HM Revenue & Customs

Income Tax: changes to dividend taxation [6094]

Who is likely to be affected?

Anyone who is liable to income tax on dividend income.

General description of the measure

From 6 April 2016 the Dividend Tax Credit will be replaced by a new Dividend Allowance in the form of a 0% tax rate on the first £5,000 of dividend income per year.

UK residents will pay tax on any dividends received over the £5,000 allowance at the following rates:

- 7.5% on dividend income within the basic rate band
- 32.5% on dividend income within the higher rate band
- 38.1% on dividend income within the additional rate band

Dividends received on shares held in an Individual Savings Account (ISA) will continue to be tax free.

Policy objective

This measure will help address the incentive for some people to set up a company and make payments as dividends rather than as wages simply to reduce their tax bill, enabling the government's plan to reduce the rate of Corporation Tax. As announced at Budget 2016, CT will now be reduced to 17% in 2020.

The measure will modernise, reform and simplify dividend taxation, creating a fairer system. Only those with significant dividend income, or those who are able to pay themselves dividends in place of wages, will pay more tax. Around 1 million individuals will pay less tax on their dividend income due to the new Dividend Allowance.

Background to the measure

This measure was announced at Summer Budget 2015. This TIIN was updated on 29 June 2016 and replaces the TIIN published on 9 December 2015.

Detailed proposal

Operative date

The measure will apply to distributions made on or after 6 April 2016.

Current law

Part 4 Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005) imposes the charge to income tax on most dividend income (including other types of distribution). Chapter 3 of Part 4 ITTOIA 2005 provides that a recipient of a dividend will receive a tax credit, equal to one ninth of the dividend value. This tax credit can be set against the person's liability to tax on dividend income for that year.

Dividend income is defined at section 19 of the Income Tax Act 2007 (ITA 2007) and includes dividends from UK resident and non-UK resident companies, as well as some other types of distributions and things that are treated as distributions.

Dividend income is charged at the dividend ordinary, dividend upper or dividend additional rates, as provided by section 8 of ITA 2007.

Proposed revisions

Legislation will be introduced in Finance Bill 2016 to amend ITA 2007 and to implement a new 0% rate for dividend income received by individuals, as well as changing the rates of tax for dividend income. The new nil rate will apply to the first £5,000 of a person's dividend income and will be available annually.

The rates of income tax for dividends received above the allowance on or after 6 April 2016 be:

- 7.5% for dividend income within the basic rate band
- 32.5% for dividend income within the higher rate band
- 38.1% for dividend income within the additional rate band

The Dividend Allowance applies to the first £5,000 of an individual's taxable dividend income and is in addition to the provisions for ISAs and the tax-free personal allowance. The dividend allowance will apply to dividends received from UK resident and non-UK resident companies.

Dividend income that is within the dividend allowance (and savings income within the new savings allowance) will still count towards an individual's basic or higher rate limits - and may therefore affect the level of savings allowance that they are entitled to, and the rate of tax that is due on any dividend income in excess of this allowance.

In calculating into which tax band any dividend income over the £5,000 allowance falls, savings and dividend income are treated as the highest part of an individual's income. Where an individual has both savings and dividend income, the dividend income is treated as the top slice. To see some examples of how this should work in practice see the 'Dividend Allowance factsheet' published on GOV.UK on 17 August 2015.

Alongside the introduction of the new dividend rates and the dividend allowance, legislation will be introduced in Finance Bill 2016 to amend ITTOIA 2005 to abolish the dividend tax credit.

Summary of impacts

Exchequer impact (£m)

2015 to 2016	2016 to 2017	2017 to 2018	2018 to 2019	2019 to 2020	2020 to 2021
-	+2,750	-425	+1,700	+2,740	+2,775

These figures represent the combined Exchequer impact of 'Dividends tax: abolish credit, introduce new £5,000 allowance, and increase effective rate by 7.5pp', and 'Tax Motivated Incorporation: reduction due to dividend tax reform'. These figures are set out in Table 2.1 of Summer Budget 2015 and have been certified by the Office for Budget Responsibility. More details can be found in the policy costings document published alongside Summer Budget 2015.

Economic impact

This measure is not expected to have any significant macroeconomic impacts.

The costing includes a behavioural adjustment for individuals reducing their taxable dividend income. The costing also makes an allowance for fewer future incorporations of businesses, and for some individuals forestalling the measure by bringing forward income to benefit from lower marginal tax rates.

Impact on individuals, households and families

Ninety-five per cent of all taxpayers - and more than three quarters of all those who receive dividend income - will either gain or be unaffected by these changes. Around 1 million individuals will benefit from a tax reduction on their dividend income due to the Dividend Allowance.

The majority of non-taxpayers and basic rate taxpayers do not currently need to inform HM Revenue and Customs (HMRC) of their dividend income. From April 2016, individuals who receive dividends between £5,001 and £10,000, and who need to pay tax on those dividends at the basic rate, will have to inform HMRC of their dividend income for the first time. This number is estimated to be fewer than 15,000 customers. (Individuals with more than £10,000 of dividend income are already required to be in Self Assessment.)

Around 2 million individuals are expected to have some tax to pay on their dividend income after April 2016, compared to 1.8 million if these reforms had not been put in place. This tax will be collected automatically through PAYE in most cases, although further details will be published in good time ahead of any tax being due.

The measure is not expected to impact on family formation, stability or breakdown.

Equalities impacts

This measure will have substantially more impact on men than women as they are more likely to have dividend income.

Older people over 65 are more likely to receive dividend income. Of these 87% will be better off or unaffected. Those who would be negatively impacted will still be paying less tax on dividend income than from pension or wages income.

It is not anticipated that there will be adverse impacts on any other group with protected characteristics.

Impact on business including civil society organisations

This measure is expected to have a negligible impact on businesses or civil society organisations because the impact will mostly apply to individual shareholders.

Operational impact (£m) (HMRC or other)

HMRC will need to make changes to IT systems to deliver this change at an estimated cost of £1.2 million.

Other impacts

Other impacts have been considered and none have been identified.

Monitoring and evaluation

This measure will be monitored through information collected in tax returns and income tax receipts.

Further advice

If you have any questions about this change, please contact Adrian Coates on Telephone: 03000 586041 or email: adrian.coates@hmrc.gsi.gov.uk.