What are the new rules on savings from 6 April 2016?

- A tax free ‘personal savings allowance’ of £1,000 (or £500 for higher rate taxpayers) is introduced for savings income (including things like credit union, NS&I and PPI compensation interest) – on top of the 0% starting rate (£5,000).
- According to the Government, this will take 95% of taxpayers out of savings tax altogether. Because of this, from 2016/17, banks and building societies will no longer take 20% tax from the interest earned on savings. This removes the need for those with no tax liability on their bank or building society interest to complete forms R85. (It also means that you no longer need to complete form R40 to claim a refund of any tax overpaid.)
- On savings income that exceeds the new allowance, basic rate taxpayers will pay tax at 20% and higher rate taxpayers will pay tax at 40%.

Please note that we do not cover the position of additional rate taxpayers (those with income over £150,000 a year) in this factsheet.

So, will I get my savings income tax free?

First things first: non-savings income (things like employment or pension income) is always taxed before savings income.
- If, when added to your non-savings income, your savings income comes within your annual personal allowance (£11,000 in 2016/17), then it will be tax free.
- If, when added to your non-savings income, your savings income falls over the personal allowance but under £16,000, there is a special 0% ‘starting rate for savings band’ that applies (to savings income only), meaning it will also be tax free.

Things like Blind Person’s Allowance may increase the £11,000 and £16,000 figures. In any other case, you will usually only pay income tax on the savings income you receive if it exceeds the new personal savings allowance.

Interest from ISAs is not counted towards the personal savings allowance because it’s already tax free.

How much will my personal savings allowance be?

The amount of your personal savings allowance depends on your ‘adjusted net income’. Adjusted net income is your total taxable income (including savings income and dividends) less certain tax reliefs, for example Gift Aid donations and pension contributions.

<table>
<thead>
<tr>
<th>Adjusted net income</th>
<th>Personal savings allowance</th>
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<tbody>
<tr>
<td>Up to £43,000</td>
<td>£1,000</td>
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<tr>
<td>Between £43,001 and £150,000</td>
<td>£500</td>
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As you can see, £1 of additional income can cost you £500 of allowance!

Basic example—personal savings allowance

Henry earns £25,000, and has savings income of £600. He has to pay tax at 20% on £14,000 of his earnings (the amount left once his £11,000 personal allowance is used) however his savings income is tax free due to his new £1,000 allowance. If his savings income was £1,250 instead of £600, he would have 20% tax to pay on £250. As tax is no longer collected at source on interest, he will have to pay this £50 tax to HMRC another way (see later).
Important note
Income that is within your personal savings allowance is still counted as taxable income – it is just taxable at 0%. This means that it still counts towards your basic (20%) or higher rate (40%) limits (£43,000 and £150,000 respectively) and may therefore affect the level of tax you pay on savings income that exceeds your personal savings allowance and the rate of tax you pay on dividend income. It can also affect the level of personal savings allowance available in the first place.

Example—how personal savings allowance income counts towards basic rate band limit
Magda has earnings of £42,000 and savings income of £1,750. She has to pay tax at 20% on £31,000 of her earnings (the amount left once her £11,000 personal allowance is used). After her earnings are taken into consideration, she has £1,000 left in her basic rate band.

To work out how much her personal savings allowance is and how much tax she has to pay on her savings income, she needs to first work out her ‘adjusted net income’. Her adjusted net income is her total income less any reliefs. She has not made any pension contributions or any Gift Aid donations, so her adjusted net income is £43,750 – she must include all her savings income. As her adjusted net income is more than £43,000, her personal savings allowance is £500.

Although £500 of her savings income is tax free due to the personal savings allowance, it uses up some of the capacity left in her basic rate band, meaning only £500 of her remaining savings income (of £1,250) can be taxed at 20% – tax of £100. This means that she has to pay 40% on £750 – tax of £300. As tax is no longer collected at source on interest, she has to pay this total of £400 tax (£100 + £300) to HMRC another way (see later).

This factsheet is intended to provide general information only and does not constitute advice. We have done our best to ensure that the information in this factsheet is up to date as of May 2016. You can read our full disclaimer on our website: www.litrg.org.uk/legal.
What are the new rules on dividends?

**Dividends**
- You no longer get a 10% tax credit attached to your dividends. The amount you get is the taxable amount.
- Instead, there is a new tax-free dividend allowance which means that you do not have to pay tax on the first £5,000 of your dividend income.
- On dividend income that exceeds the new allowance, basic rate taxpayers will pay tax at 7.5% and higher rate taxpayers will pay tax at 32.5%. (When looking at which rate band may apply to your dividends, you should note that non-savings income and savings income is always taxed before dividend income.)

Like the personal savings allowance, income that is covered by the dividend allowance still counts as taxable income and therefore still uses up the basic rate band or the higher rate band of tax. This can affect the rate of tax payable on dividend income that exceeds the allowance. It can also affect the level of the personal savings allowance available.

