TAXANGLES from COMPASS ACCOUNTANTS

A newsletter for proactive planning...

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What the hike in the dividend tax rate means for personal and family companies

In her tax-raising Budget on 26 November 2025, the Chancellor announced that the dividend ordinary rate and the dividend upper rate are to rise by two percentage points from 6 April 2026. This will affect director/shareholders in personal and family companies who extract profits in the form of dividends.

How dividends are taxed

Dividends have their own tax rates, which are lower than the standard income tax rates. Dividend income which is not sheltered by the personal allowance or the dividend allowance is treated as the top slice of income. It is taxed at the dividend ordinary rate where it falls in the basic rate band, at the dividend upper rate where it falls in the higher rate band and at the dividend additional rate where it falls in the additional rate band. For 2025/26, the dividend ordinary rate is 8.75%, the dividend upper rate is 33.75% and the dividend additional rate is 39.35%.

From 6 April 2026, the dividend ordinary rate rises to 10.75% and the dividend upper rate rises to 35.75%. There is no change in the dividend additional rate which remains at 39.35%. All individuals are entitled to a dividend allowance, which is £500 for 2025/26 and remains at this level for 2026/27. The dividend allowance acts as a nil rate band; dividends sheltered by the allowance are tax-free. However, it uses up part of the band in which it falls.

Impact of the rise

Where profits are extracted as dividends and the shareholder is a basic or higher rate taxpayer, they will pay an additional £20 in tax on every £1,000 of dividends paid in 2026/27 as compared to 2025/26. A shareholder taking £50,000 of dividends a year will pay an additional £1,000 in tax. Additional rate taxpayers are unaffected by the change.

Beating the rise

Where a personal or family company has retained profits, consideration should be given to paying dividends before 6 April 2026 if the tax hit will be lower than if the dividend is paid on or after that date. However, if dividends have already been paid to use up the basic rate band, there is no point paying a dividend if it would be taxed at the dividend upper rate if paid before 6 April 2026 and at the dividend ordinary rate if paid on or after that date; 10.75% is lower than 33.75%. In a family company scenario with an alphabet share structure, to minimise the total tax paid on profits extracted as dividends, make sure shareholders' dividend allowances and basic rate bands are used up before paying dividends taxable at the higher rates. Consideration could also be given to extracting profits in other ways, such as employer pension contributions or tax-free benefits in kind.

Changes to ISAs and the savings tax rate on the horizon

During the Chancellor's Budget speech, savers received the unwelcome news that the rate of tax on savings income is to increase and the cash ISA limit to fall. Both changes will take effect from 6 April 2027.

Taxation of savings income

The taxation of savings income is quite complex as a number of factors come into play.
The first complication is the personal savings allowance, which is available to some taxpayers but not all. Basic rate taxpayers have a personal savings allowance of £1,000, whereas for higher rate taxpayers, the allowance is only £500. Additional rate taxpayers do not receive a personal savings allowance. Where available, the personal savings allowance is in addition to the personal allowance.
The second complication is the savings starting rate band. The savings starting rate of tax of 0% applies to savings income within the savings starting rate band. This is set at £5,000. However, if the taxpayer has non-savings income in excess of their personal allowance, the savings starting rate band is reduced pound for pound. Individuals with taxable non-savings income of £5,000 and above do not benefit from the savings starting rate band.

Where an individual has savings income that is not sheltered by the personal allowance or the personal savings allowance and which does not benefit from the savings starting rate, it is currently taxed at the normal income tax rates, i.e. 20% where it falls in the basic rate band, 40% where it falls within the higher rate band and at 45% where it falls in the additional rate band.

However, this is to change. From 6 April 2027, savings income will be taxed at the relevant savings tax rate. The rates will be two percentage points higher than the standard income tax rates. Consequently, for 2027/28, savings income will be taxed at 22% where it falls in the basic rate band, at 42% where it falls in the higher rate band and at 47% where it falls in the additional rate band.

