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TAIT WALKER

Options to mitigate income tax for higher paid employees

How to change your remuneration package to maximise your income

Highly paid employees and directors, in particular those earning over £100,000 a year can often optimise their taxable income by making choices about how to receive their income.

It is important to understand the Income Tax implications of your income being at a certain level, particularly as post tax income is what you will receive.

Additional income such as a bonus, employee benefits or child benefit can impact your tax rates and eventual post tax income received. Tax planning can be done once you understand where your income levels sit within the tax rate bands, such as pension savings, charitable donations and utilising allowances.

£150,000

Once income reaches £150,000 the additional rate of 45% applies

Dividends are taxed at 38.1%

£125,140

Once income reaches £125,140 the personal allowance is completely withdrawn

Income is taxed at the higher rate of 40% on income between £50,271 - £150,000

Dividends are taxed at 32.5%.

£100,000

Once income reaches £100,000 the personal allowance is withdrawn by £1 for every £2 of income over the threshold

The entitlement to government funded childcare is not available

£60,000

Once income reaches £60,000 any child benefit received is fully withdrawn

£50,000

Once income reaches £50,000 any child benefit received is clawed back

Income is taxed at the basic rate of 20% on income above the personal allowance and up to £50,270

Dividends are taxed at 7.5%

£12,570

Income is tax free within the personal allowance of £12,570

£0

What planning can be done to save income tax?

Pension savings

Private pension contributions reduce your relevant earnings when calculating if your income has breached the personal allowance (PA) threshold of £100,000. If your earnings are over £100,000 your PA is reduced by £1 for every £2 of income over the threshold. By making a pension contribution you could potentially reinstate your PA as well as receive income tax relief. Basic rate relief is given at source as the government top up your pension by £2 for every £8 you contribute. If you are a higher rate taxpayer you can claim the additional relief on your tax return.

As an example, if your income is £100,000 but you receive a bonus of £10,000 you will lose £5,000 of your PA. This will result in additional tax due of:

Higher rate tax at 40% on the bonus of £10,000	£4,000
Income previously covered by the PA now taxable at 40%	£2,000
Total tax due on the bonus of £10,000	£6,000

The effective rate of tax on receiving the bonus is 60%. By making a net pension contribution of £8,000 you will save £2,000 of tax by retaining your PA, as well as be able to claim higher rate income tax relief on the pension contribution of £2,000. Your pension fund will receive a gross contribution of £10,000 (after the government top up) and the net contribution made by you, after tax relief is obtained, is £4,000 (contribution of £8,000 less £4,000 of tax savings).

Benefits in kind

Low emission and electric company cars can be made in lieu of salary. In addition, there are exempt benefits you can receive from your employer, such as cycle of work schemes and mobile phones.

Charitable Donations

Like pension contributions, gift aid donations reduce your relevant earnings and can help in retaining your PA if you earn close to the threshold of £100,000.

Remuneration planning

Shareholders, including company owners can utilise their dividend allowance, ensuring the first £2,000 of dividends is tax free. Dividends are taxed at a lower rate than earnings so remuneration planning can be done to ensure income is structured in a tax efficient way.

Marriage allowance

A basic rate taxpayer can receive an allowance from their spouse or civil partner, if their partner earns below £12,570 and does not utilise all of their PA. Currently a claim can be made to transfer £1,260 which results in tax relief of £252.

Transfer investment to a spouse or civil partner

Assets can be transferred to a spouse or civil partner free of Capital Gains Tax and it could be sensible to transfer income yielding assets to a lower earning spouse to utilise their lower tax rate bands and allowances.

Now, for tomorrow

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Please do not hesitate to contact us if you would like to discuss your own circumstances.