New savings and dividend tax rules – LITRG publishes the essential guide

Personal tax

01 July 2016

The Low Incomes Tax Reform Group (LITRG) has published a factsheet to help people understand the personal savings and dividend allowances, which took effect from 6 April 2016. It includes examples showing how the two allowances interact, the tax thresholds and the 0% starting rate for savings.

From 6 April 2016, there is a new set of rules for how savings income and dividends are taxed. Many will be better off, but there are pitfalls for some. LITRG has published a factsheet and website guidance to help the public understand the changes and act on them if necessary. LITRG also hopes that CIOT and ATT members will find the factsheet helpful.

The announcements in 2015 of a new personal savings allowance and dividend allowance sounded straightforward. We were told that, from 6 April 2016, people would be able to have tax-free savings income of £1,000 (or £500 for higher rate taxpayers) and tax-free dividends of £5,000. The former is a welcome change for some low-income savers; the latter makes no difference for those with small amounts of dividends but can entail an extra charge when dividend income is over £5,000 (7.5% tax within the basic rate band).

But, as is often the case, the details turned out to be far more complex. In fact, these are not allowances at all: they are nil rate bands of tax for savings income and dividends falling within them. Also, they are in addition to the 0% starting rate for savings and the interaction with this is complicated.

LITRG's factsheet and guidance draws attention to some of the key points (all figures are for 2016/17):

- Banks and building societies no longer deduct tax from the interest on your savings. As a consequence, non-taxpayers no longer need to use form R85 to stop tax being deducted; non-taxpayers might no longer need to fill in form R40 to claim back tax; individuals with savings income not covered by the 0% starting rate or personal savings allowance have to tell HMRC and pay tax through their PAYE code, or directly to it.
- Some savings income will still have tax deducted, for example the income element of a purchased life annuity or interest paid on PPI compensation. But this income will qualify for the 0% starting rate and the personal savings allowance. Depending on overall income, some individuals may need to claim tax back if they receive savings income with tax deducted.
- You look at whether the personal savings allowance applies after considering whether there is eligibility for the 0% starting rate for savings (£5,000 in 2016/17). Income covered by the personal savings allowance still counts as taxable income (albeit at 0%) and therefore still uses up the basic rate or higher rate band of tax. This can affect the rate of tax someone pays on savings income that exceeds their personal savings allowance and the rate of tax they pay on dividend income, as well as the personal savings allowance they are entitled to.
- The personal savings allowance and dividend allowance apply to total savings and dividend income, not per account or per holding.

- Dividends no longer come with a tax credit, so the amount received is the taxable sum. Above the £5,000 tax-free allowance, dividends are taxed at 7.5% if they fall within the basic rate band, 32.5% for higher rate taxpayers, and 38.1% for additional rate taxpayers with income over £150,000 a year. Individuals with dividend income greater than £5,000 have to tell HMRC and pay tax on the excess.
- Income that is covered by the dividend allowance still counts as taxable income and uses up the basic rate or higher rate band of tax. This can affect the rate payable on dividend income that exceeds the allowance. It can also affect the personal savings allowance.
- It is possible to get the personal allowance (£11,000), 0% starting rate for savings (£5,000), personal savings allowance (£1,000) and the dividend allowance (£5,000) all together. An individual could in theory have income of up to £22,000 tax-free (if it is the right amount of each sort of income).
- Individuals who make donations under gift aid need to take care to ensure that they are still paying enough tax to cover the tax the charity will claim back from HMRC. If the savings and dividend tax changes mean that an individual no longer pays any tax, HMRC could send them a bill for tax reclaimed by the charity.

The factsheet on savings and dividend tax is available on the LITRG website. Additional guidance is available on the LITRG website in the ‘Savings and tax’ section.

As we explore the two ‘allowances’ in more detail, we are uncovering more complexities, and we will be adding to our guidance in the months ahead.