In a further twist, the income tax ordering rules are also changed from 6 April 2027, moving away from the principle that reliefs and allowances are allocated so as to give the lowest tax bill. From that date, the personal allowance will be allocated first against employment income, trading and pension income, rather than against savings and property income which are taxable at a higher rate.

Cash ISAs

Savers are advised to make use of their cash ISA allowance to keep interest on savings tax-free. With the rise in the savings tax rates from 6 April 2027, using the cash ISA allowance will generate greater tax savings.

However, for those who prefer to keep their savings in cash rather than investing in stocks and shares, there is more bad news. From 6 April 2027, savers under 65 will only be able to invest £12,000 a year in a cash ISA; the ISA limit is to remain at £20,000, but for under 65s using their full allowance, at least £8,000 of that must be invested in a stocks and shares ISA.
However, savers aged 65 and over can invest the full £20,000 in a cash ISA.
Existing ISAs are unaffected by the change.

The £100k Cliff Edge

All things being equal, receiving a pay rise which takes your income over £100,000 would be seen as a cause for celebration. However, all things are not equal, and as press reports attest, some people would rather turn down a promotion or cut their hours than take their earnings over £100,000.

We explain why this is.

Reason 1 – loss of the personal allowance
Individuals have a personal allowance of £12,570, allowing them to earn £12,570 before they pay tax. However, once their income exceeds the personal allowance income limit, their personal allowance starts to reduce. The personal allowance income limit is £100,000, unchanged since its introduction.

Where adjusted net income exceeds £100,000, the personal allowance is reduced by £1 for every £2 by which adjusted net income exceeds £100,000. A person with adjusted net income of £110,000 will only receive a personal allowance of £7,570 (£12,570 – ((£110,000 – £100,000)/2)).

Once a person's adjusted net income reaches £125,140, their personal allowance is lost entirely so that they pay tax from the first pound that they earn.

The combined effect of the loss of the personal allowance and paying tax at the higher rate of 40% means that the marginal rate of tax between £100,000 and £125,140 is 60%. Add to that National Insurance of 2% and possibly student loan deductions of 9% or 15% and maybe pension contributions, the taxpayer does not actually keep much of the money that they earn between £100,000 and £125,140. Easy to see why some may deem the extra hours or workload as not being worthwhile.

Once income reaches £125,140, the marginal tax rate drops to 45% (the additional rate).

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Reason 2 – loss of free childcare and tax-free top-up

Working parents may be able to receive free childcare for children from the age of nine months to four years for 30 hours a week for 38 weeks of the year. This is valuable. However, it is only available as long as neither partner has adjusted net income of more than £100,000. Thus, once income reaches £100,000, free childcare is lost.

