ALAMY

ACTION POINTS

Check missed allowances
You may have been eligible for an allowance you didn't claim.

Remember your accountability
If you receive some income without tax deducted but you are liable for tax, you must declare it to Revenue & Customs.

Pay your dues
It is a criminal offence to try to defraud Revenue & Customs, by not declaring what you should or by claiming what you shouldn't.

Donate to charity tax-efficiently
Your donation will go further by giving via the gift-aid scheme or, if you're employed, your employer's payroll-giving scheme.

Tax basics

Tax isn't child's play, but our guide to the UK tax system should help you get a grip

We explain the taxes you might have to pay, how much of your income is taxed, plus this year's allowances, the basics of capital gains tax and inheritance tax and tax-efficient ways to give to charity.

TAX FACTS

Use our questions and answers to find your way round the UK system.

What are the taxes I might have to pay?

Some of the main taxes that you might pay are:

- income tax – on earnings, pensions, benefits, savings and investment or rental income. Your taxable income is often less than the income you actually receive (see 'Is all my income taxed?', p6). You may also be charged income tax on fringe benefits, such as a company car
- National Insurance contributions – on your income from working or business profits. Some contributions mean that you qualify for certain state benefits, such as the basic state pension, incapacity benefit and bereavement benefits. See p63
- stamp duty – charged on certain documents, and stamp duty land tax charged on land (for example, when you buy or, sometimes, transfer property). Stamp duty has now been abolished in some areas for properties of £150,000 or less
- taxes on things you buy – for example, value added tax (VAT) on most goods and services; insurance premium tax on general insurance, such as motor, household and travel insurance
- inheritance tax – on your estate after you die and possibly on some gifts you make during your lifetime. See p53
- capital gains tax – on any profit when you sell or give away something you own. See p49
- council tax (domestic rates in Northern Ireland) – charged on property by your local authority.

Are all kinds of income taxed?

No. Some are tax-free – for instance, interest and most income from sums invested in Isas (individual savings accounts) and certain National Savings & Investments products (see p35). You don't have to tell Revenue & Customs (formerly, the Inland Revenue) about tax-free income.

TIP

Make sure you arrange your affairs as tax-efficiently as possible – by claiming all the allowances you're entitled to, for instance, and keeping to deadlines. Our guide will help you.

Is all my income taxed?

No. Everyone is allowed to earn a certain amount in a tax year before tax is deducted. This is known as the personal allowance. In 2006-2007 the personal allowance for people under 65 is £5,035 (£4,895 in 2005-2006). People aged 65 or over may get a higher amount, known as the higher personal allowance. For people aged 65 to 74, this can mean a personal allowance of £7,280 in 2006-2007 (£7,090 in 2005-2006). People over 75 may get even more (£7,420 for 2006-2007; £7,220 in 2005-2006). You may also be entitled to earn more before tax if you or your spouse or registered civil partner are blind. See p31.

In addition, certain expenses can be set against tax. Some payments you make from taxable income – for example, contributions to pension schemes (see p27) or gift-aid payments to charity (see p8) – also qualify for tax relief.

So how much do I pay?

Non-savings income (from employment, self-employment, pensions and rental income) is taxed at three rates depending on how much you earn – see our 'Tax bands at a glance' table, below.

Savings income is also taxed at three rates. Depending on what tax band it falls into when added to your income from employment, it's taxed at 10, 20 (not 22) or 40 per cent. Dividend income (from shares) is treated differently. Starting- and basic-rate taxpayers pay 10 per cent tax, higher-rate taxpayers pay 32.5 per cent. Income from life insurance policies is also treated differently (see p38).

Non-savings income is normally allocated against your tax bands first before savings, dividends and capital gains – so to find out at what rate interest on your savings is taxed, you must add it to your other taxable income; see 'Example', above.

Can I get married couple's allowance?

You now qualify for this allowance only if you or your husband or wife were born before 6 April 1935. Unlike the personal allowance, the married couple's allowance is 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 tax you pay. So if you receive married couple's allowance of £6,065 in 2006-2007, £606.50 will be taken off your tax bill (£6,065 x 10 per cent). Since 5 December 2005, same-sex civil partnerships also qualify for married couple's allowance, as long as one of the partners meets the age criteria. See p33 for more on this type of restricted allowance.

EXAMPLE

Jane earns £35,000 a year. In addition, she has £1,000 savings income, £500 dividend income and a £3,000 taxable capital gain. Her only allowance is the personal allowance of £4,895. She works out how much income tax she'll pay for 2005-2006.

