Dividends and tax codes

Synopsis: HMRC have started to code out the extra dividend tax due in 2016/17.

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Now is the time when HMRC issues PAYE codes for the forthcoming tax year. These are generally based on the most recently received self assessment return: for example, the 2014/15 return will provide data on which HMRC will attempt to set 2016/17 codes.

Reports are coming in that HMRC is allowing for the new dividend tax in the codes now being sent out. This has a number of consequences...

- Basic rate taxpayers who are within self assessment and had dividend income of over £5,000 in 2014/15 could find themselves with a line in their coding which says 'dividend tax'. The accompanying note says 'This is to collect the basic rate of tax due on your dividend income,' although it is unlikely that many recipients will realise that 'basic rate' in this instance means 7.5%.

- The code adjustment figure is calculated to produce the appropriate amount of tax by reducing personal and other allowances and will not look anything like the actual dividend income received. For example, a basic rate taxpaying company director who had £25,000 of dividend income in 2014/15 will in 2016/17 be presumed to have a dividend tax liability of £1,500 ([£25,000 - £5,000] @ 7.5%), assuming his personal allowance is fully covered with other income. To collect this HMRC would apply a dividend tax adjustment of £7,500 as this would yield tax of £1,500 (£7,500 @ 20%). For a higher rate taxpayer, the corresponding tax bill would be £6,500 ([£25,000 - £5,000] @ 32.5%) and the dividend tax adjustment £16,250 – probably enough to produce a K code: that is a negative tax code.

- Basic rate taxpayers outside the self assessment system slip through the net for now, as HMRC will not have details of their 2014/15 dividend income. However, they will be caught for 2018/19 because of the need to complete a self assessment return for 2016/17 if they have a dividend tax liability. In those circumstances the need to file a return and the 2016/17 balance payment due on 31 January 2018 could both come as unwelcome surprises.

- The taxpayer can appeal against the coding using a form, which amounts almost to a mini-tax return based on expected 2016/17 income.

Tax returns allow taxpayers who put an X in box to request that HMRC does not collect tax due for the current tax year on dividends and other sundry income via a 'coding out' – the default is the HMRC will grab the amount due
as soon as it can. However, some accountants are reporting HMRC have ignored the all-important X, while others are now suggesting HMRC will want confirmation of no coding out each year, outside of the tax return.

Comment

There is a case for saying that PAYE codes are not worth arguing about, especially given HMRC's miserable response times. However, while the numbers should all balance in the end, some people will want to defer as much tax as possible for as long as possible, while for others a monthly tax collection, even in advance, is a sensible way of budgeting.