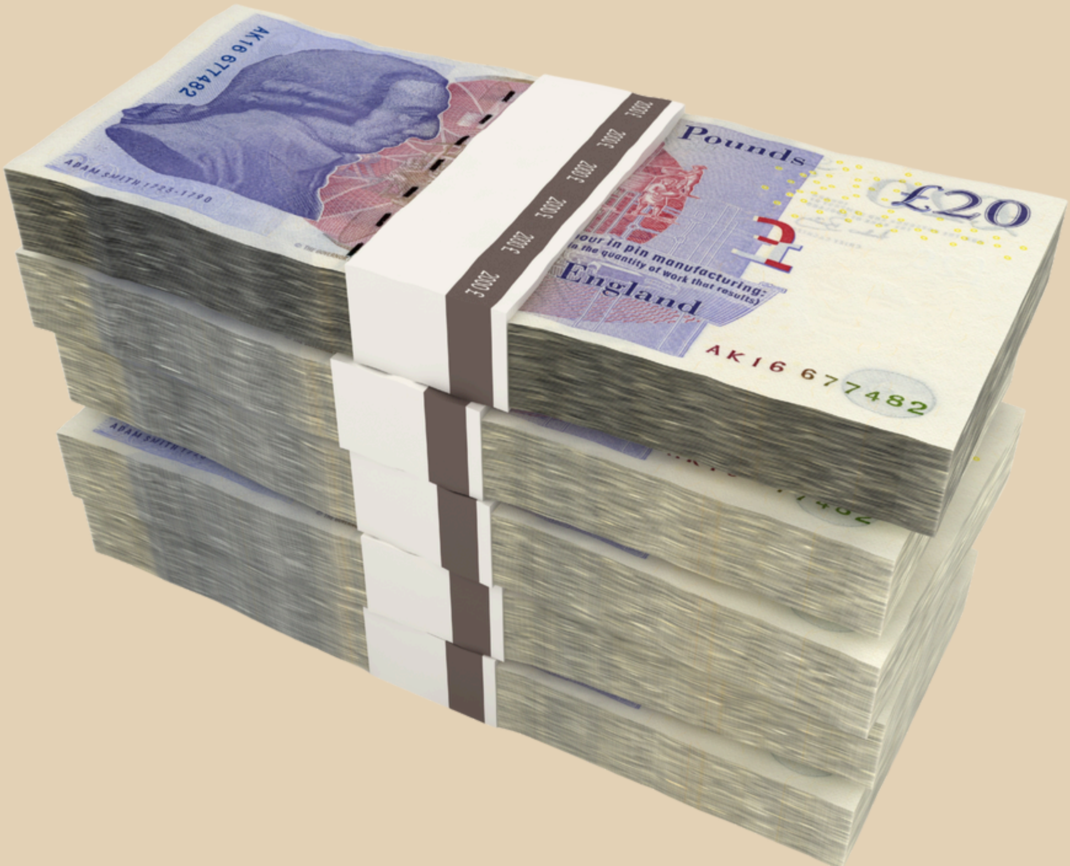
Working parents may also be able to benefit from the Government's tax-free childcare scheme which provides up to £2,000 a year towards childcare costs (and up to £4,000 a year if the child is disabled). Under the scheme, the Government provides a £2 tax-free top-up for every £8 that the parents deposit in a dedicated account, up to the £2,000/£4,000 maximum top-up. However, as with free childcare, tax-free childcare is not available where either partner earns £100,000 or more.

For parents with young children, earning £100,000 or more will significantly increase their childcare costs.

Beating the system

There is a way to have the benefit of earning more than £100,000 a year and keeping your personal allowance, free childcare and the tax-free top-up. This is by making personal pension contributions to reduce your adjusted net income to below £100,000. You will still get the benefit of the money eventually, while retaining the personal allowance and childcare benefits.

The more altruistic can make charitable donations to reduce adjusted net income to below £100,000, which works in the same way.



Benefit in kind changes

As far as benefits in kind are concerned, there were both winners and losers in the Budget.

Winner – easement for plug-in hybrid electric vehicles
Under the company car tax rules, the taxable amount depends predominantly on the list price of a car and its CO2 emissions. From 1 January 2025, new European Union and United Nations emissions standards were introduced which found the CO2 emissions for plug-in hybrid electric vehicles (PHEVs) to be higher than previously thought. Normally, an increase in the CO2 emissions figure would mean an increase in the taxable amount.

However, an easement will mean that, for a limited period, the amount charged to tax under the benefit in kind rules will be determined by reference to a nominal CO2 emission figure of 1g/km. Where a car's CO2 emissions are between 1 and 50g/km, the appropriate percentage depends on the car's electric range.

To be eligible for the easement the following conditions must be met:
·the vehicle was first registered on or after 1 January 2025;
·its CO2 emissions figure is 51g/km or above;
·it was registered under an emissions standard other than Euro 6d-ISC-FCM or Euro 6e; and
·the car's electric range is at least one mile.
The easement will apply retrospectively from 1 January 2025.

