

## The new dividend regime

### Notes to support the client letter

Every Chancellor wants to make his mark and the Summer Budget has allowed George Osborne to give full reign to his reforming ideas for the tax system unfettered by the constraints imposed upon him by a Coalition government.

The fundamental change to the dividend regime is simple enough in principle. A Dividend Tax Allowance charges £5,000 of dividend income at 0% income tax, the complexities of the notional tax credit regime are thrown away and three new rates of taxation are applied to dividends above £5,000 depending upon whether the taxpayer is a basic rate, higher rate or additional rate taxpayer.

A policy note was issued by the government on 17 August 2015. This gives some examples of how the regime will work. See: [www.gov.uk/government/publications/dividend-allowance-factsheet/dividend-allowance-factsheet](http://www.gov.uk/government/publications/dividend-allowance-factsheet/dividend-allowance-factsheet)

However there has been no draft legislation. The new regime will be legislated for in Finance Bill 2016. This may mean that we do not see the draft legislation until the Autumn Statement in early December.

What we do not know is:

- The interaction, if any, between the Dividend Tax Allowance and the 0% savings rate introduced in 2015/16.
- The impact on double tax agreements for non-UK dividends and the non-resident investor receiving UK dividends.

### The basics of the new regime

The Dividend Tax Allowance does not change the amount of income that is brought into the income tax computation. Instead it charges £5,000 of the dividend income at 0% tax. This means that:

- The payment of low salary below the personal allowance will allow some dividends to escape tax as they are covered by the personal allowance.
- The £5,000 allowance effectively reduces the available basic rate band for the rest of the dividend.

A tax computation for an individual with his own company in 2016/17 would look as follows:

Salary as director	£8,000
Dividend income	£41,000
Total income	£49,000
Less personal allowance	£11,000
Taxable income	£38,000

Tax at 0% on	£5,000
Tax at 7.5% on balance of basic rate band ((£32,000 - £5,000)	£27,000
Tax at 32.5% on	£6,000

£32,000 is the basic rate band for 2016/17.

### **What about savings income?**

If a person has savings income such as bank interest or interest on loans he has made to his company, the position is rather more uncertain due to two factors:

- Legislation for a Personal Savings Allowance will also be introduced in Finance Bill 2016 to apply a Personal Savings Allowance to income such as bank and building society interest from 6 April 2016. The Personal Savings Allowance will apply for up to £1,000 of a basic rate taxpayer's savings income, and up to £500 of a higher rate taxpayer's savings income each year. The Personal Savings Allowance will not be available for additional rate taxpayers.
- In 2015/16 some individuals qualify for the 0% starting rate of tax on taxable savings income up to £5,000. The rate is not available if taxable non-savings income (broadly earnings, pensions, trading profits and property income) exceeds the starting rate limit.

Dividends do not fall within the definition of savings income and we do not expect them to fall within the definition for the Personal Savings Allowance either. Para 1.187 of The Red Book states this:

*Combined with the increases the government has made to the personal allowance and the introduction of the Personal Savings Allowance, from April 2016 individuals will be able to receive up to £17,000 of income per annum tax-free.*

The £17,000 is therefore made up of £11,000 personal allowance, £1,000 Personal Savings Allowance and £5,000 Dividend Tax Allowance. So the Personal Savings Allowance and Dividend Tax Allowance would appear to act independently as exemptions.

However we don't know anything on the interaction, if any, between the Personal Allowance and the 0% starting rate.

If clients with their own company do have significant savings income and little other income such as a salary, their prospective tax liabilities cannot be computed until we find out more.

### **Is a dividend still better than a salary as a means of profit distribution?**

In the appendix to this note are some computations of the cost to the company of making additional post tax funds available to a director-shareholder as a bonus or as a dividend. The director-shareholder will receive an additional £10,000 after accounting for all taxes. So a £10,000 bonus needs to be grossed up for the income tax and NI contributions that would be due. A dividend needs to be grossed up by the income tax payable.

In all cases, a dividend is cheaper than a bonus. The 2015/16 figures are given as a comparison.

## Does a client save by being a company rather than as an unincorporated business?

Based on what we know so far the calculations are that incorporation may still result in lower tax bills than remaining unincorporated but the tax savings are significantly reduced.

