Orange Genie

Contractor Management Outsourcing

Accountancy

CHANGES TO DIVIDENDS: HOW DO THEY AFFECT YOU?

G392(1.1 - 10/16)

Introduction

From April 2016 a new tax-free Dividend Allowance will replace the Dividend Tax Credit. The rates of tax applied to dividends are also changing and these changes will affect anyone who has dividend income.

The Chancellor expects to collect £2.5bn in additional tax in the 12 months from April 2016, following the introduction of these new rules.

This document explains what you need to know about dividends, the impact the new rules will have on you and your income, as well as explaining how to make the most of dividends and tax free allowances.

Your dedicated accountant will be able to go through these changes to dividends with you in more detail and help you understand the implications and opportunities that are relevant to your personal situation. Call your accountant now on 01296 468185 or email them directly to find out more.

The legislation to introduce these changes has not yet been formally adopted. This guide is based on our best understanding of the information that we have currently seen from HMRC at that time of publication.

Dividends – a refresher

A dividend is a distribution of profit, paid by a company to its shareholders. The directors are responsible for ensuring dividends are legal; they decide when a dividend is declared, how much it should be and when it is payable.

A dividend is legal provided the company has sufficient profits after tax to pay both the dividends and the company's future liabilities, including all future taxes.

Dividends are paid out in proportion to shareholdings. If you own 100% of the shares you will receive 100% of the dividend paid. If you own 80% of the shares and your partner owns 20%, a £10,000 dividend will be paid out as £8,000 to yourself and £2,000 to your partner.

Dividends – the old rules

Up until 5 April 2016, dividends will be received net of a tax credit of 10%. This works much the same way as Building Society interest which is received net of basic rate tax at 20%. The only difference is that the basic rate of tax on dividend income is 10% not 20%.

Dividends received by a basic rate taxpayer will not attract any further tax, however higher and additional rate tax payers will have further personal tax to pay. How much additional tax, will depend on an individuals overall income, including bank interest, salary, rental income, investment income and any other sources.

Example:

A shareholder receives £9,000 dividend income. For tax purposes this is grossed up by the 10% tax credit and is declared as £10,000 received, with a notional tax of £1,000 suffered. What is the taxpayer's liability on this income?

a) As a basic rate tax payer – there is no further liability. The tax due on the gross dividend is £1,000 (£10,000 @10%) but the notional tax credit has already been applied and the taxpayer has received £9,000

b) As a higher rate taxpayer – an additional 32.5% tax is due on the gross dividend, less the 10% notional tax credit already suffered

£10,000 @ 32.5%	£3,250
Less tax credit	£1,000
Tax payable	£2,250

Why does this make sense if the higher rate of tax is 40%? Well when a company makes profits it suffers 20% Corporation on Tax. In order to pay £9,000 in dividend, profits of £11,250 need to have been made. Corporation tax paid would have been £2,250.

Between the company and the shareholder £4,500 tax will have bee paid on the profits of £11,250 – this equates to 40%

Dividends – the new rules

From 6 April 2016, the way dividends are taxed is changing. The notional 10% tax credit is disappearing and the following new rates and allowances will apply:

- £5,000 tax free dividend allowance to be introduced
- Dividends in excess of £5,000 will be taxed at the following rates
  - Basic rate 7.5%
  - Higher rate 32.5%
  - Additional rate 38.1%

Under the new rules the amount of dividend you receive will be treated as your gross income. The first £5,000 of dividend income will be completely tax free and whilst the amount your receive in total may appear to be less than under the old rules, you will not reach the threshold for higher or additional rate tax quite so quickly. All dividends received in excess of the first £5,000 will attract additional tax.

The following table sets out how the new rules will affect you. For simplicity we have assumed

- The personal allowance has been used to cover salary
- There is no other income in the year
- Basic rate tax band is £32,000

Dividend	Tax Credit	Gross Dividend	Tax under current rules	Exemption under new rules	Tax under under new rules	Increase in tax
£5,000	£556	£5,556	£0	£5,000	£0	£0
£10,000	£1,111	£11,111	£0	£5,000	£375	£375
£20,000	£2,222	£22,222	£0	£5,000	£1,125	£1,125
£28,800	£3,200	£32,000	£0	£5,000	£1,785	£1,785
£30,000	£3,333	£33,333	£300	£5,000	£1,875	£1,575
£32,000	£3,556	£35,556	£800	£5,000	£2,025	£1,225
£39,470	£4,386	£43,856	£2,668	£5,000	£4,452	£1,784
£40,000	£4,444	£44,444	£2,800	£5,000	£4,625	£1,825
£50,000	£5,556	£55,556	£5,300	£5,000	£7,875	£2,575

A quirk of the new rules is that in these circumstances, with dividend income of £28,000 and £39,470 you would pay the same additional tax. This is due to the removal of the tax credit which has the effect of delaying when income falls within a higher tax band.

So what should you do?

If you plan to take a dividend, you should consider whether to take this before or after 6 April 2016. Your accountant can work with you to decide the best timing of your dividend, since there is no benefit in taking an additional dividend ahead of April 2016, to "beat" the new rules if the result is to push you from one tax band and into another.

When considering your strategy for the future you might also like to consider:-

- **Utilising full basic rate tax allowances and tax bands** - you and your partner should make full use of your personal allowances and basic rate tax band, thereby maximising dividends at the lowest tax rates
- **Use the tax free dividend allowance** – everybody is entitled to £5,000 dividend exemption from 6 April 2016. Consider your shareholdings to ensure that this is utilised
- **Use ISA's wisely** – all taxpayers will see a tax increase of 7.5% on divided income in excess of £5,000 per annum. ISA's are not affected by the new tax payable so it might be worth transferring investments into an ISA to shelter the dividends from the increase in tax. This will have the effect of increasing the tax free dividend available fro your company
- **Careful planning** – ensure you plan carefully ahead of 6 April 2015 to use up your personal allowance and basic rate band, maximising the dividend this tax year.
- **Review company structures** – ensure that your company is structured in the most tax efficient manner, considering additional shareholders and classes of shares.

Conclusion

The taxation of dividends is changing and it will have a financial impact on those operating through a Limited company or thinking about doing so. Whilst take home pay may be reduced, the many other benefits of operating a limited company remain. To make sure you understand the implications for your and your circumstances talk to one of our accountants today.

Genie Accountancy advice thousands of contractors on a daily basis and understand what is important to you. Our low fixed price monthly fee of £99 plus VAT provides you with unlimited advice from a dedicated accountant. Our online bookkeeping software makes it easy for you to manage your business and tax liabilities. Together we can ensure your business is a success.

Contact us today to discuss how to get the best from your contract and company.

01296 468 185

www.orangegenieaccountancy.com

newbusiness@orangegenie.com