STEP 1 Jane applies non-savings income against the tax bands. She deducts her personal allowance from her income. This leaves her with £30,105 which she'll be taxed on. The first £2,090 is taxed at 10 per cent (the starting rate); the remaining £28,015 is in the basic-rate tax band, which means it's taxed at 22 per cent.
Tax on non-savings income **£6,372.30**

STEP 2 Jane applies savings income against the tax bands. Jane has used £28,015 of the £30,310 basic-rate tax band, so she has £2,295 left. All her savings income (£1,000) falls within the basic-rate tax band so it is taxed at 20 per cent.
Tax on savings income **£200**

STEP 3 Jane applies dividend income against the tax bands. She has now used £29,015 of the £30,310 basic-rate tax band, so she has £1,295 left. All her dividend income (£500) falls within the basic-rate tax band, so it is taxed at 10 per cent.
Tax on dividend income **£50**

STEP 4 Jane applies her capital gain against the tax bands. She has only £795 of her basic-rate tax band left, so £795 of her £3,000 capital gain is taxed at 20 per cent and the remaining £2,205 is taxed at 40 per cent.
Tax on capital gains **£1,041**

Jane's total tax bill £7,663.30

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 p14). Although most people pay tax through PAYE, some people have to fill in a tax return – if you are self-employed, for example, or have a large amount of investment income (see p60). The tax return tells Revenue & Customs how much income you received during the tax year and what allowances and other reliefs you're entitled to.

If you receive some income without tax deducted but you are liable for tax, you have to declare the income to Revenue & Customs – your tax office will tell you how to do this. You pay the extra tax either through a tax return or via an adjustment to your tax code if you are a PAYE taxpayer.

Most savings and investments income has tax deducted before you receive it at the special savings rate of 20 per cent. You have 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. Non-taxpayers may be able to claim it all back. See p36.

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 p36).

What about National Insurance?

Everyone who earns over a certain threshold has to pay National Insurance as well as income tax. In 2006-2007, National Insurance contributions for employees (class 1) are 11 per cent of earnings between £97 and £645 a week and

TAX BANDS AT A GLANCE

	2005-2006 tax year (£)	2006-2007 tax year (£)
Starting rate (10 per cent)	up to 2,090[a]	up to 2,150[a]
Basic rate (22 per cent)	2,090 to 32,400[a]	2,151 to 33,300[a]
Higher rate (40 per cent)	over 32,400[a]	over 33,300[a]

a Deduct unrestricted allowances from your income before applying the tax bands

SAVE ON YOUR TAX

Claim all the allowances you are entitled to, even those that no longer exist. It could lead to a reduction in the amount of tax you pay

You might be able to save on tax by claiming allowances you were once eligible for but did not claim, even if they no longer exist. You have until 31 January 2007 to claim allowances you were eligible for in the 2000-2001 tax year.

There are two types of allowance. An unrestricted allowance is treated as the amount of income you can earn tax-free; a restricted allowance relief is limited to a maximum of 10 per cent of the allowance (so you get up to 10 per cent of the allowance off your tax bill). The table shows the amount of each allowance and what it could be worth – though, depending on your income, you may not get the full amount.

ALLOWANCES AT A GLANCE

	2000-2001 (£)		2001-2002 (£)		2002-2003 (£)		2003-2004 (£)		2004-2005 (£)		2005-2006 (£)		2006-2007 (£)	
	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth	Amount	Worth
UNRESTRICTED														
Personal	4,385		4,535		4,615		4,615		4,745		4,895		5,035	
Higher personal (65 to 74)	5,790		5,990		6,100		6,610		6,830		7,090		7,280	
Higher personal (75 or over)	6,050		6,260		6,370		6,720		6,950		7,220		7,420	
Blind person's	1,400		1,450		1,480		1,510		1,560		1,610		1,660	
RESTRICTED														
Married couple's	2,000[a]	200	2,070[a]	207	2,110[a]	211	2,150[a]	215	2,210[a]	221	2,280[a]	228	2,350[a]	235
Higher married couple's (65 to 74)	5,185[a]	519	5,365[a]	537	5,465[a]	547	5,565[a]	557	5,725[a]	573	5,905[a]	591	6,065	607
Higher married couple's (75 or over)	5,255	526	5,435	544	5,535	554	5,635	564	5,795	580	5,975	598	6,135	614
Widow's bereavement	2,000[b]	200												
Maintenance relief	2,000[c]	200	2,070[c]	207	2,110[c]	211	2,150[c]	215	2,210[c]	221	2,280[c]	228	2,350[c]	235
Children's tax credit			5,200	520	5,290	529								
Baby rate					10,490	1,049								

UNRESTRICTED

Personal The main allowance that everyone gets. It's unlikely you won't have received it. If you're 65 or over, you can claim a higher amount. You can't claim any unused part back or transfer it to your spouse.

Blind person's In England and Wales, you must be registered as blind on a local authority register to claim this. In Northern Ireland or Scotland, you qualify if you can't perform any work for which eyesight is essential. You can transfer any unused surplus to your spouse or, since 5 December 2005, a registered civil partner.

