Has the dividend allowance cut hit home?

The dividend allowance, which was originally introduced from 6 April 2016, was cut from £5,000 a year to £2,000 from 6 April 2018. Fortunately, the tax rates on dividend income, above the allowance, remain at 7.5% for basic rate taxpayers, 32.5% for higher rate taxpayers and 38.1% for additional rate taxpayers; and dividends received on shares held in an Individual Savings Account (ISA) continue to be tax free.

Many family-owned companies will allocate dividends towards the end of their financial year and/or the tax year, so for many people, it will be around March/April 2019 when the impact of the reduction hits home.

How much tax is paid on dividend income is determined by the amount of overall income an individual receives. This includes earnings, savings, dividend and non-dividend income. The dividend tax will primarily depend on which tax band the first £2,000 falls in.

For a basic rate tax payer – in 2018-19 this generally means someone with income less than £46,350 – the reduction in the dividend allowance from £5,000 to £2000 could lead to an increase in dividend tax of £225. Higher rate and additional rate tax payers may be worse off by £975 and £1,143 respectively.

It is worth noting that if dividend income falls between multiple tax bands, the figures specified above will be different.

Examples

Dividend income only

An individual who receives dividend income only of less than £2,000 in 2018/19 will have no tax to pay on their dividend income as it falls within the dividend nil rate band.

Basic rate taxpayer

An individual who has, say, dividend income of £10,000 and other taxable income of £8,000 in 2018/19, will pay tax as follows:

Total income	£18,000
Less personal tax allowance	(£11,850)
Taxable income	£6,150
Dividend income taxable at nil rate (£2,000 x 0%)	£0
Dividend income taxable at ordinary rate (£4,150 x 7.5%)	£311.25
Total tax liability	£311.25

Higher rate taxpayer

An individual who has, say, dividend income of £10,000 and non-dividend income of £40,000 in 2018/19 will pay tax as follows:

Total income	£50,000
Less personal allowance	(£11,850)
Taxable income	£38,150
Non-dividend income at basic rate (£28,150 at 20%)	£5,630
Dividend income taxable at dividend nil rate (£2,000 at 0%)	£0
Dividend income at dividend ordinary rate (£4,350 at 7.5%)	£365.25
Dividend income at dividend upper rate (£3,650 at 32.5%)	£1,186.25
Total tax liability	£7,181.50

In this example, personal allowances are deducted first against other income, leaving £28,150 of other income falling within the basic rate tax band (£34,500 for 2018/19). Dividend income falling within the basic rate tax band is £6,350 (£34,500 minus £28,150 used), with the remaining £3,650 falling above the basic rate limit. The dividend nil rate is allocated to the first £2,000 of dividend income, falling wholly within the basic rate limit, leaving £4,350 within the basic rate limit. The remaining £3,650 of dividend income is taxable at the dividend upper rate of 32.5%.

These examples show how complicated the allocation of various rate bands and tax rates can be, even in situations where a straight-forward dividend payment is made. Family business structures may be particularly vulnerable to the impact of the reduction in the dividend allowance, especially where multiple family members take dividends from the family company. A pre-dividend review may be beneficial, as family members could find themselves far worse off than first thought.

Partner Note: ITA 20017, s 8 and s 13A; F(No 2)A 2017, s 8