SQUIRE PATTON BOGGS

# DIVIDENDS
## Back to the Drawing Board

### The changes to the taxation of dividends proposed in the Budget seem to be worthy of rather more attention than they have received.

This looks like a serious revenue raiser for HMRC which is another way of saying it is a serious tax increase. It would be nice to have some more details, but this is something which will feature in the Finance Bill 2016 so we will have to wait until next year before we get further information.

The idea is that the tax credit on dividends is removed and replaced by a £5,000 exemption with the balance being taxable at varying rates of tax. This means that virtually everybody affected by this change will be worse off – except higher rate and additional rate taxpayers with dividend income of less than £5,000. At the moment they are paying an effective rate of 25% (or 30.6% for additional rate taxpayers) on those dividends whereas under the new rules they will pay nothing at all. Maybe Mr Osborne has been overwhelmed with guilt about those paying the higher rates of tax. Or maybe not.

You might have thought that the £5,000 exemption would be good for everybody but it is no benefit at all to basic rate taxpayers. Their dividends are effectively exempt anyway being automatically covered by the tax credit so this makes no difference to their tax position.

This could be pretty irritating for the small business. At the moment, a husband and wife with a small business drawing salaries of (say) £10,000 and dividends of about £30,000 each would have no income tax liability at all on their combined income of £80,000. However next year they will each be liable to tax on £25,000 of their dividends.

The way these new rates will work is that basic rate taxpayers will pay 7.5% on their dividends over £5,000, compared with zero at the moment; the higher rate taxpayer will be paying tax at the rate of 32.5% on such dividends, rather than 25% at the moment; and additional rate taxpayers will be paying tax at 38.1% on those dividends rather than 30.6% at the moment.

When you look at these figures something becomes immediately obvious. If you ignore the £5,000 exemption, everybody is going to pay an extra 7.5% on their dividends – whatever their tax bands.

This is certainly going to give rise to some behavioural change because nobody is going to want to pay 20% corporation tax and then 38.1% on their dividends. The decisions about whether or not to incorporate will be seriously affected and so will the comparisons between drawing salaries and receiving dividends.

There are of course lots of permutations, the idea being to get the most money out of the company with the minimum outflow of tax – and whether a salary will be cheaper than a dividend in terms of income tax, corporation tax and NIC, particularly bearing in mind that a salary (and the associated NIC) is deductible for corporation tax.

A serious amount of forest is going to be consumed in creation of the spreadsheets necessary to do all the comparative calculations as everybody strives to end up with the most advantageous position.