

The A9 Partnership Ltd

Changes to tax on dividends

The Chancellor announced a major reform to dividend taxation which will affect many owners of small and medium sized business, who currently extract profits by dividends.

While it is proposed to reduce the corporation tax rate to 19% from 2017 and 18% by 2020 this will be offset by an increase in the dividend tax rates leaving the director shareholders worse off in most cases.

Full details of the new rules are not yet available, with budget information being limited on the subject, however it will be effective from 6th April 2016 and the revised rates of taxation have been provided.

Who will be affected

Currently many businesses pay director shareholders a mixture of salary and dividends. The main purpose being it is more tax efficient than paying a salary or bonus. A basic rate tax payer currently has no tax to pay on a dividend drawn from the company, with the company suffering tax at 20%, thereby an effective rate of 20%. A higher rate tax payer suffers tax at 25% on the net dividend drawn, however the effective rate is 40%, which is still lower than a salary as a result of the national insurance which is not payable on the dividends. Additional rate taxpayers will also suffer further tax.

New rates

We have been advised the rates from 6th April 2016 will be:

Income tax bands	New rate	Existing rate
Basic rate	7.5%	0%*
Higher rate	32.5%	25%
Additional rate	38.1%	30.56%

*10% tax credit covers basic rate liability

The new rules include a £5,000 dividend exemption. It is not clear if this will apply to all dividend income regardless of the amounts received or whether the exemption is removed if the dividend income is above this level.

How will it affect you

This will be a real tax increase for all small company shareholders who extract profits from a company by way of dividend. If we can illustrate by example

Basic rate tax payer – Current		Higher rate tax payer – Current	
Dividend	£20,000	Dividend	£20,000
Current tax payable	Nil*	Current tax payable 25%	£4,000
*10% tax credit covers the basis rate			
Basic rate tax payer – Proposed		Higher rate tax payer – Proposed	
Dividend	£20,000	Dividend	£20,000
Exemption	<u>£ 5,000</u>	Exemption	<u>£ 5,000</u>
Taxable	<u>£15,000</u>	Taxable	<u>£15,000</u>
Tax payable 7.5%	£1,125	Tax payable 32.5%	£4,875

More information will be provided as it becomes clearer of how it will operate, however in the meantime if you wish to speak to your Director or Manager please do not hesitate to contact us.