TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

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www.compassaccountants.co.uk

Do you now need to pay tax on your dividend income?

The fall in the dividend allowance in recent years may mean that you now need to pay tax on your dividend income for the first time.

The dividend allowance

The dividend allowance was introduced from 6 April 2016. It is available to all taxpayers regardless of the rate at which they pay tax and in addition to any other allowances that they may receive (such as the personal allowance or the personal savings allowance). Dividends sheltered by the allowance are taxed at a zero rate. However, they use up part of the tax band in which they fall.

The dividend allowance was set at £5,000 for 2016/17 and 2017/18. However, it was reduced to £2,000 for 2018/19, remaining at this level up to and including 2022/23. It was further reduced to £1,000 for 2023/24 and again to £500 for 2024/25.

For years prior to 2016/17, dividends came with a tax credit which matched the dividend ordinary rate of 10% on the gross dividend. This meant that basic rate taxpayers had no further tax to pay on dividend income, regardless of the amount, as long as their total income did not push them into the higher rate tax band.

Taxation of dividends

Where dividends are not sheltered by the dividend allowance or any personal allowance not used elsewhere, they are taxed at 8.75% where they fall in the basic rate band, at 33.75% where they fall in the higher rate band and at 39.35% where they fall in the additional rate band. To work out which rate applies, dividends are treated as the top slice of income.

Impact of the falling dividend allowance

The fall in the dividend allowance in recent years may mean that taxpayers who have never previously paid tax on their dividend income now have some dividend tax to pay for the first time.

Example

Barbara has had some privatisation shares for many years. She has increased her holdings by taking advantage of scrip dividends and rights issues. She receives dividend income of around £1,500 a year. She has other income of £30,000 a year from her state pension and an occupational pension. She does not complete a tax return.

For years prior to 2023/24, Barbara's dividend income was sheltered by the dividend allowance and she had no tax to pay.

However, for 2023/24, her dividend income of £1,500 exceeds the dividend allowance of £1,000 by £500. As her dividend income falls in the basic rate band, she will need to pay tax of £43.75 on her dividend income (£500 @ 8.75%).

For 2024/25, the dividend allowance is only £500, and Barbara's dividends exceed her dividend allowance by £1,000. As a basic rate taxpayer, she will need to pay tax of £87.50 (£1,000 @ 8.75%) on her dividend income in 2024/25.

Telling HMRC

If you are now liable to pay tax on your dividend income, you will need to tell HMRC. The way in which you do this depends on whether you already complete a tax return and the amount of your dividends.
If you already complete a Self Assessment tax return, as will be the case if you are self-employed or have other income, such as rental income, to declare, you simply include your dividend income on the dividend pages of your return.

If you do not need to complete a tax return, for example, because you are taxed under PAYE, if your taxable dividends are £10,000 or less, you can simply call the HMRC helpline on 0300 200 3300 to tell them about your dividend income. You can ask that they amend your tax code to collect the tax that you owe through PAYE. However, if you have taxable dividend income of more than £10,000, you will need to complete a Self Assessment tax return. You will need to register for Self Assessment no later than 5 October after the end of the tax year in which the need to first report the income arose.

Investing the proceeds from the sale of the family home and the IHT gifts from income exemption

For many people, there will come a time when it becomes sensible or necessary to sell the family home, either to downsize or because of a move to live with a relative or into care. This may result in funds being released, which may be considerable. Thoughts may turn to whether now is the time to pass wealth down to subsequent generations. However, this must be balanced against the needs of retaining sufficient funds to meet one's own lifestyle and also to meet any current and future care costs.

From an inheritance tax perspective, it is possible to take action to minimise any future tax bills. Subject to available exemptions, inheritance tax is payable to the extent that the deceased's estate exceeds their available nil rate bands. This may include the deceased's own nil rate band and, where the main

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residence or funds released from the sale of it are passed to a direct descendant, the residence nil rate band. Currently, these are set at £325,000 and £175,000 respectively. Where the deceased is widowed, their estate can also use any unused nil rate bands of their spouse or civil partner.

Rather than giving away the proceeds from the sale of the home, a decision may be taken instead to invest the proceeds. Increases in interest rates in recent years provide a greater opportunity to earn investment income than in the past. Where the income generated is not needed to maintain living costs, it can be given away. This can be advantageous from an inheritance tax perspective as an exemption exists for gifts out of income.

