CHANGES TO DIVIDENDS

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Dividends have been a very tax-efficient way of making savings in National Insurance Contributions (NIC) and Income Tax contributions for a number of years, with many business owners and director/shareholders choosing a smaller salary, plus an additional remuneration package paid as dividends.

However, this has now all changed from April 2016 as the income tax position of dividend income will effectively increase for most taxpayers. This may have a direct impact on the overall savings in NIC and income tax that can be achieved after 5 April 2016.

Up to 5 April 2016, no additional income tax would be due if a company paid a dividend to its shareholders, as long as the person receiving the dividend was a standard rate tax payer.

Individuals receiving dividends then only paid additional personal tax if their dividend income fell partly or wholly within the higher rate (40 per cent) or additional rate (45 per cent) bands. The following rates applied for 2015-16:

- All dividend income in the standard rate band was taxed at 10 per cent. As the tax credit was deductible, recipients paid no tax
- All dividend income at the higher rate was taxed at 25%
- All dividend income at the additional rate was taxed at 30.56%

From 6 April 2016, the way dividends are being taxed changed. The 10 per cent tax credit was abolished and each individual has a flat rate dividend allowance of £5,000.

Any dividends received by an individual in excess of the £5,000 allowance will be taxed as follows:

- 7.5 per cent if your dividend income is within the standard rate (20 per cent) band
- 32.5 per cent if your dividend income is within the higher rate (40 per cent) band
- 38.1 per cent if your dividend income is within the additional rate (45 per cent) band

Comparison of tax payable on dividend income of £27,000 (net 2016-17)

Income tax due if dividend received is £27,000	**2015-16**	**2016-17**
Dividend is within the standard rate band	Nil	£1,650
Dividend is within the higher rate band	£6,750	£7,150
Dividend is within the additional rate band	£8,250	£8,382

In all cases, any tax liabilities for 2016-17 will be collected on 31 January 2018. At the same time, HMRC will also add 50 per cent of the tax liability to the first self-assessment payment on account for 2017-18, also due 31 January 2018, with a further 50 per cent due at the end of July 2018.

The new changes will also have an impact on PAYE codes for owners and directors in 2016-17. Under the new rules, HMRC will amend tax codes to automatically 'code out' a sum approximately equal to the amount of dividend tax due for that tax year.

The deduction in the PAYE code will be clearly labelled as dividend tax, but HMRC's estimated figure might not always be accurate. In order to work out whether HMRC's deduction is fair, taxpayers will need to estimate their total income tax liability for 2016-17 to ensure the figures provided are accurate with their own.

Additionally, if individuals have not already paid the balance of their income tax due for the previous tax year, HMRC will add a five per cent surcharge on the amount due.

Mark Finch, Director
McPhersons Chartered Accountants

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Mark Finch – Director McPhersons Chartered Accountants

01424 730000 | info@mcphersons.co.uk | www.mcphersons.co.uk

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