

Personal Tax - Dividends and Interest

Dividend and savings allowances are available. We consider the opportunities and pitfalls of the personal tax rules.

Dividend income

When dividends are received by an individual the amount received is the gross amount subject to tax. The availability of the Dividend Allowance (DA), introduced from 2016/17 onwards, means that the first £5,000 of dividends are charged to tax at 0%. Dividends received above this allowance are taxed at the following rates:

- 7.5% for basic rate taxpayers
- 32.5% for higher rate taxpayers
- 38.1% for additional rate taxpayers.

Dividends within the allowance still count towards an individual's basic or higher rate band and so may affect the rate of tax paid on dividends above the £5,000 allowance.

Dividends are treated as the top slice of income and the basic rate tax band is first allocated against other income.

It was announced in Budget 2017 that the DA will be reduced to £2,000 from 6 April 2018.

Example

Mr A has non-dividend income of £41,000 and receives dividends of £9,000. The non-dividend income is taxed first. Of the £41,000 non-dividend income, £11,500 is covered by the Personal Allowance, leaving £29,500 to be taxed at the basic rate.

The basic rate band for 2017/18 is £33,500 so this leaves £4,000 of dividend income that is within the basic rate limit before the higher rate threshold is crossed. The DA covers the £4,000, leaving £1,000 of the DA to be used for the dividends in the higher rate band.

The remaining £4,000 of dividends fall in the higher rate tax band and are therefore taxed at 32.5%.

Savings income

Some individuals qualify for a 0% starting rate of tax on savings income up to £5,000. However this rate is not available if non-savings income (broadly earnings, pensions, trading profits and property income) exceeds the starting rate limit.

The Savings Allowance (SA), available from 2016/17 onwards, taxes savings income within the SA at 0%. The amount of SA depends on the individual's marginal rate of tax. An individual taxed at the basic rate of tax has an SA of £1,000 whereas a higher rate taxpayer is entitled to a SA of £500. Additional rate taxpayers receive no SA.

Savings income includes:

- interest on bank and building society accounts
- interest on accounts with credit unions or National Savings and Investments
- interest distributions from authorised unit trusts, open-ended investment companies (OEICs) and investment trusts
- income from government or corporate bonds
- most types of purchased life annuity payments.

Is savings income received net or gross of tax?

This is much more complicated than you may think. The government has removed the requirement (from 6 April 2016) for banks and building societies to deduct tax from account interest they pay to customers.

Some types of interest have always been received without tax deduction at source and will therefore continue to be paid gross. Interest on corporate bonds listed on the London Stock Exchange is paid gross for example. However, in 2016/17 basic rate tax continues to be deducted at source from some forms of savings income such as interest distributions from unit trusts and OEICs. This requirement is removed from April 2017.

Switching investments

Given the lower amount of SA, higher and additional rate taxpayers could seek to maximise their use of the DA by moving investments out of interest bearing investments to ones which pay out dividends. This could be through direct shareholdings or through dividend distributing equity funds in unit trusts or OEICs.

In addition, assets held for capital growth could be transferred to dividend paying investments. Any gains realised by the investors on the sale of assets would be exempt up to the CGT exemption which is £11,300 for 2017/18. Further gains over this amount are only charged to tax at 20% for higher and additional rate taxpayers following the reduction in CGT rates from 6 April 2016.

Interaction between DA and SA

If the amount of dividends an individual receives is covered by the DA but those dividends would have meant that they were higher rate taxpayers without the DA, then this would affect the amount of SA they would receive.

Example

Mrs B has a salary of £42,000, interest income of £1,000 and dividends of £5,000. Although the

dividends are covered by the DA, Mrs B's total income is £48,000 so she is a higher rate taxpayer. She would therefore only receive £500 of SA against the £1,000 of interest income.

Check your coding

Where savings income exceeds the SA, there will be tax to pay on the excess. HMRC have indicated that they will normally collect this tax by changing individual's tax codes. To allow them to do this they will use information from banks and building societies. However in some cases HMRC have been overestimating the amount of interest people are likely to earn and adjusting their coding accordingly. So it is worth checking coding notices when they come through.

Gift Aid donations

Take care if you make Gift Aid donations. A charity can reclaim the tax on a Gift Aid donation only if the individual has paid the amount of tax being reclaimed. Prior to April 2016 this tax would have included dividend tax credits and tax deducted at source on interest income.

Following the introduction of the SA and DA, any income within these allowances is not taxed so the tax reclaim by the charity does not relate to tax paid. Where this happens the individual is responsible for ensuring that the donation is covered and HMRC have powers to recover any shortfall from the taxpayer.

So people with lower levels of income and dividends or savings below the DA or SA amounts who make Gift Aid donations could be affected. Individuals will need to withdraw any Gift Aid declarations that they have made to ensure that they do not get hit with a tax bill.

Planning for spouses

The introduction of Dividend and Savings Allowances may also mean it is time to consider the allocation of investments between husband and wives or civil partners. If just one partner has investments generating dividends or savings it could be beneficial to transfer part of the investments to the other partner to ensure they receive income which utilises their DA or SA. Any transfer of assets between husbands and wives or between civil partners who are living together can be made without any capital gains tax being charged.

With savings rates generally being at about 1.5% - 2% utilising the £1,000 basic rate SA would mean having interest earning assets of between £50,000 and £66,667. For dividends, assuming an average yield of 3%, the investment level would be £166,667 to fully utilise the £5,000 DA.

How we can help

If you would like further details on any matter contained in this factsheet please contact us on 0121 711 2468 or 024 7651 8555.