Gifts out of income exemption

An inheritance tax exemption is available for normal expenditure out of income. To benefit from the exemption, gifts must:
·form part of the transferor's normal expenditure;
·be made out of income; and
·leave the transferor with enough income to maintain their standard of living.

To utilise this exemption, income not needed to maintain the transferor's standard of living could instead be used to help a child with rent, pay a grandchild's school fees or pay part of a son or daughter's monthly mortgage payments. What is key here is that there is a regular pattern of spending, rather than ad hoc cash gifts, such that the payment of the rent or the school fees becomes part of the transferor's normal monthly expenditure. Where this is the case, the gifts are not treated as potentially exempt transfer (so there is no IHT charge if the transferor dies within seven years); rather they are exempt from inheritance tax and fall outside the transferor's estate.

Case study

Betty is a widow in her eighties. She feels that she can no longer manage on her own at home. Her son invites her to live with him and his wife and she moves in with them. Betty sells her home for £900,000. On her death, her estate will benefit from both her and her late husband's nil rate bands and residence nil rate bands (totalling £1 million). She has savings and investments of £80,000, which generate an income of £4,000 a year. Betty receives pensions of £30,000 a year which are more than sufficient to meet her living costs.
Betty invests the proceeds from the sale of her home, receiving interest of £54,000 a year. Her savings allowance of £500 is already used against the income from her existing investments. At 2024/25 rates, she will pay tax of £18,346 ((£16,270 @ 20%) + (£37,730 @ 40%)), leaving her with £35,654 after tax. As her estate is already close to her available nil rate bands, from a tax perspective, if she retains the income, and passes it on at death, it will suffer a further charge of 40%, reducing the amount available to her family.

However, if instead she decides to take advantage of the exemption for normal expenditure out of income and meet, say, rent of £1,200 a month for each of her two grandchildren, she can pass on £28,800 a year free of inheritance tax, allowing her family to benefit from more of her estate. Had she instead left the £28,800 in the bank passing it on at her death, it would have suffered IHT at 40%, reducing the amount available to her family by £11,520 a year to £17,280. Any lost interest on her savings income is more than outweighed by the IHT savings.

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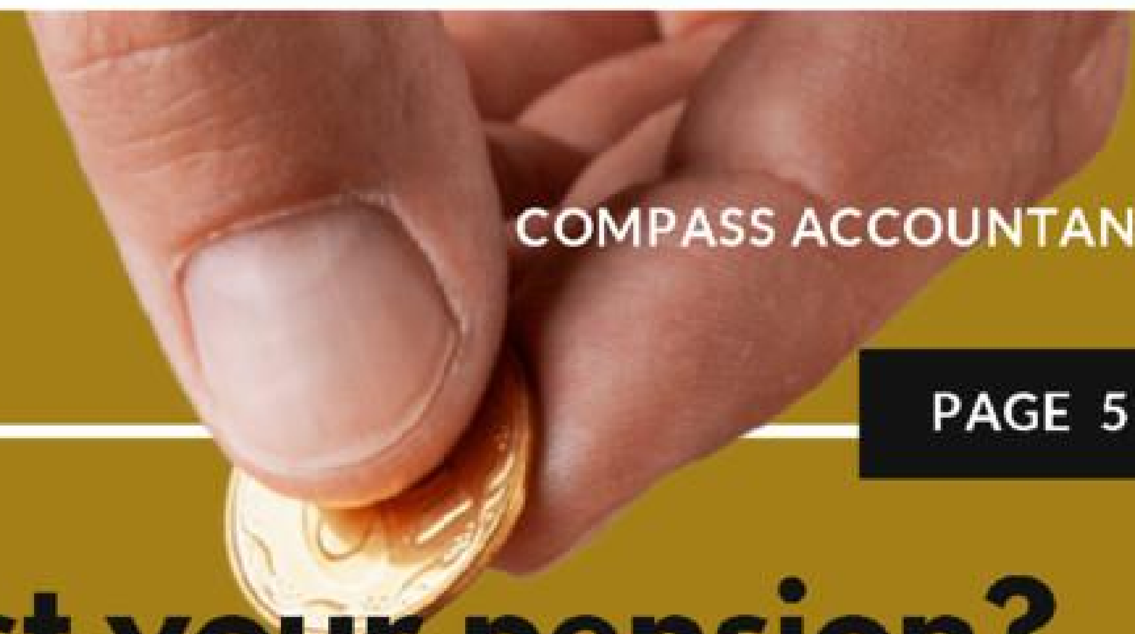

Will paying voluntary NICs boost your pension?

