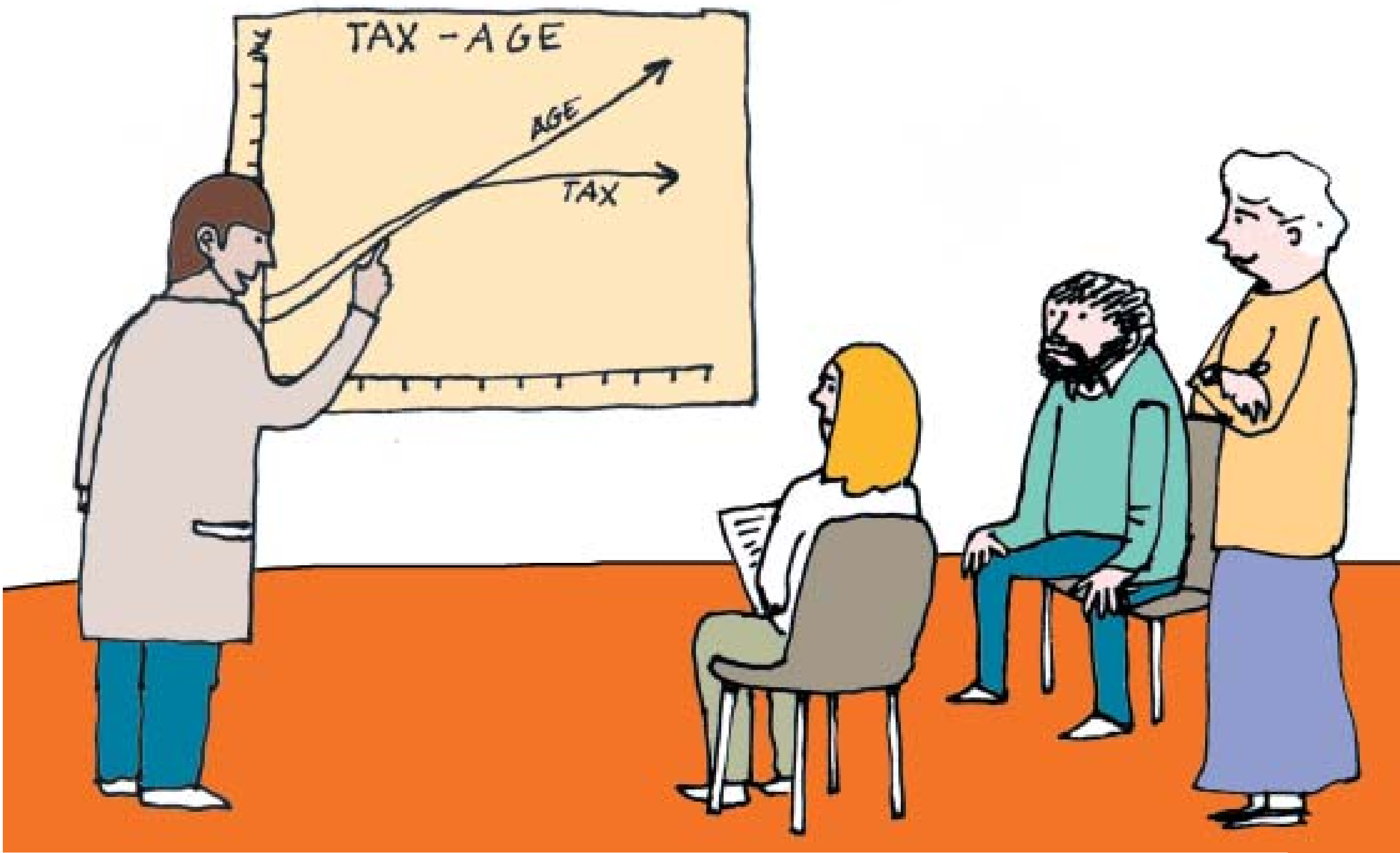

TAX IN LATER YEARS

You don't escape paying tax when you get older – but you do pay less. You may also be entitled to extra allowances

From the year you reach 65, you may be able to receive more income before you start having to pay tax.

EXTRA TAX ALLOWANCES

Everyone gets a personal allowance – an amount of income you can have tax-free each year. For most people, it's £4,745 in 2004-2005 (and £4,895 in 2005-2006). But from the start of the tax year in which you reach 65, you may get a higher amount, called age allowance. This is:

- £6,830 in 2004-2005 (£7,090 in 2005-2006) if you're aged 65 to 74
- £6,950 in 2004-2005 (£7,220 in 2005-2006) if you are 75 and over.

If your 'total income' exceeds a certain amount – £18,900 in 2004-2005 (£19,500 in 2005-2006) – you lose £1 of the extra allowance for every £2 of excess income. For example, if your total income is £20,500 in 2004-2005, it is £1,600 over the limit and so you lose £800 of allowance, reducing, for example, a 65-year old's allowance from £6,830 to £6,030. But your allowance is never reduced to below the amount under-65s get. Use the calculator on p43 to work out how much you can get.

