RAYMOND JAMES

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"Are you stuck with a 60% income tax rate? More people than ever are being caught out by the UK income tax system"

More individuals are now enjoying six-figure incomes, a significant achievement in their careers. However, affluent earners are confronted with a substantial spike in their tax obligations.

Earning a £100,000 annual salary can sound rather attractive, yet without careful financial planning, the tax consequences of such a substantial income can be hefty.

This is due to the likelihood of facing an unexpectedly hefty tax bill, leading to an effective tax rate of 60%. If you consult the HM Revenue & Customs website, you will correctly find that the income tax rate for someone earning £100,000 is 40% (inclusive of your basic salary, bonuses, and other earnings). The rate only increases to the additional rate of 45% once your earnings exceed £125,140.

So where does this 60% tax rate come into play?

The so-called 60% tax bracket happens due to the gradual removal of the personal allowance, once your earnings exceed £100,000.

The personal allowance is the amount you can earn each year before you start paying income tax – currently £12,570. However, once you earn more than £100,000, that allowance is tapered at a rate of £1 for every £2 you earn over that threshold.

This effectively increases the amount of income tax you pay by 20% on earnings between £100,000 and £125,140.

Take the example of a £5,000 pay rise that takes your income to £105,000 a year. That £5,000 will be taxed at 40%, meaning you'll pay £2,000 in income tax. But, the 1:2 rate of removal on the personal allowance will also mean you lose £2,500 of tax-free income. So, that £2,500 will also be taxed at 40%, adding a further £1,000 tax to your bill. This means the total income tax you pay on your £5,000 pay rise is £3,000, equating to a 60% income tax bill.

How can I avoid the 60% income tax rate?

With a bit of planning, it is possible to avoid the 60% tax rate. While you can't completely escape income tax, you can minimise the taxable portion of your income. Although it may seem counterintuitive, if executed correctly, this approach can be implemented without causing financial strain and has the potential to boost your long-term financial stability.

Make additional pension contributions.

The simplest method of leap frogging the tax rate is to increase your pension contributions which has the effect of reducing your taxable income. Income tax relief is available on any money that you pay into your pension within your annual allowance (£60,000 in 2023/24).

Going back to the example outlined earlier, if you take the £5,000 pay rise as salary, you'll only take home £2,000 after 60% tax has been deducted. But if you pay it into your pension, you'll get its full value, without paying any tax on it.

Whilst you won't have access to these funds until you reach the age of 55 (which will increase to 57 in 2028), you'll receive £3,000 more compared to taking the same amount as your salary. The contribution can grow within a pension wrapper free from income and capital gains tax constraints over the long-term. Moreover, you'll have the option to withdraw 25% of your pension as tax-free cash.

Exactly how tax relief on your pension works will depend on the type of pension you hold, therefore it is prudent to take advice before undertaking any actions.

What other options are available to me?

There are a number of other strategies that you can take to improve your tax efficiency, avoiding the 60% tax rate:

- Take non-cash employee benefits such as a company car, private health insurance etc. through a salary sacrifice scheme.
- Donate to charity and claim the Gift Aid tax relief.
- Look for tax efficient investments.

Don't forget to check whether you need to register for self-assessment as a result of any pay rises. Penalties may apply for failing to register.

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