To qualify for a full state pension, you need 35 qualifying years. You can earn these through paying National Insurance contributions or being awarded National Insurance credits. If you will not have sufficient qualifying years for a full state pension when you reach state pension age, you can 'buy' additional qualifying years through the payment of voluntary contributions. Employed earners earn a qualifying year for each year that their earnings exceed the lower earnings limit for the year, which for 2024/25 is £6,396.

For 2023/24 and earlier tax years, self-employed earners earned a qualifying year through the payment of (or award of) Class 2 contributions where profits exceed the small profits threshold, set at £6,725 for 2023/24. For 2024/25 onwards the liability to pay Class 2 contributions is abolished and the self-employed build up a qualifying year through the payment of Class 4 contributions where profits exceed the lower profits limit (set at £12,570 for 2024/25). Self-employed earners whose profits fall below the lower profits limit but which are at least equal to the small profits threshold (of £6,725 for 2024/25) receive a National Insurance credit.

National Insurance credits are paid in various circumstances, for example, to those claiming child benefit for a child under the age of 12, regardless of whether they elect to actually receive the benefit. Credits are also awarded to those on certain benefits and to carers in receipt of carer's allowance.

Check your state pension record

Before paying voluntary National Insurance contributions, it is important to check your state pension record. You can do this by visiting the Gov.uk website at www.gov.uk/check-state-pension. You can also check your state pension record using the HMRC app.
If you do not already have the 35 qualifying years needed for a full state pension or will not do so by the time that you reach state pension age, you can check your National Insurance record by visiting the Gov.uk website at www.gov.uk/check-national-insurance-record. This will show you what years count as qualifying years and where there are gaps in your record.

Paying voluntary contributions

To qualify for a full state pension, you need 35 qualifying years when you reach state pension age, whereas if you have at least ten qualifying years, you will receive a reduced state pension.

If you have less than 35 qualifying years, paying voluntary contributions will increase the state pension that you receive as long as you have at least ten qualifying years when you reach state pension age. If making voluntary contributions will not give you the magic ten qualifying years at state pension age, paying the contributions is not worthwhile. Once you reach 35 qualifying years, there is no benefit in making further additional voluntary contributions. Remember to factor in any National Insurance credits that you will receive.

You can make voluntary contributions by paying Class 3 contributions or, where you have low profits from self-employment, by making voluntary Class 2 contributions.

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Class 3 contributions

Class 3 contributions can be paid voluntarily to plug gaps in your National Insurance record. These are weekly contributions, which for 2024/25 are payable at the rate of £17.45 per week. Contributions must normally be paid within six years from the end of the tax year to which they relate. Where the contribution is paid in the current or following tax year, it is payable at the rate for the year to which it applies; however, where it is paid later than this, it is payable at the highest rate prevailing in the period from the year for which they are being paid and the year in which the contributions are actually paid.

An extended time limit applies to fill gaps in the period running from 6 April 2006 to 5 April 2016. Contributions for this period can be made until 5 April 2025. Contributions paid in 2024/25 are payable at the 2022/23 rate of £15.85 per week. The deadline for paying contributions for 2016/17 and 2017/18 has also been extended to 5 April 2015.

Voluntary Class 2

Self-employed earners with profits below the small profits threshold can pay Class 2 contributions voluntarily. This remains the case from 2024/25 following the abolition of the liability to pay Class 2 contributions. Where this option is available, it is much cheaper than paying voluntary Class 3 contributions – for 2024/25, voluntary Class 2 contributions are payable at the rate of £3.45 per week. These are paid through the Self Assessment system. As with Class 3, voluntary Class 2 contributions can normally only be paid for the previous six years; however, an extended deadline of 5 April 2025 applies to contributions for the period from 2006/07 to 2015/16, for which contributions can be made in 2024/25 at the 2022/23 rate of £3.15 per week. The deadline for paying voluntary Class 2 contributions for 2016/17 and 2017/18 has similarly been extended.

