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# Will dividends remain tax efficient?

**Changes to the way dividends are taxed were announced in the 2015 Summer Budget, so are dividends still tax efficient?**

## Budget changes

The Government announced that income tax rates will remain 'locked' until 2020, however the taxation of dividend income is set to change from 5 April 2016:

- The notional 10% dividend tax credit has been abolished.
- The £5,000 dividend allowance will be reduced to £2,000 from 6 April 2018.
- The personal allowance can also be used against dividend income although this will continue to be tapered for income (including dividends) over £100,000.
- The dividend rates from 6 April 2016 are as follows:
    - Basic rate – 7.5%
    - Higher rate – 32.5%
    - Additional rate – 38.1%

The reduction in corporation tax rates from April 2017 and 2020 (19% and 17% respectively) will mean more profits can be paid out as a dividend and this will increase the tax efficiency of dividends over salary or bonus in the future.

Company owners who can withdraw funds through pension contributions, interest on directors loans or rental payments from their company will find that these are more tax-efficient (if less flexible) than taking dividends.

## Other matters to consider

The company's current share ownership structure may mean it is not as straightforward to withdraw value as the owners might wish, but expert advice should be taken before any restructuring or other withdrawal arrangements are put in place.

Dividends have the cash flow advantage that they can be received gross, whereas PAYE and NIC must be deducted in real time at source from salary and bonus payments.

Where companies undertake qualifying R&D activity or have qualifying patent box profits, the corporation tax relief available may reduce the tax advantage of taking dividends rather than salary.

The table overleaf provides illustrations for different methods of withdrawing value from your company.

**We would recommend company owners seek our expert help to review how they should extract value from their business and whether payments should be brought forward so that they remain tax-efficient.**

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# Illustrations for different methods of withdrawing value from a company

## Dividend v Bonus *

Dividend of £1,000 in 7.5% band - net £925 cash. Bonus of £1,098 (cost neutral to co) would net £747. 23.82% improvement over bonus

Dividend of £1,000 in 32.5% band - net £675 cash. Bonus of £1,098 (cost neutral to co) would net £637. 5.96% improvement over a bonus

Dividend of £1,000 in 38.1% band - net £619 cash. Bonus of £1,098 (cost neutral to co) would net £582. 6.35% improvement over a bonus

## Rent v Dividend *

Dividend of £1,000 in 7.5% band - net £925 cash. Rent of £1,250 (cost neutral to co) would net £1,000. 8.1% improvement over a dividend

Dividend of £1,000 in 32.5% band - net £675 cash. Rent of £1,250 (cost neutral to co) would net £750. 11.1% improvement over a dividend

Dividend of £1,000 in 38.1% band - net £619 cash. Rent of £1,250 (cost neutral to co) would net £688. 11.1% improvement over a dividend

* Ignores effect of the £5,000 dividend allowance and personal allowance

The above provides an overview of the dividend planning available. If you would like specific advice on your individual circumstances, please contact:

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