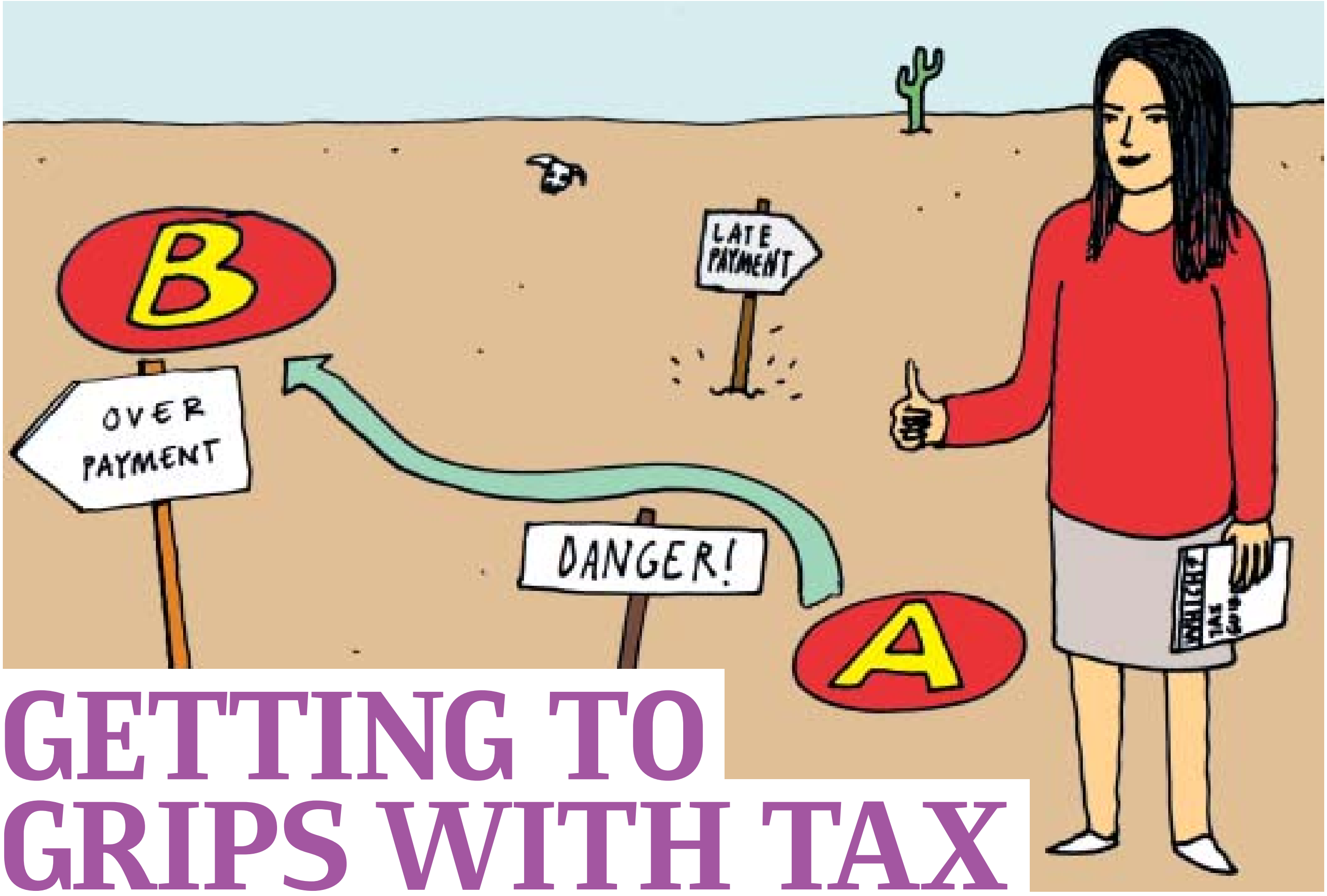


# GETTING TO GRIPS WITH TAX

From paying it to saving it – we guide you through the ins and outs of our tax system

Finding your way round the UK tax system can seem like an assault course, so we've done the training for you. The next three pages round up the main things you need to know about tax and point you to other parts of the *Which? Tax Saving Guide* where you can get further information.

## TAX QUESTIONS

Everything you wanted to know about tax but were afraid to ask? Not quite, but here are the answers to some common tax questions.

### What taxes might I have to pay?

Some of the main taxes you might pay are:

- income tax – on earnings, pensions, savings, investment or rental income. Your taxable income is often less than the income you actually receive (see 'Is all my income taxed?', opposite).

