A guide to

ACCA

Income tax and pensions 2010/11

A SIMPLE GUIDE TO THE UNDERSTANDING THE NEW 50% INCOME TAX RATE, PERSONAL ALLOWANCE RESTRICTION AND THE PENSION RESTRICTION

This is a basic guide to highlight the changes to income tax, personal allowance and pensions relief announced in Budget and Pre-Budget 2009 reports, prepared by the technical advisory service for members and their colleagues or clients. It is an introduction only and should not be used as a definitive guide, since individual circumstances may vary. Specific advice should be obtained, where necessary.

50% income tax rate

The Budget 2009 introduced the new income tax rate band of 50% for individuals earning in excess of £150,000. The date this is applicable from is 6 April 2010 and is not to be confused with the 50% Bank Payroll charge.

Dividends are treated as the top slice of income. The highest rates of tax an individual pays are 10% for basic rate tax payers, 32.5% thereafter and 42.5% where income exceeds £150,000.

Personal allowance

Reduced personal allowance for individuals earning in excess of £100,000 from April 2010, reduced on a sliding scale. The way it is calculated, for every £2 of income that exceeds £100,000 the personal allowance will be reduced by £1. There will be no personal allowance for individuals earning in excess of £112,950.

Pensions relief

The final major change for personal income is in relation to pensions. No higher rate relief will be available for individuals earning in excess of £130,000, the relief being restricted to 20%.

Examples

A few simple examples to help demonstrate how the income tax, personal allowance and pensions relief is calculated for higher earning individuals from April 2010 in a number of different scenarios. Even though the examples refer to employment income, self-employed income can be easily substituted.

Example 1 – partial abatement of personal allowance

Individual with employment income of £110,000, has a standard personal allowance of £6,475 and has made no pension contribution.

Total income	£110,000
Less personal allowance (W1)	(£1,475)
Income subject to tax	£108,525
37,400 x 20% =	£7,480
71,125 x 40% =	£28,450
	£35,930

Working 1
Excess of earnings over £100,000 after pension contribution is £10,000; take half of this excess, i.e. £5,000 and restrict the personal allowance by this amount. Therefore £6,475 less £5,000 gives £1,475.

Example 2 – abatement of personal allowance; unrestricted pension relief
Individual with employment income of £110,000, has a standard personal allowance of £6,475 and has made a net pension contribution of £4,000.

Total income	£110,000
Less personal allowance (W2A)	(£3,975)
Income subject to tax	£106,025
42,400 (W2B) x 20% =	£8,480
63,625 x 40% =	£25,450
	£33,930

Working 2A
Excess of earnings over £100,000 after grossed up pension contribution is £5,000 (W2B) (£110,000 less £5,000); take half of this excess, i.e. £2,500 and restrict the personal allowance by this amount. Therefore £6,475 less £2,500 gives £3,975

Working 2B
Basic rate band extended by grossing up the personal allowance by the pension contribution, £4,000 x (100/80) = £5,000. Therefore, the basic rate band is £37,400 + £5,000 = £42,400.

Example 3 – full abatement of personal allowances
Individual with employment income of £115,000, has a standard personal allowance of £6,475 and has made no pension contribution.

Total income	£115,000
Less personal allowance (W3)	(£0)
Income subject to tax	£115,000
37,400 x 20% =	£7,480
77,600 x 40% =	£31,040
	£38,520

Working 3
Excess of earnings over after pension contribution £100,000 is £15,000, take half of this excess, i.e. £7,500 and restrict the personal allowance by this amount. Therefore there will be no personal allowance.

Example 4 – abatement of personal allowance; K code
Individual with employment income of £95,000, has a tax code of K800, which consists of an estimated personal allowance of £1,000 and correct restriction for benefits in kind of £9,000 and has made no pension contributions.

Salary	£95,000
Add benefits in kind	£9,000
Total income	£104,000
Less personal allowance (W4)	(£4,475)
Income subject to tax	£99,525
37,400 x 20%=	£7,480

62,125 x 40%=	£24,850
	£32,330

Working 4

Excess of earnings over after pension contribution £104,000 (£95,000 plus £9,000) which includes benefits included in the tax code and then take half of this excess; i.e. £2,000 and restrict the personal allowance by this amount. Therefore £6,475 less £2,000 gives £4,475.

Example 5 – full abatement of personal allowance; 50% marginal tax rate

Individual with employment income of £160,000, has a standard personal allowance of £6,475 and has made no pension contribution.

Total income	£160,000
Less personal allowance (W5)	(£0)
Income subject to tax	£160,000
37,400 x 20% =	£7,480
112,600 x 40% =	£45,040
10,000 x 50% =	£5,000
	£57,520

Working 5

Excess of earnings over after pension contribution £100,000 is £60,000, take half of this excess, i.e. £30,000 and restrict the personal allowance by this amount. Therefore there will be no personal allowance.

Example 6 – 50% marginal tax rate; pension contributions liable to special annual allowance charge

Individual employment income of £200,000, has a standard personal allowance of £6,475, does not normally make a regular pension contribution and has decided to make a one-off single net personal pension contribution of £40,000.

Total income	£200,000
Less personal allowance (W6A)	(£0)
Income subject to tax	£200,000
87,400 (W6B) x 20% =	£17,480
62,600 x 40% =	£25,040
50,000 x 50% =	£25,000
	£67,520
Add Pension restriction (W6C)	£6,000
	£73,520

Working 6A

Excess of net income over after deducting the grossed-up pension contribution of £50,000 is £150,000; take one-half of this excess of £150,000 over £100,000, i.e. £25,000 and restrict the personal allowance by this amount. Therefore there will be no personal allowance.

Working 6B

Basic rate band extended by grossing up the personal allowance by the pension contribution, £40,000 x (100/80) = £50,000. Therefore, the basic rate band is £37,400 + £50,000 = £87,400

Working 6C

Pension contribution is subject to the Special annual allowance, £20,000. Gross pension contribution (W6A) £50,000 less £20,000 = £30,000. This £30,000 is restricted by multiplying it by the Special annual allowance rate of 20%, giving a £6,000 restriction.

Example 7 – 50% taxpayer with bank interest and income taxable at the dividend rate

Individual with employment income of £160,000, bank interest of £8,000 (net) and dividend income of £9,000 (net), has a standard personal allowance of £6,475 and has made no pension contribution.

Employment income	£160,000
Gross Interest (£8,000 x 100/80)	£10,000
Gross Dividend income (£9,000 x 100/90)	£10,000
Total income	£180,000
Less personal allowance (W7)	(£0)
Income subject to tax	£180,000
37,400 x 20% =	£7,480
122,600 x 40% =	£45,040
20,000 x 50% =	£10,000
10,000 x 42.5% =	£4,250
Less tax deducted at source	£65,770
	(£3,000)
	£63,770

Working 7

Excess of earnings over after pension contribution £180,000 is £80,000; take half of this excess, i.e. £40,000 and restrict the personal allowance by this amount. Therefore there will be no personal allowance.

Further consideration

Further details can be found on the HMRC website regarding the special annual allowance:

http://www.hmrc.gov.uk/budget2009/pensions-technical-1550.pdf

This is a guide for ACCA members to assist in understanding the 50% income tax rate, personal allowance restriction and pensions relief from 5 April 2010.This document has no regulatory status and provides an overview of the scheme.

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