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Dividend taxes will increase for many company owners

Q: **As an owner-manager of a profitable company, enjoying the profits as salary and dividends, how will the recent Budget changes to dividend tax rates affect my tax bill? Is there anything I could do before the changes come into force to save tax?**

A: No doubt these questions are on the minds of many Kent company owners and, as with most tax matters, the answers depend on your circumstances.

Let's start by summarising the changes based on what the Chancellor has announced and the little guidance HMRC has released. Draft legislation will not be available for some time and could differ from the current guidance.

From 1 April 2016 we expect:

- Increased effective rates of dividend taxes of:

Rate band	2016/17	2015/16
Basic (up to £32k p.a. from April 2016)	7.5%	0%
Higher (up to £150k p.a.)	32.5%	5%
Additional	38.1%	30.56%

- Introduction of a £5,000 annual dividend allowance.

Individuals with modest dividends (less than £5,000 p.a.) will likely be better off while those with higher dividends will face increased tax liabilities from 2016/17 onwards.

Company: Salary vs. Dividends

Historically, it has been cheaper for owner-managers to take profits as dividends rather than salary. The new rules maintain that position; although the tax saving is reduced - a smart move by the Chancellor as the changes are unlikely to deter a dividend reward approach and will simply achieve a higher tax yield.

Company vs sole trade/ partnership

Under current rules, in tax terms only, operating profitably through a company with full extraction of profits is cheaper than operating in an unincorporated form – the new rules only change this position once profits reach circa £140,000. Above this level of profits there is a maximum 0.3% tax saving through being unincorporated, so we do not expect that this small saving will influence incorporation decisions. Indeed where profits are retained in a company for reinvestment in the business, there will be considerably higher tax savings.

Other commercial factors continue to be relevant to decisions on which structure best suits your business.

Beware the £5,000 tax free allowance!

While you will pay no tax on the first £5,000 of dividends received each year as a result of the new allowance the £5,000 is still technically taxable income (albeit at a rate of 0%) so will be relevant for other purposes such as state benefits applications and whether the child benefit tax charge for higher earners applies to you.

What action could you take pre 1 April 2016...

Based upon the guidance we have so far, accelerating dividends into the 2015/16 tax year may generate an overall tax saving to you, depending on your levels of income this tax year.

It is worth noting however that bringing forward dividends could also bring forward tax payments and affect cashflow.

There are some areas of risk where bringing forward dividends could in fact increase your overall tax liability. For example if you were to push your taxable income into the £100,000 – circa £120,000 bracket (where higher effective rates of tax apply due to the loss of your personal allowance), or if you push your income above the basic rate threshold.

Keep in mind also:

- Companies with multiple shareholders will have differing shareholder needs to consider;
- Distributable reserves must be available for legal dividend declarations.

We would strongly recommend that you seek advice to ascertain how the changes will affect you and identify any tax saving opportunities appropriate to your circumstances.

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