RESTRICTED

Married couple's You can now claim this only if you or your spouse or registered civil partner were born before 6 April 1935. Higher amounts are available if your income falls below a set limit – see p33 for more.

Widow's bereavement This was given to widows in the year of their husband's death and for the year after, provided that they didn't remarry. It was abolished for deaths after 5 April 2000, though a woman widowed in 1999-2000 can still claim it for 2000-2001 unless she remarried in the year of her husband's death.

Maintenance relief This is available to some people who make enforceable maintenance payments (see p31). Either the payer or recipient must be born before 6 April 1935.

Children's tax credit This was introduced on 6 April 2001 and abolished in April 2003. You can claim any missed allowance you didn't claim at the time if a child under 16 was living with you at any time between 6 April 2001 and 5 April 2003. In 2002-2003 the allowance was doubled if you had a baby between 6 April 2002 and 5 April 2003. It has been replaced by the child tax credit.

NOTES TO TABLE

a Available only if you or your spouse were born before 6 April 1935

b Available only if you were eligible to claim widow's bereavement allowance in 1999-2000

c Available only if you or your ex-spouse were born before 6 April 1935

Figures are rounded up to the nearest pound

Warning

As gift aid involves claiming back tax on gifts made, non-taxpayers should normally not use it as a tax-efficient way of donating to charities.

1 per cent on earnings above this. See 'National Insurance', p63.

When do I have to pay capital gains tax?

In 2006-2007 you can make capital gains of £8,800 before paying capital gains tax. 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, as with savings income, not 22) or 40 per cent, depending on which tax band the gains fall into. So if you make taxable capital gains of £1,000, say, they would be taxed at 20 per cent if, when added to your other income, they fall in the basic-rate tax band (see 'Tax bands at glance', p6). For more on capital gains tax, see p49.

And inheritance tax?

In 2006-2007, inheritance tax applies to estates above £285,000. Forty per cent tax is payable on anything that falls above this threshold (apart from where there are tax exemptions). See p53.

Can I donate to charity tax-efficiently?

You can make your gift go further if you donate in a tax-efficient way.

- Gift aid – charities reclaim the basic rate of tax on any gifts you make, increasing the value of the gift. So a £10 donation through gift aid is worth £12.82 to the charity.

For your gift to qualify for gift aid, you must pay enough tax to cover the amount of tax the charity will reclaim in the tax year in which you make the gifts. You must also 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). Revenue & Customs also stipulates that you must not draw 'excessive benefits' from the charity in return for your donation. See HMRC helpsheet IR65 *Giving to charity by individuals*. If you are a higher-rate taxpayer, you can claim back the difference between the basic and higher rate of income tax on any gifts made through gift aid. As gift aid involves claiming back tax on gifts made, non-taxpayers should not normally use it. 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 that a donation of £10 will cost a basic-rate taxpayer £7.80 and a higher-rate taxpayer £6.

Are there any other tax-efficient ways of giving?

You can get tax relief by giving shares or securities to charity. The amount you can deduct is the market value of the investments plus any costs you incur such as stockbrokers' fees. You have to take away the value of anything the charity gives you in return. You're not liable for capital gains tax when you dispose of them.

You claim your tax relief through question 15a on your tax return. If you don't get one, you should ask your tax office to amend your PAYE code for the year. See HMRC leaflet IR178 *Giving shares and securities to charity* for more information.

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.

Can I avoid paying tax?

Tax avoidance, where you arrange your finances to pay as little tax as possible, is a legal, recognised principle, though it is being increasingly attacked by Revenue & Customs. Tax evasion, where you conceal income or gains or fraudulently claim allowances or other deductions, is a criminal offence. You can be fined or even imprisoned.

MORE HELP

Which? Tax Saving Guide 2006-2007

SOME BASIC TAX TERMS AT A GLANCE

ASSET
Any property (not just buildings) owned by an individual or company.

FRINGE BENEFIT
Benefits in kind, usually received in a form other than cash.

HMRC
Her Majesty's Revenue & Customs, the government department responsible for collecting most tax revenue and for paying tax credits and child benefits. Previously known as Inland Revenue.

INCOME
Any amount of money earned over a set period of time – for example, salary and interest from savings.

PAYE
Stands for pay as you earn – the system by which your employer deducts tax and National Insurance contributions from your salary and passes it on to HMRC.

PERSONAL ALLOWANCE
The amount you can earn before you start to pay tax.

RESTRICTED ALLOWANCE
Relief is limited to 10 per cent of the allowance. This means it reduces your tax bill by up to 10 per cent of the allowance you're entitled to.

UNRESTRICTED ALLOWANCE
An allowance which is treated as the amount of income you can earn tax-free.