Are your family tax winners or losers?

Inheritance tax reforms will protect many family homes. We explain the new deal and other key tax changes for 2008-09

The new tax year begins on 6 April, and there are changes on the way. Some people may be out of pocket, but others will benefit from major changes to inheritance and capital gains tax. Here we explain the changes and give illustrative examples to show the impact they could have on typical consumers.

Inheritance tax

If your estate is likely to be worth more than £312,000 and you have been worried that your children may need to sell your home to meet their inheritance tax (IHT) bill, you can rest more easily. Changes to the system mean that most widows, widowers and surviving civil partners are now able to add their deceased partner's unclaimed IHT allowance to their own, effectively doubling the amount that can be passed on tax-free.

A widow or widower whose spouse made no taxable (or potentially taxable) gifts, either in their will or the seven years before death, can leave £624,000 of their own estate free of IHT in 2008-09. The rest is taxed at 40 per cent. Under the previous system, they would have had to pay 40 per cent on anything more than £312,000 in 2008-09.

If you live in a house worth more than £312,000 you can rest more easily

The change will remove a serious source of anxiety from many people's lives. However, unmarried partners, or those not in a civil partnership, do not benefit, as they cannot use their partner's allowance.

The threshold at which inheritance tax is payable has increased from £300,000 to £312,000 for 2008-09, as one of a series of increases that will see it reach £350,000 by 2010-11.

EXAMPLE

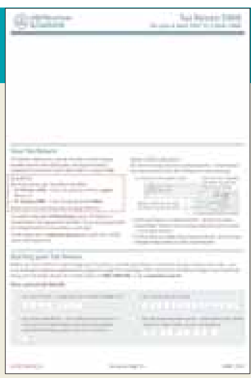
Mrs Smith lives in a house worth £450,000 and also has savings and investments worth £50,000. Her husband died last year and had not made any gifts in the last seven years. Under the old rules, if Mrs Smith was to die during the 2008-09 tax year, only £312,000 of her estate would have been free from IHT. Her children would have faced a 40 per cent charge on the remaining £188,000 – a bill of £75,200. Under the new tax system, there would be no bill to pay.

POTENTIAL WINNERS Married couples, civil partners, widows and widowers with estates worth between £312,000 and £624,000.

POTENTIAL LOSERS People who spent money making arrangements specifically to minimise their IHT bill.

UNAFFECTED Unmarried couples, single people and couples with estates worth less than £312,000.

NEW SIMPLER TAX FORM LAUNCHED



If you find filling in your tax return confusing, there is good news. The basic self-assessment tax return has been simplified and shortened for 2008-09. Instead of ten pages, the standard form now has only six. The questions are intended to be clearer and easier to follow, too.

If you want to work out your own tax bill, you now have to order extra pages. You will need to order the 'tax calculation summary' form (SA110 2008) in advance by calling 0845 900 0404.

If you file online, your tax bill will be worked out automatically.

Don't miss a tax deadline

How to avoid a £100 fine

- If you fill out a paper tax return, this must be sent back by 31 October this year (in previous years you had until 31 January).
- The deadline for getting HMRC to work out your bill if you make a paper return has been extended to 31 October from 30 September.
- 31 January remains the deadline for online filing. You face a fine of up to £100 if you miss a deadline.

Capital gains tax

Capital gains tax (CGT) bills are set to fall for some people selling second homes, shares or other high-value possessions. However, they could rise for large business investors.

If your capital gain (the difference between the price you paid and the price you sell at) is more than the tax-free limit of £9,600 in 2008-09, you will now face a CGT bill of 18 per cent on the rest. Most taxpayers previously paid 20 per cent or 40 per cent, depending on their income.

At the same time, taper relief and indexation, which reduced CGT bills on items you sold after owning them for a number of years, have been abolished.

Many owners of business assets, particularly those selling off long-held family businesses, would have been hit by the abolition of taper relief. Under the old system they might have paid CGT at 10 per cent, rather than the new 18 per cent rate.

To help, the government is offering 'Entrepreneurs' relief' for people selling businesses and large shareholdings. The first £1m gain will be taxed at 10 per cent, with any gain above this being taxed at 18 per cent. To qualify, you must own the business or at least 5 per cent of its shares.