Setting up as a sole trader

The way in which you operate your business determines the taxes that you pay and also your reporting obligations.
If you work for yourself and run your business on your own as an individual other than through a limited company, you are a sole trader. By contrast, if you operate your business through a personal company, even if you are the sole employee and director, the company has its own legal identity.
As a sole trader, you will pay income tax and Class 4 National Insurance contributions on your profits. For 2023/24 and earlier years, Class 2 National Insurance contributions were also payable.

Registering as a sole trader

Your registration obligations depend on whether you are already registered for Self Assessment, which may be the case, for example, if you have rental income to report to HMRC, and where you are not already registered, the level of your gross trading income.

If you are not already registered for Self Assessment and have trading income for a tax year of more than £1,000, you will need to register for Self Assessment by 5 October following the end of the tax year (so by 5 October 2025 if you

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start self-employment in 2024/25 and have gross trading income of more than £1,000). You can register online on the Gov.uk website. If you are already registered for Self Assessment for another reason, you will need to register as a sole trader for Self Assessment as this will register you for Class 4 National Insurance contributions. You can also register if you have low profits but want to pay voluntary Class 2 National Insurance contributions.

Gross trading income of £1,000 or less

If your gross trading income (i.e. before the deduction of expenses) is £1,000 or less, you can take advantage of the trading allowance. This allows you to enjoy your profits tax-free and without any need to tell HMRC about them. You can still benefit from the trading allowance if your gross trading income is more than £1,000 by deducting the £1,000 allowance rather than your actual expenses. This will be worthwhile where your expenses are less than the allowance. However, in this instance, you will need to be registered as a sole trader for Self Assessment.

If your income is £1,000 or less, but you have made a loss, it is worth registering and filing a tax return so that you can claim relief for the loss.

Records

You will need to keep records of your business income and expenses. You can find guidance on the records that you will need to keep by visiting the Gov.uk website at www.gov.uk/self-employed-records.

Income tax and National Insurance

If you are self-employed, you will pay income tax on your profits. From 2024/25 onwards, the profits that are taxed for the tax year are those for the tax year (i.e. 6 April to the following 5 April) regardless of the date to which you prepare accounts. An accounting date of 31 March to 5 April inclusive is treated as corresponding to the tax year.

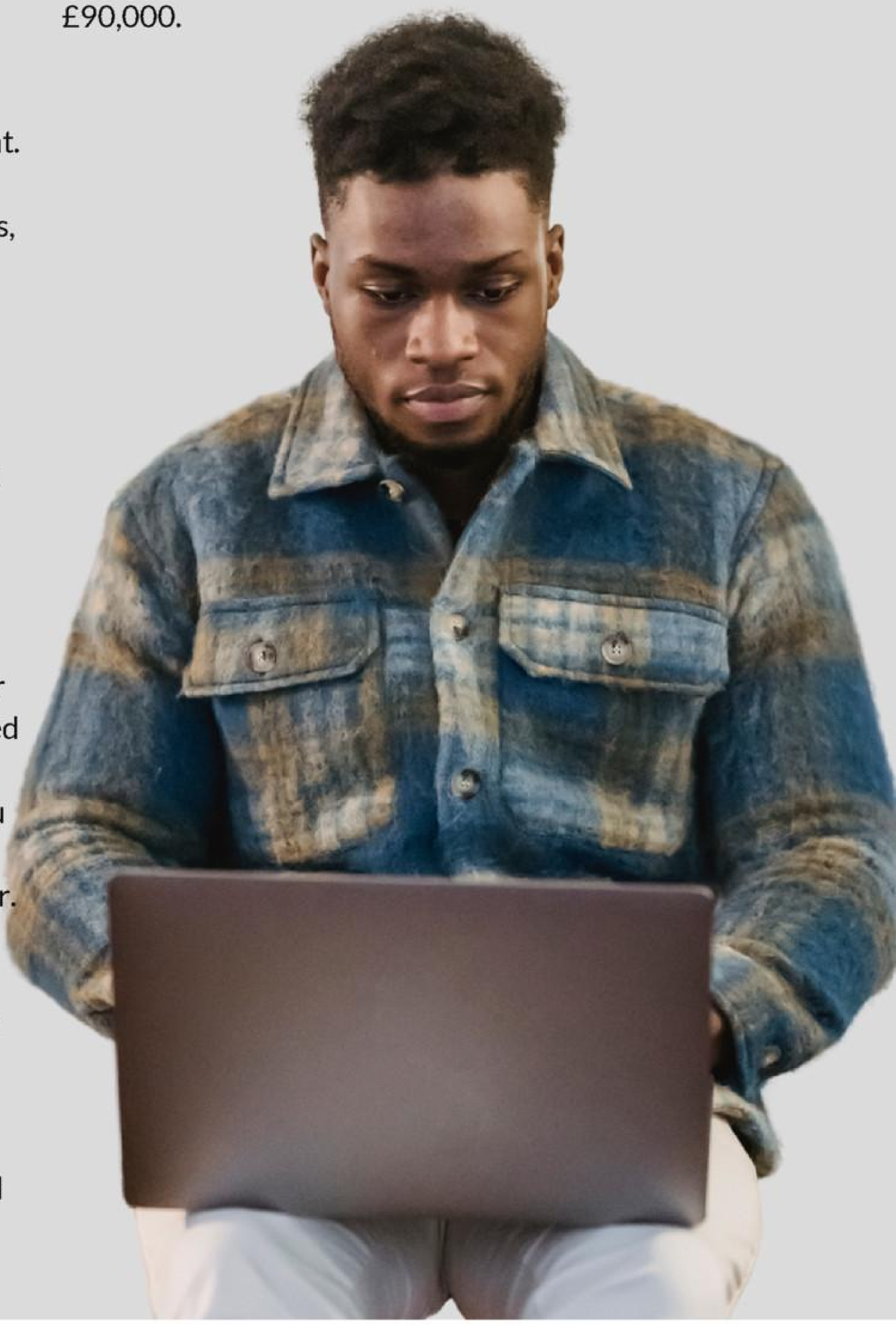
Your income tax liability is calculated by reference to your total income for the tax year, including your profits from self-employment. You will need to file a tax return by 31 January after the end of the tax year (so by 31 January 2026 for 2024/25). You will also need to pay Class 4 National Insurance on your profits if they exceed £12,570.