**Example — dividend allowance and affect on rate bands**

Serenna has earnings of £35,000 and receives dividends of £10,000. She has to pay tax at 20% on £24,000 of her earnings (the amount left once her £11,000 personal allowance is used). She does not have to pay tax on £5,000 of her dividend income because of her dividend allowance, however the dividends that fall within the dividend allowance still use up her basic rate band, so she has to pay tax at 7.5% on £3,000 of her remaining dividend income (£225) and at 32.5% on £2,000 on the rest (£650). Serenna has to pay £875 of tax on her dividend income and needs to contact HMRC to pay it (see below).

**Could I be worse off under the new dividend rules?**

Basic rate taxpayers with dividend income above the £5,000 allowance could be worse off. This is because dividends above the £5,000 allowance but still in the basic rate tax band (up to £43,000 for 2016/17) will be charged at 7.5%. This represents a tax rise — under the old system basic rate taxpayers had no further tax liability on dividends received.

Please note that if you have dividend income of more than £5,000 but your total income is less than £11,000 your income is covered by your personal allowance anyway. If your dividend income is received through an ISA, it will remain tax free.

**Example — dividend allowance for basic rate taxpayers**

Liz has a pension of £20,000 and receives dividends of £12,000. She has to pay tax at 20% on £9,000 of her pension (the amount left once her £11,000 personal allowance is used). The £5,000 dividend allowance would apply to some of her dividends leaving the remaining £7,000 to be taxed at 7.5%. Liz would have tax of £525 to pay on the dividends and would need to contact HMRC to sort it out (see below). Had they been received in the 2015/16 tax year, there would have been no more tax for Liz to pay on her dividends.

**What if I need to pay tax to HMRC?**

If you normally complete a tax return, you must include the amount of savings or dividend income in the relevant section. If you do not normally complete a tax return, you need to tell HMRC about the taxable income. The plan is that banks and building societies will give HMRC information about any savings income directly (this doesn’t apply for dividend income), but to be on the safe side, we recommend you tell HMRC separately also.

Continued...
What if I need to pay tax to HMRC? (continued)

The HMRC Income Tax Helpline is 0300 200 3300 (textphone 0300 200 3319). It is open from 8am to 8pm, Monday to Friday, and from 8am to 4pm, Saturday. Have your National Insurance number with you when you phone. It is also a good idea to make a note of the date and time of your call, as well as the name of the adviser that you speak to and what is said.

If they can, HMRC will take the extra tax you owe from your wages or pension by changing your Pay As You Earn (PAYE) code. You should then get a PAYE Coding Notice in the post showing the change, which you should check carefully. Otherwise they may send you a bill at the end of the tax year or ask you to fill in a tax return.

Can I get both the personal savings allowance and dividend allowance?

If you have savings income and dividend income, you may potentially make use of both the personal savings allowance and the dividend allowance.

**Example – personal savings allowance and dividend allowance together**

A) Finlay has employment income of £18,000, savings income of £800 and dividend income of £4,000. He has to pay tax at 20% on £7,000 of his employment income (the amount left once his £11,000 personal allowance is used). His adjusted net income is £22,800, so his personal savings allowance is £1,000. This means he does not have to pay any tax on his savings income. He does not have to pay any tax on his dividend income either, thanks to his dividend allowance of £5,000.

B) If Finlay has employment income of £38,000, savings income of £800 and dividend income of £5,000, he has to pay tax at 20% on £27,000 of his employment income (the amount left once his £11,000 personal allowance is used). His adjusted net income is £43,800, so his personal savings allowance is £500. £500 of his savings income is tax free and he has to pay tax at 20% on the remaining £300 (since it falls within the basic rate band). He does not have to pay any tax on his dividend income, however, as it is still covered by his dividend allowance of £5,000.

D) Let’s consider one final scenario – if Finlay’s employment income is £15,000 instead (with £800 of savings and £6,000 of dividends as before) then this time, his savings income of £800 is covered by the special 0% starting rate for savings band. His personal savings allowance is wasted – he cannot use it against his dividends. £5,000 of them will be tax free due to the dividend allowance and £1,000 of them will be taxed at 7.5% (falling as they do within the basic rate band).

C) Carrying on the example above, if Finlay’s dividend income is £6,000 instead, he has to pay tax at 32.5% on £1,000 of his dividends, since this falls within the higher rate band – the £5,000 of dividends covered by the dividend allowance and the savings income covered by the personal savings allowance still use up the basic rate band.

I give to charity under Gift Aid, is there anything I should note?

You may be used to relying on the tax paid on your savings and the tax credit on your dividends to cover your Gift Aid donations. If you will no longer pay tax on them due to the new rules, but continue to donate to charity under a Gift Aid declaration, the charity will still assume the donation has come from someone paying tax and claim an amount back from HMRC. You might then be faced with a bill from HMRC for the amount they have claimed.

You may wish to cancel your Gift Aid declaration. You can still donate to charity, but the charity cannot claim Gift Aid relief from HMRC. You should also bear this in mind when visiting attractions which invite you to Gift Aid your ticket entry.

More information?

There is some basic information about the new rules on [www.gov.uk](http://www.gov.uk) under ‘Tax on savings interest’ and ‘Tax on dividends’.

Our website is full of detailed tax information, including lots more on savings and dividends: [www.litrg.org.uk](http://www.litrg.org.uk)