PHOTOGRAPHY GETTY IMAGES, ALAMY

EXAMPLE

Mr Jones, a 40 per cent taxpayer, is selling a holiday cottage he bought for £65,000 in May 2000. He will sell it this May for £160,000. Under the old system he would have paid £23,912 in CGT. However, under the new system he will pay only £15,372 – a saving of £8,540.

POTENTIAL WINNERS Most people who would previously have paid CGT at 40 per cent and some 20 per cent taxpayers.

POTENTIAL LOSERS People who would previously have paid CGT at less than 18 per cent because they held assets for a long time.

UNAFFECTED People whose capital gain is less than around £9,600 in 2008-09. (Married couples who own assets jointly have a combined allowance of £19,200.)

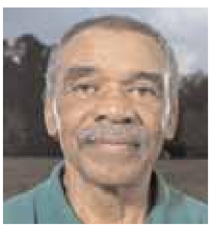
Income tax

The basic rate of income tax has been cut by 2 per cent to 20 per cent, and the 10 per cent starting tax rate for low earners has been abolished. The top rate of tax stays at 40 per cent, but the threshold at which you start to pay this rate on taxable income rises to around £35,800 in 2008-09 and £37,425 in 2009-10 (final figures will be confirmed in the 2008 Budget).

The changes will have little impact on most people's wallets, as the fall in the basic rate is cancelled out by the abolition of the starting rate. There is a fear that low earners could be worse off, and the government is raising some tax credits to help, but single people with no children will not benefit.

The government has increased age-related allowances so that retired people pay tax on less of their income. If you are aged between 65 and 74 you can earn £9,030 in 2008-09 before you start paying tax (previously the limit was £7,550). Those aged 75 and beyond will be able to earn up to £9,180 tax-free.

EXAMPLE



Mr Johnson is 60 and lives alone. He earns £18,000 a year. Under the old system he would have paid £2,486 income tax. Under the new system his income tax bill will rise by £27 to £2,513.

POTENTIAL WINNERS People aged over 65, who will pay tax on less of their income.

POTENTIAL LOSERS Low earners under 65, particularly single people without children; those who fail to claim tax credits.

LARGELY UNAFFECTED Most middle-income earners.

Tax bills are set to fall for many people selling second homes

OUR ESTIMATES

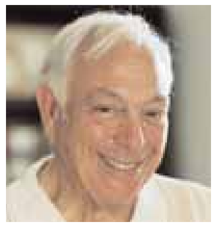
Our figures are estimates. Final figures will be confirmed in the Budget. We have assumed that:

- the upper limit for starting rate tax on savings (10 per cent) will increase from £2,230 to £2,320.
- the starting point for 40 per cent income tax will rise from £34,600 to £35,800 of taxable income.
- the capital gains tax allowance will rise from £9,200 to £9,600.

Savings tax

If you have little or no income apart from your savings (below around £2,320 for 2008-09), you can reclaim half the tax you pay on some of your savings interest (it is normally deducted at 20 per cent by banks and building societies). To do this, use repayment claim form R40. People who earn less than £5,435 in total don't have to pay tax on savings at all. Use form R85 to receive interest tax-free if this applies to you. See www.which.co.uk/money for more.

EXAMPLE



Mr Gregory is 66. His pension pays him £10,000 a year and he also receives £1,500 interest on his savings. He has to pay tax on £970 of his pension, as his age means he can now earn £9,030 before he starts paying tax (see 'Income tax', left). £1,350 of his savings income will fall into the starting rate band and be taxed at 10 per cent (£135). The remaining £150 will be taxed at 20 per cent (£30).

The total tax due on his savings income is therefore £165. If tax were charged at 20 per cent on the full amount, with the bank or building society deducting £300, he could claim a tax refund of £135 using form R40.

Increased Isa limits

Save £600 more in a cash Isa in 2008-09

TAX-FREE SAVINGS The overall annual Isa limit has been increased for 2008-09, from £7,000 to £7,200. Of this, the amount you can put into a cash Isa has gone up from £3,000 to £3,600. For more on Isas, see 'Are you ready for the risk?', p22, and 'Money monitor', p26.

For more on tax, see the *Which? Tax Saving Guide*, which will be sent to all members with the June issue.