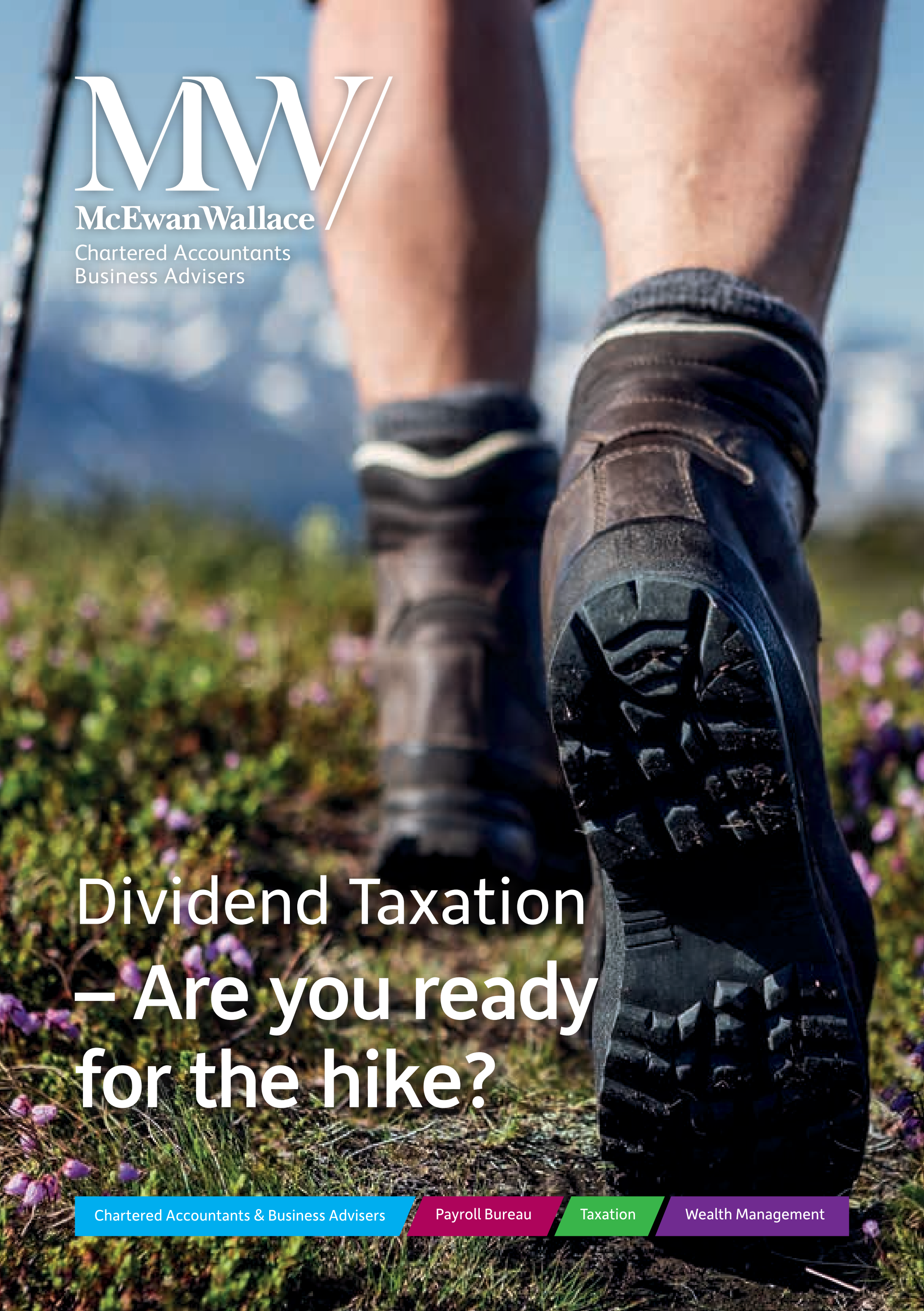

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Dividend Taxation – Are you ready for the hike?

