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Helping smaller businesses and their owners manage their accounting, business and taxation

Numerical Guide to the Dividend Tax

This summary explains the main changes to the way in which dividends will be taxed from 6 April 2016 and includes a few examples supplied by H M Revenue & Customs.

If you take most of your business income through dividends then you will be worst off. However, it is generally still better to trade as a limited company than a sole trader.

A summary of the changes

- From April 2016, notional 10% tax credit on dividends will be abolished.
- A £5,000 tax free dividend allowance will be introduced.
- Dividends above this level will be taxed at 7.5% (basic rate) and 32.5% (higher rate)
- Dividends received by pensions and ISAs will be unaffected
- Dividend income will be treated as the very top slice of an individual's income.
- Individuals who are basic rate payers who receive dividends of more than £5,001 will need to complete self-assessment returns from 6 April 2016.

Impact

The changes are aimed to tax small companies who pay a small salary designed to preserve entitlement to the State Pension, followed by a much larger dividend payment in order to reduce National Insurance costs.

This measure will have a very harsh effect on those who work with spouses in family companies. A couple could be over £5,000 p.a. worse off.

How does it work?

If you have dividend income (dividends held outside of an ISA) of £5,000 or less per year you will pay no tax on your dividends, even if you are a higher rate taxpayer. Your dividends are covered by the £5,000 dividend allowance.

If your dividend income is received through shares in an ISA, as now, these remain tax-free and the dividend allowance will not affect this income.

If your total income is less than £11,000 (the amount of the 2016-17 personal allowance) your income is covered by your personal allowance and your dividend allowance is effectively unused.

Example 1

- Non-dividend income (e.g. salary or rents of £6,500) and dividend income of £12,000
- You pay £187.50 more a year in tax

Type of income	Personal Income	Basic rate allowance	Band
Non-dividend income	6,500	6,500	
Dividend	12,000	4,500	7,500
Totals	18,500	11,000	7,500
Less Dividend Allowance			(5,000)
Taxed at 7.5%			2,500
Tax due			**£187.50**

Example 2

- Non-dividend income (e.g. salary or rents of £6,500) of £20,000 and dividend income of £6,000
- You now pay £75 more a year in tax

Type of income	Personal Income	Basic rate allowance	Band
Non-dividend income	20,000	11,000	9,000
Dividend	6,000	0	6,000
Totals	26,000	11,000	15,000
Dividend in basic rate band			6,000
Less Dividend Allowance			(5,000)
Taxed at 7.5%			1,000
Tax due			**£75.50**

Tax effect of the changes on you

If your non-dividend income is £43,000 and your dividend income is £5,000, no tax is due on your dividends.

If you are a basic rate taxpayer, and you receive all your taxable income in dividends you will be up to £2,025 worse off.

If you are a higher rate taxpayer, and you receive £50,000 of income in dividends in 2016/17 you will be worse off by £2,575

The examples over the page outline the cost of the new measures to small company owners/investors.

Basic rate taxpayers

Old dividend rules: (if dividend tax was not in place in 2016/17)

Assuming gross dividend is £32,000 (including tax credit and assuming that the taxpayer has other income which takes up their personal allowance).

The first £32,000 falls into the basic rate band - taxed at 10% = £3,200. You receive a tax credit = £3,200. No further tax is paid.

New dividend 2016/17: Basic rate taxpayer - £32,000 of dividends

If you are **a basic rate taxpayer**, and you receive all your taxable income in dividends **you will be up to £2,025 worse off**. The basic rate tax threshold for 2016/17 is £43,000 (personal allowance of £11,000, plus basic rate tax band of £32,000).

If a dividend of £32,000 is received it is taxable as follows, breaking it down into the different "slices":
The first £5,000 - covered by your dividend allowance
The next £27,000 (the remainder of your basic rate band) - taxed at the new 7.5% = £2,025 tax due.

Higher rate taxpayers

Old dividend rules: (if dividend tax was not in place in 2016/17)

The following examples assume that the taxpayer has other income which takes up their personal allowance.

If a dividend of £50,000 is received that is grossed up to £55,555 taxable as follows, breaking it down into the different "slices":

The first £32,000 - taxed at 10%	£3,200
The next £23,555 is taxed at 32.5%	£7,655
You receive a tax credit	(£5,555)
Tax is paid of	£5,300

New dividend 2016/17: Higher rate taxpayer - £50,000 of dividends

A higher rate taxpayer will pay tax at 32.5% on any dividend income in excess of the new £5,000 dividend allowance and basic rate threshold.

If you are **a higher rate taxpayer**, and you receive £50,000 of income in dividends in 2016/17 **you will be worse off by £2,575**

If a dividend of £50,000 is received it is taxable as follows, breaking it down into the different "slices":
The first £5,000 - covered by your dividend allowance

The next £27,000 - taxed at the new 7.5%	£2,025
The next £18,000 - taxed at 32.5%	£5,850
Total tax due	£7,875