Anyone accessing an eligible PHEV company car before 6 April 2028 will be able to benefit from the easement until the arrangements are varied or renewed or, if earlier, 5 April 2031.

Winner 2 – expansion of workplace benefits relief
Currently, reimbursed expenses are only tax-free if the employee would be entitled to a tax deduction had they met the cost themselves.
However, from 6 April 2026, employers who reimburse the costs of eye tests, flu vaccines and home working equipment will be able to do so tax-free.

Winner 3 – delayed start to ECOS changes
Legislation to bring certain cars made available to employees under an employee car ownership scheme (ECOS) within the tax charge for company cars had been due to come into effect on 6 April 2026. The changes will not be introduced until 6 April 2030.

Losers – removal of relief for homeworking expenses
An administrative easement that allowed employees to claim a flat rate deduction of £6 per week for the additional costs of working from home is being removed from 6 April 2026. This is worth £124.80 to a higher rate taxpayer and £62.40 to a basic rate taxpayer.
Employers will still be able to make a tax-free payment of £6 per week for additional homeworking costs, and employees will still be able to claim a deduction for the actual extra cost (although this will involve more work).

New 40% FYA and reduction in WDAs

A new 40% first-year allowance (FYA) is to be introduced from April 2026. It will apply to main rate expenditure on new assets, excluding cars. Both companies and unincorporated business will be able to benefit. The new allowance will be available from 1 January2026 for corporation tax and from 6 January 2026 for income tax.

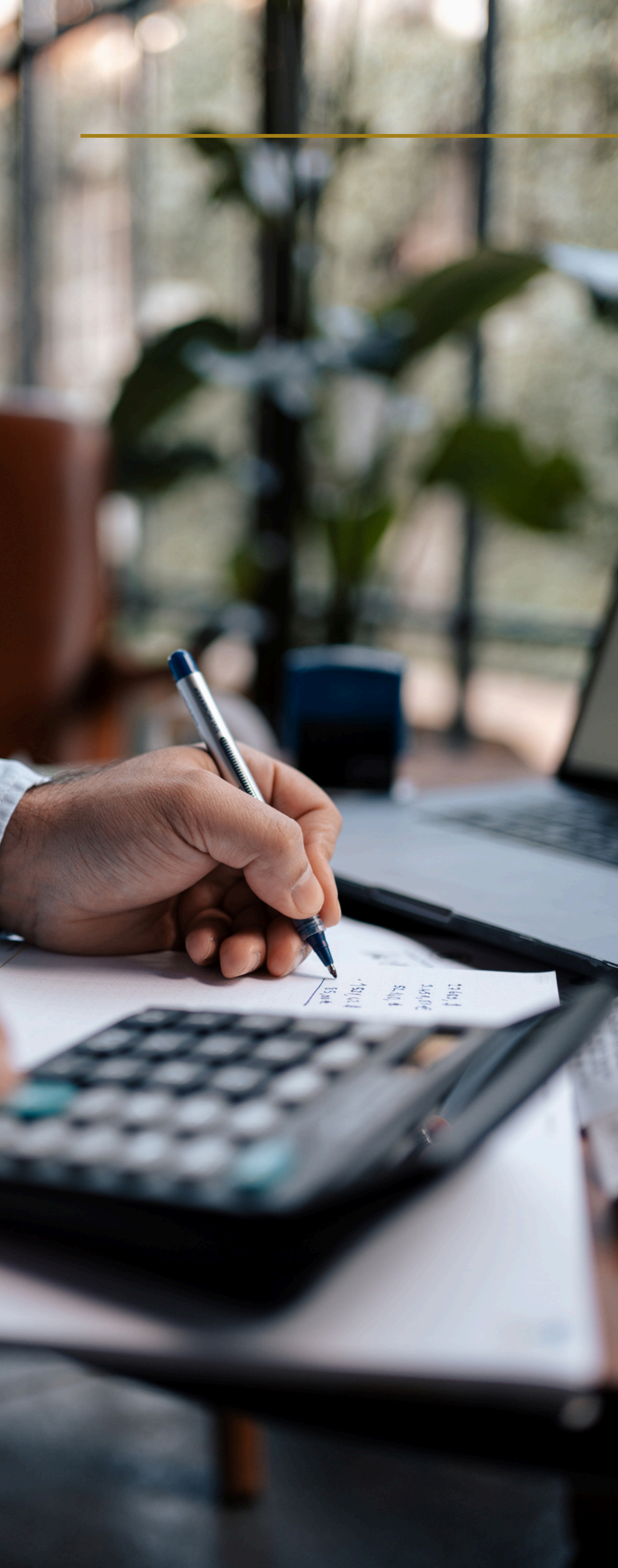
From 1 April 2026 for corporation tax and 6 April 2026 for income tax the main rate of writing down allowance (WDA) is reduced from 18% to 14%. A hybrid rate will apply where the chargeable period spans the date of the rate change.

