Director's salary and dividend guidelines for the 2016-17 tax year

The 2016-17 tax year has brought with it some major changes to how dividends are taxed which in turn has had an effect on the optimum tax planning positions for directors who are also shareholders.

How dividend taxation works from 6th April 2016

As was previously the case, dividends are not a deductible trading expense for companies so 20% Corporation Tax is payable on any profits used to finance dividend payments.

However, the old 10% personal dividend tax credit has been scrapped and a new £5,000pa tax-free dividend allowance has been introduced.

Over and above this £5,000 tax-free dividend allowance, dividend income is taxed as follows:

- Any dividends within your unused personal tax allowance (£11,000 for 16-17) are tax free
- Any dividends in the Basic Rate tax band (up to £43,000 for 16-17) are taxed at 7.5%
- Dividends in the Higher Rate tax band are taxed at 32.5%
- 37.5% tax will apply on dividends above the Additional Rate Tax band (£150,000 for 16-17)

Salary & National Insurance Contribution (NIC) Rules

Salaries constitute gross taxable income for personal tax planning purposes and are often less tax-efficient than dividends because they create potential Employer and Employee NIC Liabilities. There are two National Insurance thresholds and an Employment Allowance to be particularly aware of:

1. **Lower Earnings Limit** – as long as you earn above £5,824 in 2016-17 you are protecting your entitlement to future state pension and benefits.
2. **Primary Threshold** – if you earn above £8,060 in 2016-17 you and the company have to start paying NIC's (but see below).
3. **Employment Allowance** – any company employing more than a single owner-director can apply for relief from up to £3,000 of Employers NIC's.

Salary & Dividend Strategies

With the above in mind, I have outlined two potential remuneration strategies below, assuming you want to keep your total taxable income below the Higher Rate tax threshold of £43k for the 2016-17 tax year and assuming no income from other sources and standard tax allowances.

Option 1 – Simpler

- Pay yourself a gross salary of **£8,040** - just below the Primary Threshold for NIC's
- Draw **£34,960** of gross dividends up to the Higher Rate personal tax threshold.
- The first £2,960 of gross dividends up to the unused personal allowance (£11,000 less £8,040) are tax-free, as are the next £5,000 up to the tax-free dividend allowance. The balance of £27,000 dividends (£34,960 less £2,960 less £5,000) are taxed at the 7.5% rate applicable to Basic Rate taxpayers (so £2,025 income tax is payable).
- The company needs to make **£43,700** of taxable profits and pay **£8,740** (20%) Corporation Tax to finance a gross dividend of £34,960.
- So, the company has to earn **£51,740** of profits before all drawings to finance an £8,040 salary and a £34,960 gross dividend on which **£2,025** personal tax is payable leaving a net income of **£40,975** in your pocket (**79.2%**).

Option 2 - More Complicated

- Pay yourself a gross salary of **£11,000** up to the Personal Tax Allowance
- Your gross salary nets down to £10,645 after deduction of ***Employees*** National Insurance (no ***Employers*** National Insurance is payable if your company qualifies for the £3,000 Employment Allowance, though it does take some effort to apply for it).
- Draw **£32,000** of gross dividends up to the Higher Rate personal tax threshold.
- The first £5k of gross dividend is tax free and the residual £27,000 is taxed at the 7.5% rate applicable to Basic Rate taxpayers, so £2,025 of income tax is payable
- The company needs to make **£40,000** of pre-tax profits and pay **£8,000** (20%) Corporation Tax to finance a gross dividend of £32,000.
- In this example the company has to earn **£51,000** of profits (before drawings) to finance an £11,000 gross salary less c**.£355** Employees NIC (leaving **£10,645** net salary) and a £32,000 gross dividend, of which £27,000 is taxed at 7.5% or **£2,025** (leaving £29,975 net dividend), effectively putting **£40,620** net in your pocket (**79.6%**).

Tax Planning Ideas

Here are some tax planning ideas you might want to consider to help reduce the impact of the dividend tax changes:

- Keep total gross income below the Higher Rate tax threshold. Any dividends taken above the higher tax band would be taxed at 32.5% minimum (and even higher if you trigger other tax thresholds and/or allowance/benefit limits).
- Don't forget to take account of any other taxable income and dividends you receive from investments when designing a remuneration strategy.
- Consider employing your spouse and transferring a minority shareholding to your spouse so they can receive salary and dividend allowances tax free.
- Set up a rental agreement with your company and claim 'use of home as office' expenses
- Make corporation-tax deductible company-sponsored pension contributions under advice.