

DIVIDENDS - THE POST 6 APRIL 1999 REGIME

A number of changes have taken place to the taxation treatment of companies and shareholders of companies as from 6 April 1999.

We highlight below the main areas of change and some of the planning opportunities that arise from these changes.

Please speak to us if you wish to pursue any of the strategies outlined below.

CHANGES FOR COMPANIES

Prior to 6 April 1999 a company was required to pay advance corporation tax (ACT) shortly after the payment of a dividend to its shareholders. The ACT was a payment in advance of a corporation tax liability, the balance of which was payable nine months and one day after the end of an accounting period. In some cases the ACT could not be set off against the corporation tax liability and relief had to be given against corporation tax from earlier or later accounting periods.

From 6 April 1999 a company no longer pays ACT on dividends. There is thus no cash outflow to the Revenue when a dividend is paid.

The tax position of the individual shareholder is, broadly, unaffected by this change (see below).

The company also no longer has to report the payment of the dividend on the quarterly CT61 return.

The only requirement that remains is that a company needs to issue a dividend tax voucher to the shareholder stating the amount of the dividend and the amount of the tax credit. The tax credit is computed as one ninth of the declared dividend (10% of the total of the net dividend plus the tax credit).

Due to the abolition of ACT it may be appropriate for your company to change the date on which dividends are paid. The only tax consideration now is the position of the

shareholders. In which tax year do they want the dividend to be taxed?

CHANGES FOR INDIVIDUAL SHAREHOLDERS

A dividend received on or after 6 April 1999 has a 10% tax credit rather than a 20% tax credit. In addition the tax credit cannot be repaid to an individual UK shareholder except via a PEP or ISA.

The changes have been introduced by the government in order to restrict and reduce the tax credits that have been repaid to shareholders who are exempt from tax. But the changes are not meant to increase the tax bill of an individual who is not exempt from tax and thus a number of other changes have been introduced in order to reflect this.

Under the new regime dividends are treated as the top part of an individual's income. The tax position depends on whether that top part is in the basic rate band or the higher rate band.

Dividend received by basic rate taxpayer

Prior to 6 April 1999 the tax credit of 20% of the gross dividend matched the taxation of the dividend at 20%. Although the basic rate of tax was 23%, the 20% tax credit was deemed sufficient to satisfy the basic rate liability.

From 6 April 1999 the tax credit of 10% of the gross dividend similarly matches the taxation of the dividend at 10%. There is no further liability to tax.

Dividend received by a higher rate taxpayer

Higher rate taxpayers were subject to tax at 40% on dividends before 6 April 1999. The tax credit satisfied 20% of the liability leaving an additional 20% to pay. So for a £720 cash dividend, the 20% tax credit brought the gross dividend to £900. The total tax liability of £360 was met by a £180 tax credit and a £180 liability settled directly by the taxpayer to the Revenue.

A £720 cash dividend paid on or after the 6 April 1999 to the individual shareholder results in a £180 liability to be paid by the taxpayer to

the Revenue despite the changes to the tax credit. This is achieved by taxing the dividend at a new higher rate of 32.5% as shown in the example below.

The figures (in tabular form) are

	Before 6.4.99	From 6.4.99
	£	£
Net dividend	720	720
Tax credit (1/4 / 1/9)	<u>180</u>	<u>80</u>
	£900	£800
Higher rate tax (40%/32.5%)	360	260
Less: tax credit	<u>(180)</u>	<u>(80)</u>
Further tax payable	£180	£180

Dividend received by non-taxpayers

Prior to 6 April 1999 a non-taxpayer would have received a repayment of the 20% tax credit. There is no repayment of the 10% tax credit for dividends received from 6 April 1999 by an individual shareholder.

Some thought needs to be given therefore as to whether such shareholders should switch from investments in ordinary shares and preference shares to investments providing interest receipts.

PEPs and ISAs

Tax credits are repayable to PEP- and ISA-holders in respect of dividends paid on or after 6 April 1999, albeit at the reduced rate of one ninth. The Government have guaranteed this for a five-year period.

OTHER SHAREHOLDERS

Charities

Like individuals, charities can no longer reclaim the tax credit on dividends. Instead, a special transitional relief has been introduced. In order to assist charities in adjusting to the new regime, they are being compensated for the loss of their tax credits. For dividends paid in 1999/00, charities were entitled to claim compensation equal to 21% of the amount paid. For the four subsequent years, their compensation is being progressively reduced (17% for 2000/01 and 13% for 2001/02).

For example, a charity receiving net dividend income of £4,000 in 1998/99 would be entitled to a repayment of £1,000 (being the 20% tax credit). In 1999/00 dividend income of £4,000 would have resulted in a claim for compensation of 21% x £4,000 = £840 and in

2000/01 it would be 17% x £4,000 = £680 assuming the same level of income.

Interest in possession trusts

Payments to beneficiaries of a trust funded out of dividend income will be treated as made under deduction of non-repayable tax (10%).

This ensures that beneficiaries will be taxed on the payment from the trust in the same way as if they received the dividend income direct.

Discretionary trusts

Discretionary and accumulation trusts are subject to tax on their income and capital gains at the rate applicable to trusts (34%).

When such trusts received dividend income carrying a 20% tax credit, further tax of 14% was due.

From 6 April 1999, a new 'Schedule F trust rate' of 25% applies to dividends. This is designed to ensure that trustees do not incur any additional liability from 6 April 1999 but where much of the income of the trust is distributed there may be additional liabilities.

Trustees will need to consider the distribution policy in such circumstances. Please contact us if you require further information on this matter.

HOW WE CAN HELP

If you are a shareholder and director of a company you may wish to review the dates on which dividends are paid by the company.

If you are a trustee of a discretionary trust, you may wish to review the distribution policy of the trust.

If you act for a charity, the investment policy of the charity may need to be amended.

We will be more than happy to provide you with assistance or any additional information required.

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