

Withdrawal of personal allowances for high earners

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Withdrawal of personal allowances for high earners

1 Overview

Budget 2009 contained proposals to progressively withdraw entitlement to personal allowances for individuals with income of more than £100,000. This will apply from 6 April 2010 and, in effect, means a marginal rate of income tax of 60% on income between £100,000 and £112,950.

The silver lining of the tax cloud is that the main forms of charitable giving continue, for now, to attract tax relief at the donor's highest rate of tax. This briefing Paper provides a detailed analysis of the new tax regime and how charity tax reliefs interact with it.

2 The detail

2.1 Individuals with **adjusted net income** of over £100,000 will see some or all of their personal allowances withdrawn from 6 April 2010. For every £2 earned in excess of £100,000, £1 of personal allowance will be withdrawn. The personal allowance for 2010/11 of £6,475 (unchanged from the 2009/10 level). Therefore, those earning more than £112,950 will have a nil allowance.

2.2 **Adjusted net income** is total income less certain reliefs, such as pension contributions, loss reliefs and gifts of qualifying shares or property to charity, less the **gross** amount of gift aid donations in the year.

Accordingly, gift aid donations, and gifts of shares or property to charity can come to the rescue! Taxpayers who can make such gifts so as to reduce income below £112,950 will be able to 'reclaim' some or all of their personal allowance.

2.3 The effective tax relief for gift aid payments is 60% (transitional relief to the charity for the last remaining tax year 2010/11 is in addition to this).

Example:

Albert has an income of £100,000. Bobby has an income of £112,950. Their respective tax liabilities are:

	adjusted net income	tax liability
Albert:	£100,000	£29,930
Bobby:	<u>£112,950</u>	<u>£37,700</u>
Difference	<u>£12,950</u>	<u>£7,770</u>

Bobby's additional income of £12,950 has led to an additional income tax liability of 60%. This is higher than the rate that will be payable by those earning over £150,000 because of the withdrawal of the personal allowances on earnings between £100,000 and £112,950.

However, if Bobby were to make a gift aid payment to charity of £10,360 (net) which equates to a gross gift of £12,950 (the net payment is grossed up at the basic rate of 20%) he will enjoy tax relief of £5,180 and the charity will be able to reclaim tax of £2,590 (being the basic rate of 20% on the 'gross' gift of £12,950).

On a claim by the donor to HMRC, the gross gift reduces Bobby's adjusted net income from £112,950 to £100,000 restoring all of his £6,475 personal allowance. His tax liability now matches that of Albert – an effective tax relief of 60%.

The gift worth £12,950 to the charity has in effect cost Bobby £5,180:

Cost of net gift	£10,360
<u>Less:</u>	
Tax relief at 40% (higher rate) less 20% (basic rate) on £12,950	2,590
Tax relief at 40% on restored personal allowance of £6,475	2,590
Effective cost	£5,180
Charity receives:	
Net gift	10,360
Gift Aid tax relief (20% x £12,950, gross gift)	2,590
	£12,950

For 2010/11 only, the charity will also be able to claim transitional relief of £322.05.

3 Other forms of charity tax relief that reduce adjusted net income

In the same way that gift aid can be used to reduce adjusted net income, so can gifts of qualifying shares and securities and qualifying gifts of land. In broad terms, the amount of the reduction is equivalent to the market value of the qualifying investment at the time that it is gifted to the charity. The transfer to the charity is exempt from capital gains tax that would otherwise arise on the disposal of the asset to a non-charity.

4 Claiming the reliefs

Most, if not all, additional rate taxpayers will receive an annual self assessment tax return. Relief is claimed simply by entering the relevant amount on Page TR 4 of the return form as follows (2009/10 SA Return references):

Gift aid donations:

For gift aid donations, enter the net amount given (i.e. before any tax relief) as follows:

Made, and claimed, in the tax return year	Box 5
Made after the tax year, treated as made in the tax year	Box 8

Notes:

Box 7 is for recording gifts that were already carried back on the previous year's tax return. It is too late to be making a 'fresh' Box 7 claim on the current year's return.

There are strict time limits for a carry back of relief (Box 8) to be effective. The time limit is 31 January following the end of the tax year to which a donation is to be treated as carried back to, or the date that the Tax Return is submitted (*if earlier*).

Gifts of shares and securities:

Made in the tax return year

Box 9

Note:

Usually the amount to be entered is the market value on the date that the shares were gifted, plus any incidental costs of transfer (such as brokers' fees), less any sale proceeds (where the shares are sold to the charity at an undervalue) and any benefit received from the charity. If in doubt, refer to the Tax Return Guide, Page TRG 19 (2010) or seek professional advice. Tax anti-avoidance rules apply to the value of the shares transferred where the transaction takes place after 15 December 2009 and there is an avoidance motive involved.

Gifts of land and property:

Made in the tax return year

Box 10

Notes:

As for gifts of shares, a sale to the charity at an undervalue will also qualify for relief to the extent of the 'market value' proceeds foregone. The market value on the date that ownership passes to the charity can be increased by the legal and other costs of sale.

The transfer must be of the whole of the donor's beneficial interest in freehold or leasehold land in the UK. If property is jointly owned, all of the joint owners must join in making the gift.

If in doubt, refer to the Tax Return Guide, Page TRG 19 (2010) or seek professional advice.

5 Action Points

Donors who find themselves in the 'Personal Allowances Trap' of adjusted net income of between £100,000 and £112,950 should seriously consider the tax efficiency of making sufficient charitable gifts to restore some or all of their personal allowances, whilst providing a major benefit to charitable causes at a relatively low net cost.

Donors with adjusted net income just above £112,950 may wish to consider making charitable gifts sufficient to reduce income to below £112,950 or even below £100,000 in order to restore some or all of their personal allowances.

6 Stewardship Gold Account

The Stewardship Gold Account is an ideal means of a donor obtaining timely tax relief on their charitable donations. Having made their donation to Stewardship, the donor can make requests at any subsequent time for distributions to be made by Stewardship to their favourite charitable causes. In the meantime, the account balance is credited by Stewardship with investment returns.

For further details: <http://www.stewardship.org.uk/documents/sovereign-gold-brochure.pdf>