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There will be
some winners
but there will
be more losers
than winners.

Important changes to dividend taxation

From April 2016, the current dividend tax regime will be overhauled, resulting in a significant tax hike for most limited company owners. Here we explain how much this new measure will affect you.

The backdrop to this change which was announced in July, is that the Chancellor has to abide by the 5 year tax "Triple Lock" which means that the rate of income tax, VAT or national insurance cannot be raised. Inevitably this means that taxes will be raised elsewhere and a new "band" of tax on dividend is part of Chancellor's solution to this issue. According to the Government's estimates, the new dividend tax regime is expected to raise £2.54bn during 2016/17, with smaller, but still significant income flowing to the Treasury in subsequent years.

How are dividends taxed now?

Net dividends (the amount you draw from the company) are multiplied by 10/9 to produce the gross dividend (to take into account a notional 'tax credit' to make up for the fact that Corporation Tax has already been paid by the company). The gross dividend amount is then taxed at the current tax rates:

- 10% (basic rate)
- 32.5% (higher rate)
- 37.5% (additional rate)

But after the tax credit is taken into account, you pay no further tax at all on dividends falling into the basic tax band, 25% on dividends falling into the higher rate band, and 30.56% for the additional tax band.

So, in the current tax year (2015/16), you can earn £31,785 (gross dividends i.e. £28,606 net in your hand), in addition to the £10,600 personal allowance – a total of £42,385, and pay no income tax at all.

Proposed changes

The current system of tax credits will be abolished, and replaced by a simpler system. After the personal allowance has been taken into account (£11,000 from April 2016 if you are entitled to the entire amount), all individuals will be able to receive £5,000 of dividend income with no tax liability at all. So, if your entire income is £16,000 or less, you will pay no dividend tax at all.

Three new dividend tax bands will be created, and will apply to all dividend income in excess of £5,000 per year:

- 7.5% (basic rate)
- 32.5% (higher rate)
- 38.1% (additional rate)

However, the Treasury have since confirmed that the £5,000 dividend 'allowance' is actually a zero rate tax band just for dividend income, and it will form part of the £32,000

Other considerations

Basic Rate Band (BRB) next year. It will not be in addition to the BRB, as most commentators had hoped.

Dividends will no longer need to be grossed up. If you receive large dividends, you will find that your taxable income, as shown on your tax computation, will reduce. In some cases, this may lead to an increase in personal allowance, if the personal allowance had previously been abated due to income levels.

- Following the changes, the level of your dividends may cause you to fall within payments on account. This is where you make payments towards the estimated tax liability for the following year. If you had not previously made payments on account, this could lead to a large payment becoming due in January 2018

- Shareholders who previously had not completed self assessment tax returns may now need to register with Revenue and Customs

How will the changes affect you?

The impact of the changes to your individual tax position will depend on the level of your dividend income and whether that income falls within the basic, higher or additional rate tax band. Some examples have been included below.

Example 1 – Dividends below £5,000

If an individual's dividend income is less than £5,000 in the 2016/17 tax year, the dividends will be covered by the new dividend allowance and so no tax will be due on the dividends received regardless of the individual's other income.

If the dividends have always been within the basic rate tax band, the changes should not affect the individual's tax position. However, if the dividends had previously been taxed at higher or additional rate, the introduction of the dividend allowance will mean a reduction in the tax payable on dividends but there may be an increase in the tax liability overall due to £5,000 of basic rate band being used up by the dividend allowance.

Example 2 – Salary of £8,000 and dividends of £30,000, no other income

- Salary is included in the tax free personal allowance
- £3,000 of the personal allowance would remain to set against the dividend income and the £5,000 dividend allowance would also be available
- The remaining £22,000 of dividend income would be subject to tax at 7.5%. The tax liability would therefore be £1,650 (compared to NIL in the 15/16 tax year)

For more information about how the changes to dividend taxation will affect you, please contact

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