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The 60% Income Tax Trap

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For many workers in the UK, reaching a six-figure salary represents a significant financial milestone. However, for those earning more than £100,000, a pay rise may not increase take-home pay as much as expected. This is due to what is commonly known as the "60% tax trap", which affects earnings between £100,000 and £125,140.

This article explains how the tax trap works, how it affects individuals within this income range, and the steps that can be taken to mitigate its impact.

Income Tax Bands

Income Tax is charged on an individual's earnings according to a series of tax bands, as shown below:

Tax Band	Taxable Income	Tax Rate
Personal Allowance	Up to £12,570	0%
Basic Rate	£12,571 to £50,270	20%
Higher Rate	£50,271 to £125,140	40%
Additional Rate	Over £125,140	45%

An individual's Personal Allowance (which usually covers the first £12,570 of income) remains intact until their income reaches £100,000.

Beyond this point, the allowance is reduced by £1 for every £2 of income earned over £100,000.

As income increases, the Personal Allowance is gradually withdrawn and is completely lost once income reaches £125,140. It is this interaction between higher-rate taxation and the loss of the Personal Allowance that creates the effective 60% tax rate experienced by many higher earners.

The example below illustrates how this affects an employee earning £110,000 per year.

Worked example

Assuming that adjusted net income increases from £100,000 to £110,000:

- The additional £10,000 of income is taxed at 40%, resulting in £4,000 of Income Tax.
- The extra income also reduces the Personal Allowance by £5,000, as £1 of allowance is lost for every £2 earned over £100,000.
- That £5,000 of lost allowance means that more of the individual’s income becomes taxable at 40%, creating an additional £2,000 tax liability.
- The total tax payable on the additional £10,000 of income is therefore £6,000, resulting in an effective marginal rate of Income Tax of 60%.
- For employees, National Insurance contributions will increase the effective rate to approximately 62%.

This example demonstrates the combined effect of higher-rate taxation and the withdrawal of the Personal Allowance. Put simply, a worker may retain only around £38 of every additional £100 earned within this income range.

As a result, a £10,000 pay increase above £100,000 does not provide the same financial benefit as a £10,000 increase below this threshold.

It is also worth remembering that Income Tax thresholds have been frozen since 2021 and are currently expected to remain frozen until at least April 2031. As wages increase over time, more individuals may find themselves affected through a process known as fiscal drag, whereby earnings rise but tax thresholds remain unchanged.

How to avoid the 60% tax trap

Timely and appropriate financial planning can help reduce the impact of the 60% tax trap.

The key measure used to determine whether the Personal Allowance is reduced is “adjusted net income”, which can be reduced for tax purposes by making pension contributions or Gift Aided charitable donations.

Adjusted net income broadly consists of an individual's total taxable income before Personal Allowances, less these tax-relievable deductions.

Sources of income that are typically included when calculating net income include:

- Employment income
- Rental income
- Dividend income
- Certain state benefits
- Other taxable sources of income

Where Gift Aid donations to charity have been made, the grossed-up value of the donation can be deducted when calculating adjusted net income.

The grossed-up amount includes both the donation made and the basic-rate tax relief claimed on the donor's behalf. This can help reduce adjusted net income and potentially restore some or all of the Personal Allowance.

Pension contributions are one of the most effective ways of reducing adjusted net income.

Individuals can make contributions to a personal pension from their post-tax income. The pension provider will normally claim basic-rate tax relief automatically.

As a higher-rate taxpayer, the individual will then reclaim any higher or additional tax relief due through HMRC, typically via a Self-Assessment tax return.

The gross value of the pension contribution (i.e. including the basic rate tax relief claimed at source by the pension provider) can be deducted from total income in arriving at adjusted net income and can be used to reduce the individual’s income below the key £100,000 threshold.

This restores the Personal Allowance in full, meaning that the contribution benefits from an effective 60% tax relief. Consequently, pension contributions which have the effect of reducing adjusted net income to below £100,000 are highly tax efficient.

It is worth noting that the annual pension allowance is currently £60,000, and it may be possible to use unused allowances from the previous three tax years, depending on individual circumstances.

Alternatively, under a salary sacrifice arrangement an employee agrees to reduce their salary by a specified amount, with the employer contributing the equivalent amount directly into their workplace pension scheme.

This reduces the amount of income on which tax and National Insurance contributions are paid, again potentially saving 60% Income Tax.

Do note that from April 2029, only the first £2,000 of salary sacrifice arrangements will be exempt from employee and employer National Insurance contributions.

Conclusion

If the primary objective is to manage income efficiently and ensure that earnings are structured as tax-efficiently as possible, making use of pension contributions and Gift Aid donations can be highly effective.

Although the tax mitigation strategies discussed in this article may reduce short-term take-home pay, they achieve tax-efficiency by redirecting income into pension savings and other tax-efficient planning opportunities, rather than simply increasing the amount paid in tax.

As always, there are other factors to take into account, including accessibility (as pension savings cannot usually be accessed until at least age 55, rising to age 57 from 6th April 2028).

Understanding how the 60% tax trap operates allows individuals within this earnings range to make informed financial decisions and maximise tax efficiency.

While many people may encounter this situation as earnings rise over time, the impact and most appropriate solutions will depend on each person's individual circumstances and it is important to take personalised, independent advice.

If further advice on this subject or any other aspect of your financial planning will be welcome, please do contact us and we will be delighted to help.

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This article is not a recommendation to take any particular course of action and should not be construed as advice.

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