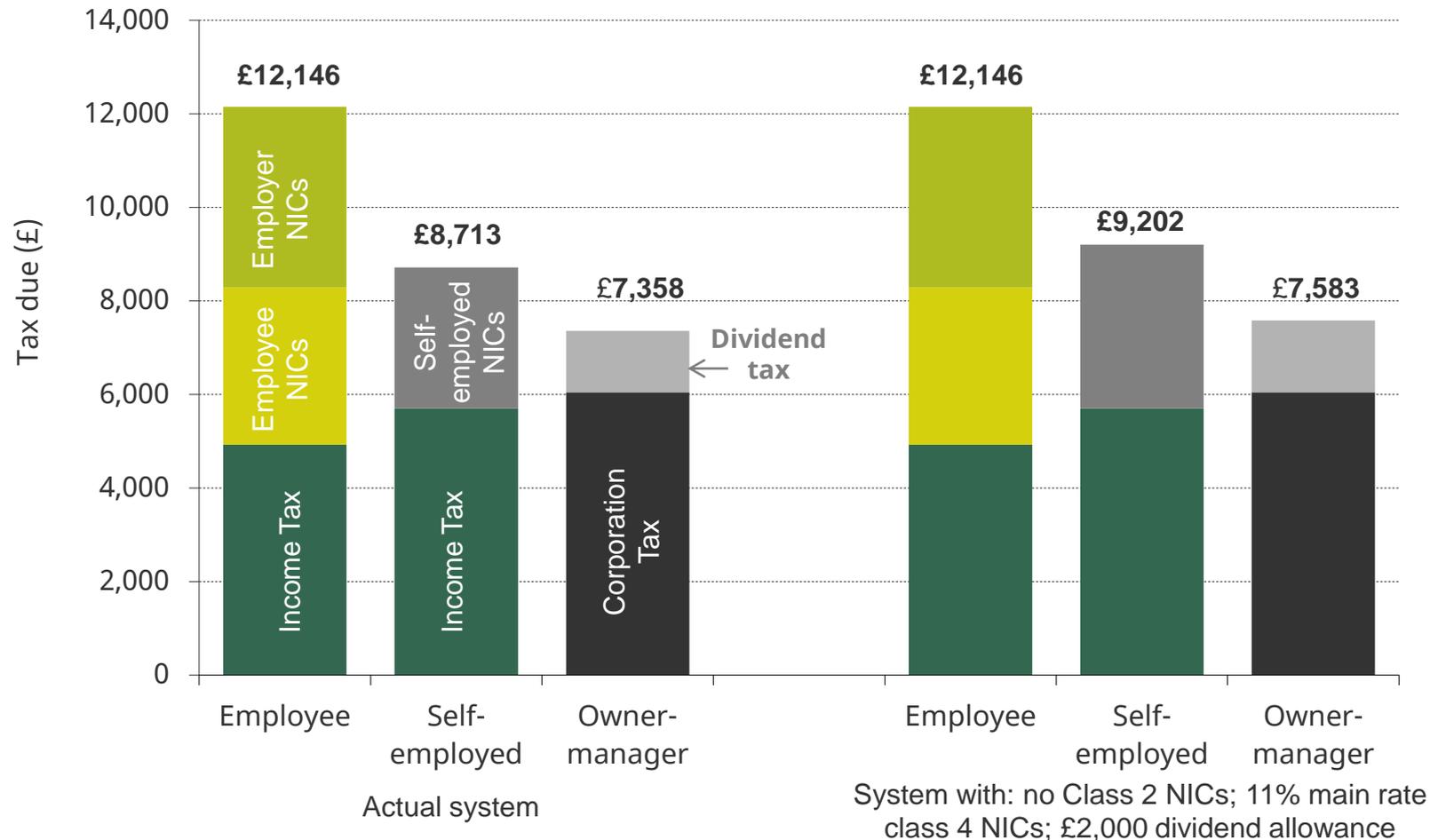
For individual with dividends >£5,000 and total income >£16,500



Note: Assumes implemented in 2017-18.

Before & after reforms

Tax due on a job generating £40,000, 2017-18



Effect of changes on incentives

March 2017 Budget changes have a fairly small effect

- Reduces incentives to switch from employment to self-employment
- Difference between self-employed and owner-managers depends on income level
- Increase incentive for owner-managers to take income as capital gains
- Reduces incentives to work and invest
- Incentives to save in shares (outside pensions & ISAs) reduced

Moving towards alignment is a step in the right direction

Differences in tax rates across legal form are costly, inefficient and unfair

- Not justified by differences in state benefits or employment rights
- Poor way to encourage entrepreneurship