For 2024/25, this is payable at 6% on profits between £12,570 and £50,270 and at 2% on profits in excess of £50,270.

Your tax and Class 4 liability must be paid in full by 31 January after the end of the tax year. Where your total tax and Class 4 liability for a tax year is £1,000 or more, you will need to make payments on account for the following tax year on 31 January in the tax year and 31 July after the tax year, unless 80% of your tax is collected at source, for example through PAYE. Each payment is 50% of the previous year's liability.

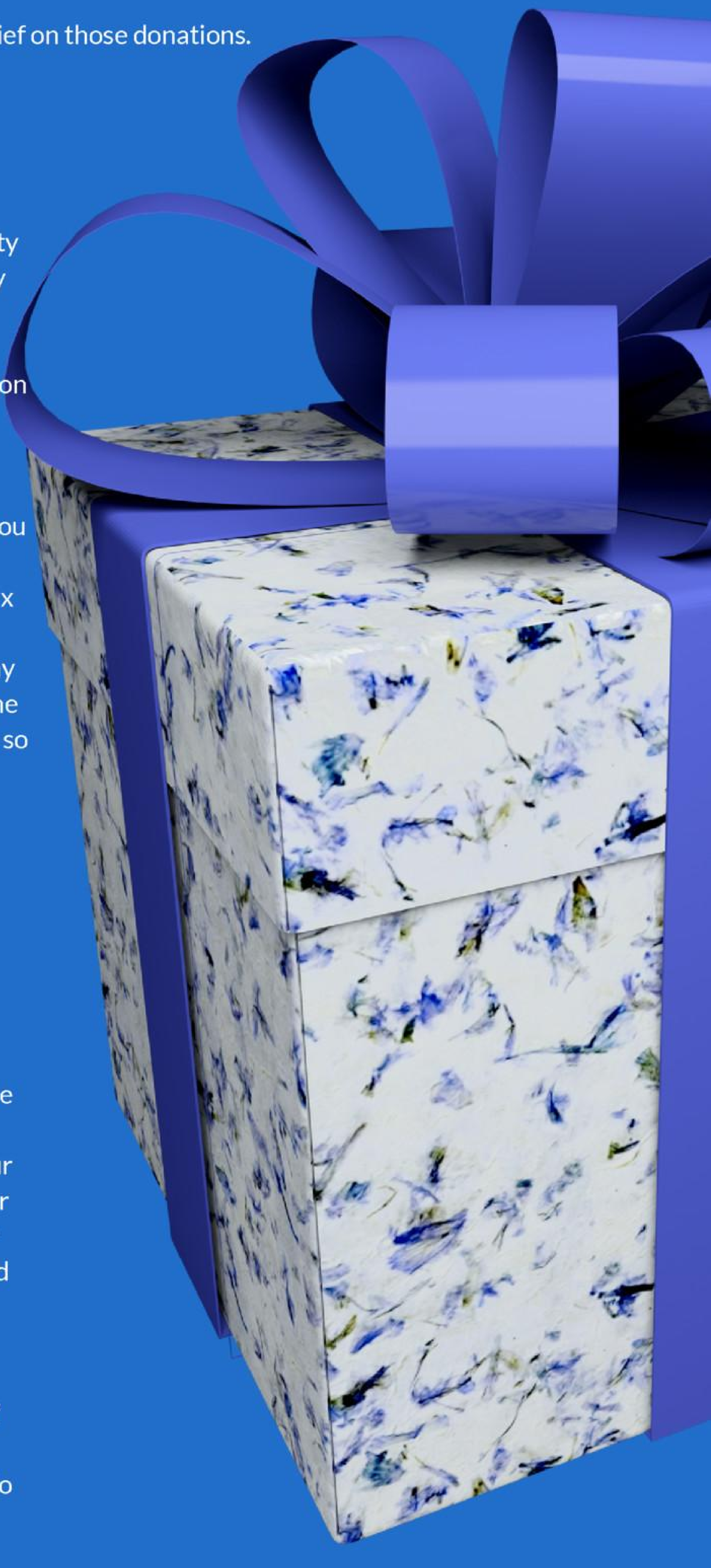
VAT

You will also need to register for VAT if your VAT taxable turnover reaches the VAT registration threshold of £90,000.



Tax relief on charitable donations

If you make donations to charity, you can benefit from tax relief on those donations. This can be achieved in various ways.



Gift aid

If you are a UK taxpayer, you can claim Gift Aid on donations that you make to charity. Where this is the case, the amount donated is treated as made net of basic rate tax and the charity reclaims basic rate tax on the donation. This means that every £1 that you donate is worth £1.25 to the charity. To donate through Gift Aid, you must make a Gift Aid declaration. The option to make a Gift Aid declaration will usually be included on charitable giving pages.

Alternatively, the charity may give you a form to sign.
The tax reclaimed by the charity is funded from the tax that you have paid. It is important therefore that you only make a declaration where you have paid sufficient tax to cover the tax that the charity will claim back. If this is not the case, or you make a Gift Aid declaration but are not a taxpayer, HMRC may recover the tax claimed by the charity from you. If your income falls, it is prudent to review any ongoing Gift Aid declarations so you do not get caught out.