  You may also be charged income tax on income you're deemed to have – for example, the value of fringe benefits and, from 6 April 2005, the value of continuing to use assets you have given away
- National Insurance contributions – on your income from working or your business. Some National Insurance contributions are used to help you qualify for certain state benefits, including the basic state pension, incapacity benefit and bereavement benefits
- capital gains tax – on any profit when you sell or give away something you own
- inheritance tax – on your estate after you die and possibly on some gifts that you make during your lifetime
- council tax (domestic rates in Northern Ireland) – charged on property by your local authority
- taxes on things you buy – for example, value added tax (VAT) on the price of most goods and services; insurance premium tax on premiums for general insurance such as household, motor and travel policies
- stamp duty – charged on certain documents and stamp duty land tax on land (for example, when you buy or, under some circumstances, transfer property). Stamp duty has now been abolished in some areas for residential properties of £150,000 or less and non-residential properties in these areas are totally exempt.

**Stamp duty has been abolished in some areas for residential properties of £150,000 or less**

**Are all kinds of income taxed?**
No, they're not. Some are tax-free – for example, interest from money invested in cash Isas (individual savings accounts) and certain National Savings & Investments products (see p50). You don't have to tell the Inland Revenue about any tax-free income.

**Is all my income taxed?**
Again, the answer is no. Everyone is allowed to earn a certain amount in a tax year before tax is deducted. This is known as the personal allowance. You may also be entitled to earn more before tax if you or your husband or wife are aged over 65 or blind (see p40).

In addition, certain expenses can be set against tax. Some payments you make from taxable income qualify for tax relief – examples are contributions to pension schemes (see p44) or Gift Aid payments to charity (see p6).

**How is the tax collected?**
If you work for an employer or receive an employer's pension or personal pension, it's usually collected under the pay as you earn (PAYE) scheme (see p16). If most of your income is taxed under PAYE, and you also have some untaxed income from another source, you can usually pay the extra tax via PAYE.

Some savings and investments income has tax deducted at the special savings rate of 20 per cent before you receive it. There's further tax to pay only if you're a higher-rate taxpayer. Starting-rate (10 per cent) taxpayers may be able to claim back half of the tax, and non-taxpayers all of it (see p48).

Dividends from UK shares and distributions from some unit trusts are paid to you net of tax at 10 per cent. Starting- and basic-rate taxpayers pay no more tax, but non-taxpayers can't claim this back. Higher-rate taxpayers pay a further 22.5 per cent (again, see p48).

Most people pay tax through PAYE, but some have people to fill in a tax return (see p10). Groups that have to fill out a tax return include the self-employed and those with a large amount of investment income (see p10). The tax return tells the Revenue how much income you received during the tax year and what allowances you're entitled to.

If you receive your income without tax deducted but you are liable for tax, you have to declare the income to the Revenue. You will pay the extra tax either through a tax return or via an adjustment to your PAYE code if you are a PAYE taxpayer.

**Can I avoid paying tax?**
Tax avoidance – where you arrange your finances so as to pay as little tax as possible – is a recognised principle and is perfectly legal. However, tax avoidance is being increasingly attacked by the Revenue and there's no guarantee that measures you've already taken will escape a charge in the future.

By contrast, tax evasion – where you deliberately conceal income or gains from the Revenue, or fraudulently claim allowances or other deductions – is a criminal offence. You can be fined or even imprisoned if you're caught.

## TAX FACTS
Here are the tax facts for the tax year that runs from 6 April 2004 to 5 April 2005, and some we already know about for the 2005-2006 tax year.

**What allowances do I get?**
The personal allowance (the amount you can earn before you start to pay tax) for the under-65s is £4,745 in 2004-2005, rising to £4,895 in 2005-2006. People aged 65 or over may get a higher amount, known as age allowance. For people aged 65 to 74, this can mean a personal allowance of £6,830 in 2004-2005 (£7,090 in 2005-2006). People over 75 get more. See p40.

**The over-65s may get more than the personal allowance**

**I'm married. Can I get the married couple's allowance?**
You qualify for this allowance only if you or your spouse were born before 6 April 1935. Unlike the personal allowance, it's not an amount you can earn before you start paying tax. Instead, 10 per cent of the allowance is deducted from your final tax bill, reducing the amount of tax you pay. See p18 for more on this type of restricted allowance.

**So how much income tax do I pay?**
Non-savings income (from employment, pensions, self-employment and rental income) earned in 2004-2005 is taxed at three rates depending on how much you earn. The first £2,020 above your allowances is taxed at 10 per cent (starting rate), the next £29,380 at 22 per cent (basic), and anything above this at 40 per cent (higher). This type of income is normally allocated against the tax bands first before savings, dividends and capital gains. The table on the next page shows the bands of income on which each rate is levied and includes the tax bands for 2005-2006.

**What about National Insurance?**
Everyone earning over a certain threshold has to pay National Insurance as well as income tax. In 2004-2005, Class 1 (employee) National Insurance contributions were 11 per cent of earnings between £91 and £610 a week and 1 per cent on earnings above this. In 2005-2006 the rate is 11 per cent of earnings between £94

**TAX CHANGES**

This year's *Which? Tax Saving Guide* will help you check your income tax for the 2004-2005 tax year, which runs from 6 April 2004 to 5 April 2005. The next budget isn't due until after we've gone to press, so we can give details of tax changes that will apply after April 2005 only if they have already been announced. The good news is that the Chancellor announced a lot of important changes that come in from April 2005 in his pre-budget report. We'll be producing a free factsheet to update you as soon as possible after the Chancellor delivers his budget. Look out for news of it in *Which?*.

and £630 a week and 1 per cent on earnings above this. See p38 for more on NI contributions.