This is a small step towards aligning tax rates across legal forms

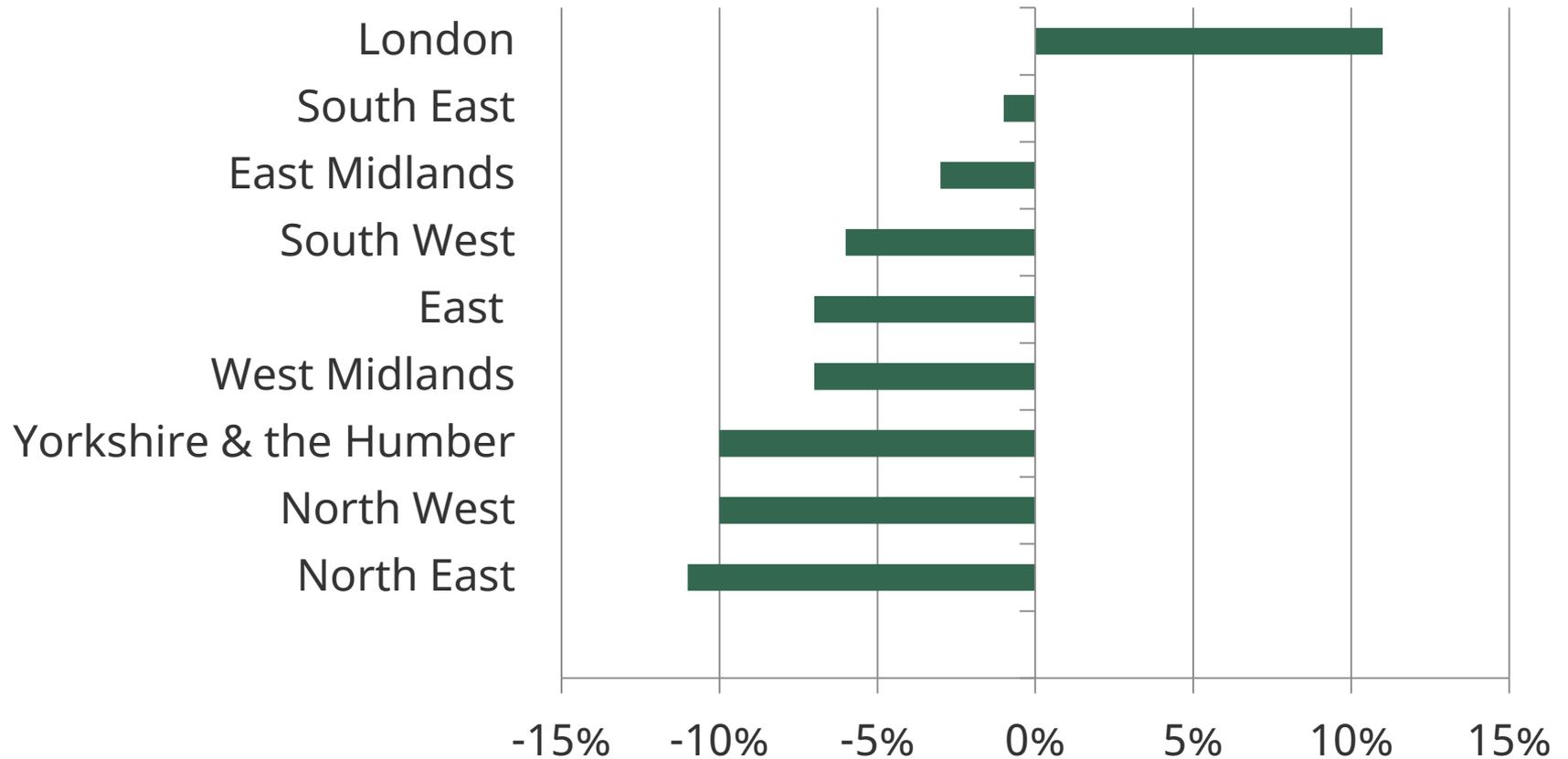
But this is a tax rise, with associated disadvantages

And don't forget the tax base

- Money invested in a business should be tax deductible

Business Rates revaluation coming in April

Long-run impact on average bill



See <https://www.ifs.org.uk/publications/8962>

More money to ease business rates transition

New cap on bill increases for those getting small business relief

- Cost: £20-25m a year

£305m to councils to fund extra discretionary business rates relief for those seeing bill increases

- Money across four years, front-loaded

One-off £1,000 discount for most pubs in 2017-18

- Cost: £25m

Summary

2ppt increase in main rate of self-employed NICs

- +£600m in 2020-21

Reduction in dividend tax allowance from £5,000 to £2,000

- +£825m in 2020-21

Money to ease business rates revaluation

- Small cost as tightly targeted at losers & pubs

Amount to fairly small changes to tax system

- Albeit ones that will have a large impact on some people