Dividend tax changes represent genuine tax rise for hard-working small business entrepreneurs

When the Chancellor announced in his 'Emergency' Summer Budget that there would be changes to how dividends were to be taxed from April 2016, it was suggested there would be no tax increase in the amount of tax payable, except for individuals receiving dividends of more than £140,000 a year.

This reassurance always seemed unlikely and HM Revenue & Custom's recent technical explanation as to how the new tax system would operate proves this not to be the case.

In fact the new regime represents a genuine tax rise for many entrepreneurial small businesses.

Under the current system, if you pay yourself a salary from your company of less than £10,600 (the current personal allowance), then take the rest of your income in the form of dividends, you will not pay any Income Tax on either the salary or 'gross' dividends (i.e. the net dividend received plus the 10% notional Tax Credit) until your total income currently exceeds £42,385.

Under the new rules from 6 April 2016, the personal allowance will still be free from Income Tax as will the first £5,000 of 'actual' dividend income received. After which all further dividends will be taxed at a minimum rate of 7½%. So somebody paying themselves £43,000 out of their own company would have £16,000 tax-free (£11,000 personal allowance and £5,000 dividend allowance) with the next £27,000 taxed at 7½%, which results in an Income Tax liability of £2,025. This might not seem much, but in comparison it is £1,919 more than under the current regime.

If your income exceeds £43,000, dividends will be taxed at 32½% above the £5,000 threshold, and if you are a high earner with more than £150,000 a year, the rate of tax on dividends will be 38.1%.

This is an Income Tax rate increase on dividends of 7½% at every level. It is a major tax increase for everybody –particularly small business owners who have traditionally paid themselves a small salary and large dividends.

The new system has been put forward as a form of tax avoidance measure, to discourage people from incorporating their business to take advantage of lower rates of Corporation Tax. The current rate of Corporation Tax is 20% but is set to fall to 18% cent over the life of this Parliament, compared with Income Tax rates of up to 45% plus National Insurance contributions.

If this change affects how you receive monies from your company, please do not hesitate to speak to the team at Inspired and we will be happy to explain and review your position with you and offer any alternatives that may be suitable.

For further information or advice please phone inBOS on 01543 624 036 or email: accounts@inbos.co.uk.