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Stealth tax catching high-earning pensioners

Navigating this requires careful planning to ensure you maximise your earnings

Recent figures from HM Revenue & Customs (HMRC) reveal a startling trend: an increasing number of pensioners are caught in a punitive 60% tax trap[1]. In the 2024/25 tax year, 77,000 individuals aged 66 and over had earnings between £100,000 and £125,140, subject to this alarmingly high effective tax rate. This figure has more than doubled in just three years, demonstrating the significant impact of frozen tax thresholds on older, higher-earning workers.

Although the official Income Tax rates are 20%, 40% and 45%, a quirk in the system creates a 60% band. This occurs because the £12,570 tax-free personal allowance gradually decreases once income exceeds £100,000. For every £2 earned over this limit, you lose £1 of your allowance. Consequently, when income reaches £125,140, the entire allowance disappears, resulting in a notably high marginal tax rate on that portion of income.

A GROWING CONCERN FOR OLDER WORKERS

To illustrate, consider an individual who receives a pay increase from £100,000 to £110,000. They would pay 40% Income Tax on the extra £10,000, which amounts to £4,000. However, they would also lose £5,000 of their personal allowance. This lost allowance is subsequently taxed at 40%, adding another £2,000 to their tax bill. Overall, they pay £6,000 in tax on the £10,000 increase, resulting in an effective rate of 60%.

The threshold for losing the personal allowance has stayed fixed at £100,000 since it was introduced in April 2010. Had this figure kept up with inflation, people could now earn around £155,000 before being affected. With Income Tax bands frozen until at least 2028/29, more people, including those past State Pension age, will fall into this bracket as more individuals continue working and earning at the top of their careers well into their late 60s.

STRATEGIC FINANCIAL PLANNING IS KEY

This situation poses a genuine risk of losing valuable experienced workers from the workforce. As taxes take an increasingly large share, many high earners might question whether continuing to work is worthwhile, possibly opting to cut their hours or retire earlier to avoid such a heavy tax burden. This is a crucial consideration, especially with the State Pension also adding to taxable income.

Nevertheless, there are effective strategies to mitigate the effects of the 60% tax trap, and pensions are a valuable tool. Contributing to a pension can lower your 'adjusted net income', the figure used by HMRC to determine your tax liabilities. By making pension contributions, you can bring your income below the £100,000 threshold, which not only entitles you to 40% tax relief but also helps you retain your full tax-free personal allowance.

NAVIGATING THE RULES AND ALLOWANCES

If you contribute to a private pension, such as a SIPP, remember to declare the contribution on your tax return to claim the full higher rate relief, as only basic rate relief is applied automatically. It is also important to be aware of certain pension rules. For instance, older workers who have already started drawing a taxable income from their pension may be subject to the Money Purchase Annual Allowance (MPAA). This reduces your annual allowance from £60,000 to just £10,000 and removes the ability to use 'carry forward' relief from previous years.

Another option is to delay claiming your State Pension. For each year you postpone, your future entitlement increases. This could be a prudent move for those currently caught in the tax trap who plan to reduce their work and enter a lower tax band soon. Navigating these complexities requires careful planning to ensure you maximise your earnings. ■

ARE YOU MAXIMISING YOUR INCOME AND PENSION PROSPECTS?

The tax landscape for high earners can be complex. If you think you might be affected and need personalised financial advice, or want to find out more or discuss your situation, don't let the tax trap catch you unprepared. Please contact us.

Source data:
[1] Freedom of Information request by Interactive Investor to HMRC 30/10/25.