DIVIDEND TAXATION REFORM - UPDATE FEB 16

The Conservative government promised no rises in Income Tax, National Insurance or VAT during the current parliament in their election manifesto. However, what they failed to mentioned was that they would be carrying out a complete overhaul of the taxation of dividends from 6 April 2016, introducing new rates of tax.

WHO WILL BE AFFECTED

The changes are most likely to affect owner managed businesses who take a small salary and large dividends to make up their remuneration package. Individuals with a large portfolio of listed shares paying out dividends are also likely to see a rise in their tax bill.

OUT WITH THE OLD…

Under the current regime, the effective rate of tax for dividends is 0% for basic rate taxpayers, 25% for higher rate taxpayers and 30.56% for additional rate taxpayers. This takes into account the 10% dividend tax credit which dividends are currently received with. Under this regime, it is currently possible to receive gross dividends of up to £42,385 (assuming no other taxable income) before being subject to income tax.

IN WITH THE NEW…

From 6 April 2016 the dividend tax credit will be abolished and all individuals will be able to receive £5,000 of dividend income tax free under the new Dividend Allowance. The tax rates on dividends in excess of this allowance will be liable to income tax at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers. Dividends in ISAs and pensions will continue to be tax free.

SALARY OR DIVIDENDS?

As each person is entitled to the Dividend Allowance, regardless of whether they are a basic, higher or additional rate taxpayer owner managed businesses should look to utilise both spouse's £5,000 allowance if possible.

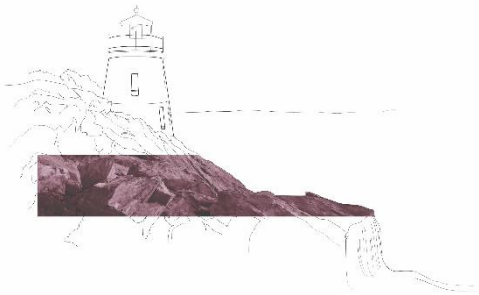
Dividends should still be more tax efficient than paying a large salary, despite the increased tax cost to the individual next year.

For example, a director previously receiving a small salary of £8,000 and dividends of up to the basic rate band would not have been subject to income tax or national insurance, However, from April 2016, tax of approximately £2,000 would be due if the director was to receive the same level next year.

A BIT OF GOOD NEWS FOR TRUSTS

The position for trusts/settlements will be more complex, for example we are not sure if the Dividend Tax Allowance will apply, and if it does, perhaps it will be split equally between trusts created by the same settlor? There is, however, some good news. All the tax paid by the trust should be added to the "tax pool" and therefore give the Trustees the ability to distribute more income without further tax charges. Previously, the 10% tax credit, which is to be abolished, did not enhance the "tax pool".

DO I NEED TO TAKE ACTION NOW?



As the new regime will only affect dividends paid after 5 April 2016, and as we are awaiting the detailed rules, there may be no reason to immediately alter your remuneration for 2015/16.

However, you may wish to consider the following:

- Acceleration or deferment of dividend payments into the current/next tax year
- A review of your remuneration strategy for 2016/17 to determine whether your tax liability could be reduced by altering your existing approach
- A review of your business operating structure