

Higher tax for the over 65s

By Bob Wheatcroft, Tax Partner at Armstrong Watson

No, this is not the slogan for a misguided new political party. It is in fact a reality of the current tax system that quite a few over 65s are caught in an income tax trap with a marginal tax rate higher than younger people on the same or even lower incomes.

To be fair, the intention of the tax system is to give extra tax relief for those over 65. Most of us have a tax free personal income tax allowance this year of £6,035 but the standard tax free allowance for over 65s is £9,030. At 75 the additional allowance goes up to £9,180. You receive the higher allowance for the tax year that includes your 65th or 75th birthday.

Most of us would, I am sure, think that this was a reasonable albeit rather limited gesture to those who have probably spent their lifetimes paying tax of one kind or another.

The rather nasty (one might say ungenerous) part of all this is that unfortunately these higher allowances are not available to everyone aged over 65. There is an income limit. In other words, the tax relief is means tested.

Means tests are common in a number of areas of the public finances. Most frequently they occur in the benefits legislation but they are uncommon in tax law. Some might think it only reasonable to stop elderly millionaires from claiming the extra allowances but, unfortunately, it is not just the rich who are caught in this particular trap.

If a person's total income from all sources, including pensions and investments, in the current year is over £21,800, then the amount of the allowance is reduced. Every £2 of additional income means a reduction of £1 in the tax allowance until it is reduced to the level of the allowance for under 65s.

For those with incomes above £21,800 but below £27,780 (or slightly more for over 75s), the net effect of this is that an extra £1 of income which is technically taxable at 20% actually increases the tax by 30p. I suspect there would be uproar if the Government were to propose raising the basic rate of tax to 30% - it hasn't been that high since 1986.

Why is this of particular interest now? The answer is that the end of the tax year is approaching and we are all being deluged with adverts for ISAs. This will, I am sure, prompt many people to review their finances and make changes. This often leads to income being crystallised and, in the case of insurance bonds in particular, this is frequently a significant amount. It is not limited to bonds, however, and may happen even with closing a savings account. Although interest rates are now very low, there may still be substantial amounts of accrued income in certain types of account.

Of course you should review your investments but do take care, and advice if necessary, and make sure that you have looked at the whole picture.

For further information on how Armstrong Watson can help you call freephone 0800 195 2161 or email moneymatters@armstrongwatson.co.uk