Dividend Strategy for 2016/17

You may have seen in our previous mailings, budget reports or national media that major change to the way dividends are taxed from 6th April 2016 – both from listed stocks and shares and shares in private companies – were announced in late 2015.

We decided to wait until after the March 2016 Budget to contact you in case there were any changes (George Osborne has had a few U-Turns recently) as we didn't want to confuse the issue with having to send a second letter.

The good news:
The tax credit will disappear from dividends. While this may sound bad for shareholders, it effectively "widens" your tax bands before you pay 40% or 45%, as up to 5th April 2016 dividends are calculated gross of the 10% tax credit, whereas you the shareholder, only received the net amount. From 6th April 2016, what you receive is what will be included in the tax calculations.

From 6th April 2016, the first £5,000 of dividends received in each tax year will be "tax free", no matter how much other income you have.

The not so good news:
Dividends above the £5,000 will be taxed at 7.5% if they fall into the basic (20%) rate of tax, 32.5% if they are at higher (40%) rate and 38.1% for dividend income falling into the additional tax (45%) rate

Currently dividends falling into the basic rate band are effectively tax free, are taxed at 25% if they are at higher rates and at 30.6% for dividends falling in the additional tax rate.

The £5,000 isn't a straight forward extra tax free amount, and may overlap with your personal allowance if other income is relatively low, effectively meaning a loss of all or part of the allowance. In addition, it does not widen the tax bands as some commentators originally thought it would.

For owner managers of companies, there are broadly three camps you can fall into:

1) Dividends regularly taken up to the basic rate band ceiling (c.£43,000 total income), providing adequate income for lifestyle with no need for an increase in income.
2) Dividends regularly taken into the higher rate band but below £100,000 total income, needed to provide required level of income.
3) Dividends regularly taken into the higher rate band and above £100,000 total income.

If you are a 1), it is likely that your best position is to remain with your usual remuneration structure in both 2015/16 and 2016/17.

For business owners in 2) or 3), where your businesses are able to declare a dividend in 2015/16 – ie. Where there are adequate retained profits – you should consider a "super dividend" in 2015/16.

Under scenario 2), you may wish to consider paying 25% tax on a dividend to take your total income up to £100,000. Between £100,000 and £121,200 of income for every £2 of income you lose £1 of your personal allowance and this range of income is taxed at a marginal rate of 60%.

Under scenario 3) where you are already reducing your personal allowance, you may wish to consider declaring an additional dividend in 2015/16 to utilise the lower tax rates up to £150,000.

Over £150,000 then you just need to decide if you want to pay tax early on a super dividend and avoid the 7.5% rate for the short term.

It is important to remember that a dividend is taxed when it is declared, not when you withdraw the cash from the business, and therefore a "super dividend" can sit on your balance sheet as a creditor until such time as you need the money and/or your business can afford the cash flow.

If you'd like to discuss the above opportunity, please do not hesitate to contact us and we will be pleased to look at your personal circumstances, as this is an area where there isn't a "one size fits all" solution