

Beat the personal allowance 'claw-back'

One of life's bigger annoyances is probably the amount of tax that is deducted from your salary every month. From April 2010 it will become even more distressing with the introduction of a new 50% income tax rate and the possible loss of your tax-free personal allowance, otherwise known as the personal allowance 'claw-back'.

It is certainly a grim thought, but with expert financial advice you can take steps to help safeguard yourself against these changes. This article will particularly focus on the new rules surrounding personal allowances and provide options that can not only protect your personal allowance but also boost other elements of your finances, such as retirement savings.

Before exploring the choices available to you, it is important to understand exactly what changes are coming into force and whether they will affect you.

What is happening in April 2010?

Put simply, if you have a total income of over £100 000, the new rules mean that for every £2 you receive over the £100 000 threshold, you lose £1 of your tax-free personal allowance, which currently stands at £6475.

So, if you are a doctor with an income of £110 000, your allowance will be reduced by £5000 to £1475 (based on this year's personal allowance) because your income exceeds the £100 000 threshold by £10 000.

What can you do?

First you need to know if these changes will affect you because the £100 000 threshold does not only apply to your earnings, but to all other taxable income such as pensions in payment, interest from savings and any other investment income.

You may want to seek expert financial advice to help you check whether you exceed the £100 000 threshold. If you

find you do, the following options could help you to fall below it and therefore mitigate the claw-back on your personal allowance:

Make extra contributions to your pension

You may be able to invest extra funds into pensions such as self-invested personal pensions (SIPPs), personal or stakeholder pensions where you can deduct the gross contribution you make from the overall income that will be assessed to determine if you are subject to claw-back on your personal allowance.

Another benefit of this is that when you make a contribution to one of these pension plans, you receive basic rate income tax relief on your contribution. This means that for every £80 (net contribution) you put into your plan, £100 (gross contribution) gets invested into your pension fund. Higher rate taxpayers can claim a further reduction in their tax bill which means the gross contribution of £100 could cost as little as £60. However, those with an income over £150 000 may have higher rate tax relief restricted.

To demonstrate how this can work, let's take a look at an example:

Dr Jones has a total income of £110 000 and let's assume that the personal allowance of £6475 still applies in the new tax year. From April 2010 this allowance will be reduced by £5000 to £1475 because his income exceeds the threshold by £10 000.

Based on this year's tax rates and bands, Dr Jones' total income tax bill might be £35 930 as he will not pay tax on the first £1475 of his income, but will pay 20% tax on the next £37 400 and 40% on the remaining £71 125.

What Dr Jones could do from 6 April 2010, instead of allowing this to happen, is pay a pension contribution of £8000 (£10 000 gross). As he can deduct this £10 000 gross pension contribution from his total income, Dr Jones remains entitled to his full tax-free personal allowance because he will not exceed the £100 000 threshold.

He can also claim further higher rate tax relief of £2000 on his pension contribution so his total tax bill for the year could

therefore be reduced to £31 930, plus his pension is boosted by £10 000.

Gift your assets

Another way to reduce your total income to below the £100 000 threshold is to gift assets that produce an income (such as shares or rented property). These could be gifted to your spouse, civil partner or even your children.

Giving away assets may also help to mitigate inheritance tax, but there can be other tax implications to consider. Also, be aware that if you choose this option, the gifts must be outright gifts.

Review your investments

You should check your investments to see whether any income (such as interest or dividends from shares) being generated is placing you over the £100 000 threshold. If this is the case, there are alternative investments such as life assurance investment bonds which are geared more towards providing capital growth than producing an income.

Salary sacrifice

You may be in a position where you can arrange with your employer to exchange salary for additional employer pension contributions. This may not be suitable for everyone but could be an option for those receiving income from private practice work.

Conclusions

It is a good idea to plan ahead of the changes taking place from April 2010 by checking if you are going to be affected and considering the options to avoid the 'claw-back' on your personal allowance.

This article has offered some suggestions, but there is no 'one size fits all' approach. Planning for the new rules may need you to review your pension contributions, investment choices and your assets. It is therefore important to seek expert financial advice to determine what is best for your personal circumstances. **BJHM**

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The above information does not constitute financial advice. For further information please speak to your financial adviser.