Utilising the new allowance

Companies have a range of options for relieving main rate expenditure in the year in which it is incurred. The annual investment allowance (AIA) provides immediate relief for qualifying expenditure on new and used assets and applies to both qualifying main rate and special rate expenditure. However, it is subject to an annual limit of £1 million.

Companies can also take advantage of full expensing to deduct qualifying expenditure on new main rate assets. Full expensing is available without limit.
Like full expensing, the new 40% FYA applies to qualifying expenditure on new main rate assets. As full expensing can be used without limit, the 40% FYA will only be of use to a company where the expenditure is outside full expensing. This will be the case, for example, for assets used for leasing.
The new 40% FYA is also available to unincorporated businesses.

The cash basis is the default basis of accounts preparation for traders. It allows capital expenditure to be deducted when computing profits unless the expenditure is of a type for which such a deduction is specifically prohibited. Cars fall into this category. Where a deduction is not allowed, capital allowances can be claimed (unless simplified expenses have been used to claim relief for mileage costs).



Capital allowances are of more relevance where the trader uses the accruals basis. Unincorporated businesses can access the AIA, but do not benefit from full expensing. The new 40% FYA will be useful to them where the AIA has been used up, and also where expenditure qualifies for the new 40% FYA but not the AIA.

Where the 40% FYA is claimed, the balance of the expenditure is relieved by main rate WDAs.

Reduction in the WDA

The rate of WDA on main rate expenditure drops from 18% to 14% from 1 or 6 April 2026. This will lengthen the period over which relief is given for expenditure on main rate assets. It will have an impact where the business opted not to claim the AIA or full expensing on qualifying main rate expenditure or, from January2026, where the new 40% FYA is claimed.

Cars, other than new zero emission cars, are not eligible for any of the FYAs. Low emission cars are allocated to the main pool. The reduction in the main rate WDA will mean that it will take businesses longer to fully relieve the cost of main rate cars than is currently the case.

Where the chargeable period spans the date on which the rate changes, a hybrid rate will apply. This will reflect the number of days in the chargeable period before the rate change and the number of days on or after the rate change. For example, where a company prepares accounts to 30 June, the hybrid rate for the period to 30 June 2026 is 17%.

TAX DIARY

JANUARY

1st January - For companies with March year ends Corporation Tax is due
7th January - Electronic Payments of VAT must have reached HMRC
7th January - Electronic Submission of VAT returns deadline
19th January - December's PAYE and Class 1 NIC Postal Payments must reach HMRC
22nd January - December's PAYE and Class 1 NIC Electronic Payments must be cleared to HMRC
31st January - Deadline for sending in your Self-Assessment Tax Return Online
31st January - Self Assessment 1st Payment on Account Deadline
31st January - Self Assessment Balancing Payment Deadline
31st January - For companies with January year ends Corporation Tax Returns are due

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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