If you are a higher or additional rate taxpayer, you can claim further relief equal to the difference between tax at your marginal rate and tax at the basic rate on your donation. This can be done in your tax return.

Payroll giving

If you are an employee and your employer operates a payroll giving scheme, you can make charitable donations through the payroll. Your employer will deduct your donations from your gross pay before tax. This automatically provides relief at your marginal rate, which means you do not need to claim higher or additional rate relief through your tax return. Your employer will pass the donations to the payroll agency that they use and the agency will pass them on to your chosen charity.

Making a gift in your Will

Donations to charity are exempt from inheritance tax. Also, if you leave at least 10% of your estate to charity, the rate at which your estate pays inheritance tax is reduced from 40% to 36%.

TAX DIARY

JULY 2024

- 1 July 2024 – Due date for corporation tax due for the year ended 30 September 2023.
- 6 July 2024 – Complete and submit forms P11D return of benefits and expenses and P11D(b) return of Class 1A NICs.
- 19 July 2024 – Pay Class 1A NICs (by the 22 July 2024 if paid electronically).
- 19 July 2024 – PAYE and NIC deductions due for month ended 5 July 2024. (If you pay your tax electronically the due date is 22 July 2024).
- 19 July 2024 – Filing deadline for the CIS300 monthly return for the month ended 5 July 2024.
- 19 July 2024 – CIS tax deducted for the month ended 5 July 2024 is payable by today.

For further information on any of the stories in this month's newsletter, or for any other matter that Compass Accountants can assist you with, please contact us on 01329 844145 or contact@compassaccountants.co.uk

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