



Income Tax threshold freeze

The Income Tax threshold freeze refers to the government's decision to hold personal allowances and tax bands at their current cash levels for an extended period, rather than increasing them in line with inflation or earnings growth.

Under current policy, the personal allowance and the basic and higher rate thresholds will remain unchanged until April 2031, extending a freeze already in place since 2022. This means that while wages, pensions and other sources of income may increase over time, the points at which tax becomes payable, and at which higher rates apply, do not move.

Although tax rates themselves have not increased for most taxpayers, the thresholds freeze means that more income is gradually pulled into tax, and into higher tax bands. This effect is commonly referred to as fiscal drag.

Why the threshold freeze matters

At first glance, freezing thresholds can appear less significant than raising tax rates. However, over time, the impact can be substantial. As incomes rise, even modestly, more individuals begin to pay tax for the first time, and many existing taxpayers drift into higher rate bands.

For example, an individual whose pay rises each year to keep pace with inflation may find that a growing proportion of their income becomes taxable, even though their real purchasing power has not increased. In practical terms, this results in a higher overall tax bill without a corresponding improvement in living standards.

This effect is gradual and often goes unnoticed until taxpayers compare their net income over several years. The absence of a clear policy announcement each year can make the change feel invisible, but the cumulative cost can be significant.

Who is affected by the freeze

The extended freeze affects a wide range of taxpayers, not just higher earners.

Employees are affected as pay increases push more of their income above the personal allowance and into higher rate bands. This is particularly relevant where annual pay awards are modest but consistent.

Pensioners are also impacted. State pension increases and private pension uprating can cause pension income to exceed the frozen personal allowance, bringing more pensioners into the tax system for the first time.

Owner managed business directors may see higher personal tax liabilities as dividends and salaries interact with static thresholds, especially where profits grow over time.

Landlords and investors are affected as rental income and investment returns are taxed against the same frozen bands, increasing the marginal rate of tax on additional income.

In short, anyone whose income rises in cash terms over the coming years is likely to feel the effect.



Impact on take home pay

One of the most noticeable consequences of the freeze is the pressure it places on take home pay.

As thresholds remain static, each additional pound of income is more likely to be taxed. Over time, this reduces the proportion of gross income that individuals keep after tax.

For those crossing into the higher rate band, the impact can be particularly sharp. A relatively small increase in income can lead to a significantly higher tax bill, especially where other factors such as the loss of personal allowance come into play at higher income levels.

This can also affect entitlement to certain allowances and reliefs, many of which are linked to income thresholds that are also frozen or restricted.

Interaction with National Insurance

While Income Tax thresholds are frozen, National Insurance thresholds have followed a similar pattern in recent years. The combined effect can further increase the tax burden on earned income.

Employees and employers may both face higher overall deductions as earnings rise. For business owners, this can influence decisions around remuneration planning, particularly the balance between salary, dividends and other forms of reward.

Although National Insurance rules differ from Income Tax, the principle is similar. Static thresholds combined with rising incomes result in higher effective rates over time.



Long term planning implications

The extended nature of the freeze means that its effects are not short term. Planning based on a single tax year snapshot is no longer sufficient.

Taxpayers benefit from understanding how their tax position may evolve over several years if no action is taken. Simple projections can highlight when higher rates will apply, or when allowances may be lost altogether.

For business owners, this may prompt a review of profit extraction strategies, pension contributions or the timing of income. For individuals, it may raise questions around savings, investments or charitable giving.

The key point is that the threshold freeze turns tax planning into a medium to long term consideration, rather than an annual exercise.

Why awareness is important

Many taxpayers are unaware that thresholds are frozen or misunderstand what this means in practice. They may assume that rising tax bills are the result of errors or inefficiencies, rather than policy design.

Accountants are well placed to bridge this gap, translating policy decisions into practical consequences for individual taxpayers.

The role of professional advice

While the threshold freeze applies uniformly, its impact varies widely depending on personal circumstances. Income sources, family situation, business structure and future plans all influence the outcome.

Professional advice can help taxpayers understand their specific position and explore appropriate responses. This may include reviewing income structure, forecasting future liabilities or identifying reliefs and allowances that remain available.

It is also important to recognise that tax planning should always be aligned with wider financial and commercial objectives. The aim is not simply to minimise tax, but to support sustainable decision making.

Summary

The extended freeze of Income Tax thresholds is a significant policy choice with long lasting consequences. Although it does not involve headline tax rate increases, it steadily increases the tax burden for many individuals and businesses.

By understanding how the freeze works, who it affects and why it matters, taxpayers are better equipped to plan ahead and avoid surprises. Clear explanations and forward looking discussions can turn a complex policy issue into an opportunity for better financial awareness and control.

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