### ...and my savings income?
Savings income received in 2004-2005 was taxed at three rates. To find out what tax rate your savings income is taxed at, you must add it to your other taxable income. Depending on what tax band it falls into, it will be taxed at 10, 20 (not 22) or 40 per cent. Dividend income is treated differently. Starting- and basic-rate taxpayers pay 10 per cent tax on dividend income, higher-rate taxpayers pay 32.5 per cent. There is special treatment for life insurance policies (see p51).

### What about capital gains tax?
In 2004-2005 you could make capital gains of £8,200 before paying capital gains tax. The limit rises to £8,500 in 2005-2006. Any taxable capital gains are treated as your final slice of income. This means they are allocated against the tax bands after all your other income. You pay 10, 20 (again, not 22) or 40 per cent, depending on which tax band the gains fall into. See p52.

**You don't pay tax on gifts to charity made through Gift Aid or a payroll-giving scheme**

### What's the inheritance tax threshold?
In 2004-2005, inheritance tax applied to estates above £263,000, rising to £272,000 in 2005-2006; 40 per cent is charged on death. See p62 for more on inheritance tax.

### I want to donate to charities
You can make your gift go further if you donate in a tax-efficient way. You don't pay tax on gifts made through the following schemes:

- Gift Aid. Charities can reclaim the basic rate of tax on any gifts you make to them, increasing the value of the gift. For example, a £10 donation through Gift Aid is worth £12.82 to the charity. For your gift to qualify for Gift Aid, you must pay at least as much tax as the charities will reclaim in the tax year that you make the gifts, and you must make a declaration to the charity that you want your gift to be treated as a Gift Aid donation (the charity will give you the necessary form). The Revenue also stipulates that you must not draw 'excessive benefits' from the charity in return for your donation. See Inland Revenue leaflet IR65 *Giving to charity by individuals*.

Higher-rate taxpayers can claim the difference between the basic- and higher-rate of income tax in their tax return on any gifts made through Gift Aid. As Gift Aid involves claiming back tax on gifts made, non-taxpayers are normally excluded. However, tax credits on dividends, which are not recoverable by non-taxpayers, do count as tax paid by the individual.

- Payroll giving. If your employer runs a payroll-giving scheme, you can use it to make regular payments to charity. You simply authorise your employer to deduct an amount from your pay or pension each month. As your gift is deducted from your pay before PAYE tax is applied, you get tax relief at your highest rate of tax without having to reclaim any money through your tax return. This means a donation of £10 will cost a basic-rate taxpayer £7.80, and a higher-rate taxpayer £6.

### Are there other tax-efficient ways of giving?
Yes. You can get tax relief against your income if you give shares or securities to charity. The amount you can deduct is the market value of the investments plus any costs you incur, such as stockbroker's fees. You have to take away the value of anything the charity gives you in return. As you're giving shares, you won't be liable for capital gains tax. You claim your tax relief through question 15a on your tax return. If you don't get a tax return, you should ask the Revenue to amend your PAYE code for the year. See Revenue leaflet IR178 *Giving shares and securities to charity*.

Similarly, you can get tax relief by giving land or buildings. The tax relief against income is in addition to the existing exemption from capital gains tax. Donors have to show that the charity has accepted the gift to get the tax relief. ■

## ALLOWANCES AND TAX BANDS

| | 2004-2005 tax year (£) | 2005-2006 tax year (£) |
|---|---|---|
| **Personal allowance** | | |
| Basic | 4,745 | 4,895 |
| Age-related: if you're 65 to 74 | 6,830 | 7,090 |
| Higher age-related: if you're 75 or over | 6,950 | 7,220 |
| **Married couple's allowance**[a] | | |
| Minimum amount | 2,210 | 2,280 |
| Either spouse aged 65 before 6 April 2000 | 5,725 | 5,905 |
| Either spouse aged 75 or over | 5,795 | 5,975 |
| **Tax bands** | | |
| Starting rate (10%)[b] | up to 2,020[c] | up to 2,090[c] |
| Basic rate (22%)[b] | 2,020 to 31,400[c] | 2,090 to 32,400[c] |
| Higher rate (40%)[b] | over 31,400[c] | over 32,400[c] |

**a** Relief restricted to 10 per cent of the allowance. Allowance abolished from 6 April 2000 for most taxpayers. It remains for married couples where one or both parties was born before 6 April 1935
**b** For 2004-2005 tax year. Rates for 2005-2006 not known at time of going to press
**c** In addition to the value of the allowances

## MORE HELP