### Current tax year - savings

The calculations below assume:

- 2015/16 tax rates and bands
- Salary from company is £8,060
- Full profit distribution

<b>Profits:</b>	<b>£30,000</b>	<b>£50,000</b>	<b>£100,000</b>
<b>Tax and NI payable:</b>	£	£	£
As sole trader	6,001	12,791	33,791
As company	4,388	9,053	29,053
<b>Potential saving</b>	<b>1,613</b>	<b>3,738</b>	<b>4,738</b>

### Additional cost of dividend payments in 2016/17

The calculations below assume:

- 2015/16 tax rates and bands except for dividend tax rates which are 2016/17
- Salary from company is £8,060
- Full profit distribution

Although we know income tax rates and bands for 2016/17, we do not know the NI bands. There is also a longer term proposed reform of Class 4 due to the abolition of Class 2. And there are also reductions in the corporation tax rates from 1 April 2017. So we have computed these figures based on the 2015/16 tax regime except for dividend tax rates.

<b>Profits:</b>	<b>£30,000</b>	<b>£50,000</b>	<b>£100,000</b>
	£	£	£
Dividends	17,552	33,552	73,552
Balance of personal allowance (£10,600 - £8,060)	2,540	2,540	2,540
Taxable dividend	15,012	31,012	71,012
<b>Tax on dividend using 16/17 rates</b>			
Basic rate band	31,785		
Dividend Tax Allowance at 0%	5,000	0	0
Balance of basic rate band	26,785		
Basic rate band at 7.5%		751	1,951
Higher rate band at 32.5%		0	0
		751	1,951
Tax on dividend using 15/16 rates		0	665
<b>Extra tax on dividends</b>		<b>751</b>	<b>1,286</b>
			<b>4,093</b>

The following table compares the current tax savings with the extra tax on the dividends

<b>Profits:</b>	<b>£30,000</b>	<b>£50,000</b>	<b>£100,000</b>
	£	£	£
Tax savings in 15/16	1,613	3,738	4,738
Less: extra tax on dividends 16/17	751	1,286	4,093
Tax savings in 16/17	862	2,452	645

So, a typical client is still saving some tax by being incorporated. For those clients who wish to incorporate, it may be best to defer the decision until sufficient detail of the new regime has been published by the government.

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For further information relating to the course or these notes contact:

Mercia Group Ltd, Best House, Grange Business Park, Enderby Road,  
Whetstone, Leicester, LE8 6EP Tel: 0116 258 1200 [www.mercia-group.co.uk](http://www.mercia-group.co.uk)

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## APPENDIX

**Director-shareholder wants to receive an additional £10,000 net of taxes. What is the cost to the company of providing bonus or dividend?**

<b>basic rate taxpayer (+ employee within full NI band)</b>			<b>higher rate taxpayer</b>			<b>additional rate taxpayer</b>		
<b>to taxpayer:</b>			<b>to taxpayer:</b>			<b>to taxpayer:</b>		
net receipt of bonus		10,000	net receipt of bonus		10,000	net receipt of bonus		10,000
IT and ee NI on net bonus	0.32	4,706	IT and ee NI on net bonus	0.42	7,241	IT and ee NI on net bonus	0.47	8,868
Gross bonus		<b>14,706</b>	Gross bonus		<b>17,241</b>	Gross bonus		<b>18,868</b>
<b>Cost to company</b>			<b>Cost to company</b>			<b>Cost to company</b>		
bonus		14,706	bonus		17,241	bonus		18,868
employer NI	0.138	2,029	employer NI	0.138	2,379	employer NI	0.138	2,604
		16,735			19,620			21,472
less CT relief	0.2	3,347	less CT relief	0.2	3,924	less CT relief	0.2	4,294
<b>cost to company</b>		<b>13,388</b>	<b>cost to company</b>		<b>15,696</b>	<b>cost to company</b>		<b>17,178</b>
<b>dividend to taxpayer:</b>			<b>dividend to taxpayer:</b>			<b>dividend to taxpayer:</b>		
net receipt of dividend		10,000	net receipt of dividend		10,000	net receipt of dividend		10,000
Tax (£5,000 already used)	0.075	811	Tax (£5,000 already used)	0.325	4,815	Tax (£5,000 already used)	0.381	6,155
Dividend payment		10,811	Dividend payment		14,815	Dividend payment		16,155
<b>saving to company of paying dividend</b>		<b>2,577</b>	<b>saving to company of paying dividend</b>		<b>881</b>	<b>saving to company of paying dividend</b>		<b>1,023</b>
<b>In 2015/16</b>			<b>In 2015/16</b>			<b>In 2015/16</b>		
cost of dividend	0	10,000	cost of dividend	0.25	13,333	cost of dividend	0.306	14,409
cost of bonus		13,388	cost of bonus		15,696	cost of bonus		17,178
<b>saving to company of paying dividend</b>		<b>3,388</b>	<b>saving to company of paying dividend</b>		<b>2,363</b>	<b>saving to company of paying dividend</b>		<b>2,769</b>