MARRIED COUPLE'S ALLOWANCE

If you are married, and either you or your husband or wife were born before 6 April 1935, the husband can claim married couple's allowance. This gives you a reduction in your tax bill of up to 10 per cent of the amount of the allowance. The minimum allowance is £2,210 in 2004-2005 (£2,280 in 2005-2006), reducing your tax bill by up to £221 for the 2004-2005 tax year (£228 in 2005-2006). You may qualify for extra married couple's allowance, depending on your income, taking the total to:

- £5,725 in 2004-2005 (£5,905 in 2005-2006) if either of you was born before 6 April 1935 but both of you are under age 75 during the whole tax year
- £5,795 in 2004-2005 (£5,975 in 2005-2006) if either of you is aged 75 or over at any time during the tax year.

The extra is reduced by £1 for each £2 by which the husband's total income exceeds the age allowance threshold of £18,900 in 2004-2005 (£19,500 in 2005-2006). If the husband also qualifies for personal age allowance, it is reduced first before any reduction in married couple's allowance. The allowance is never reduced to below the minimum amount. Use our calculator on p43 to work out how much you should get.

Age allowances are not reduced to below the minimum amount

HOW TO KEEP YOUR EXTRA ALLOWANCE

You begin to lose age allowance if your 'total income' goes over the limit. Total income means your gross taxable income less certain deductions, such as Gift Aid donations (including those made by deed of covenant) and some pension contributions. If your income is in the range where you are losing age allowance – see the table, below right – ways you could cut your total income to boost age allowance include:

- investing for tax-free income rather than taxable income – for example, by using your yearly Isa allowance and considering National Savings & Investments savings certificates
- investing for capital gains rather than income – growth unit trusts, say
- paying into a personal pension up to age 75. A contribution made by 31 January 2006 and carried back to the previous year will reduce your total income for 2004-2005
- putting off claiming your state pension if you don't need it yet. (When it does eventually start, you'll get extra pension or, if you deferred for at least a year, the option of a lump sum instead. The extra pension or lump sum will be taxable)
- making Gift Aid donations to charities, churches and approved sports clubs. A donation made now and carried back to last year will reduce your total income for 2004-2005.

You can apply to have either half or the full amount of the minimum allowance (but not the extra amount) transferred to your wife to reduce her tax bill. But the amount of allowance is still worked out on the basis of the husband's total income. You must normally apply before the start of the tax year to transfer the allowance in this way – for example, apply by 5 April 2005 for the 2005-2006 tax year. But in the year you marry, you have until the end of the tax year to make the application.

If any of the married couple's allowance allocated to you is unused at the end of the tax year (because your tax bill is too low), you can apply to have the unused part transferred to your spouse.

Under the Civil Partnership Act, the same provisions are likely to apply to same-sex couples provided that they register as a civil partnership.

Maintenance relief

Following separation or divorce, if you or your spouse were born before 6 April 1935, you can claim tax relief on qualifying maintenance payments you make up to £2,210 in 2004-2005 (£2,280 in 2005-2006). Relief is given at 10 per cent of this amount as a reduction in your tax bill. So, in 2004-2005, the maximum reduction is £221 (£228 for 2005-2006).

If you have remarried, you can claim maintenance allowance in addition to married couple's allowance if you qualify for both.

LOSING AGE ALLOWANCE

Range of income where you lose your age allowance

	2004-2005	2005-2006
If you are single person or a wife		
Aged 65 to 74	£18,900 - £23,070	£19,500 - £23,890
Aged 75 or over	£18,900 - £23,310	£19,500 - £24,150
If you are a husband		
You under 65, wife 70 to 74 in 2004-2005 or 71 to 74 in 2005-2006	£18,900 - £25,930	£19,500 - £26,750
You under 65, wife 75 or over	£18,900 - £26,070	£19,500 - £26,890
You 65 to 69, wife under 70 in 2004-2005 or you 65 to 70, wife under 71 in 2005-2006	£18,900 - £23,070	£19,500 - £23,890
You 65 to 69, wife 70 to 74 in 2004-2005 or you 65 to 70, wife 71 to 74 in 2005-2006	£18,900 - £30,100	£19,500 - £31,140
You 65 to 74, wife 75 or over	£18,900 - £30,240	£19,500 - £31,280
You 70 to 74 in 2004-2005 or 71 to 74 in 2005-2006, wife under 75	£18,900 - £30,100	£19,500 - £31,140
You 75 or over	£18,900 - £30,480	£19,500 - £31,540

If your income falls within the ranges shown, you lose some of your age allowance. If your income is at or above the top of the range, you lose all your age allowance and receive just the minimum allowance. Ages mean the age you reach on your birthday falling within the tax year. Couples should look at each person's position separately. Unmarried couples are treated as two single people. When the Civil Partnership Act comes into force, same-sex couples who have registered as a civil partnership are likely to be treated in the same way as married couples.

EARNINGS IF YOU CONTINUE TO WORK

If you are still working as an employee, your employer will pay you through PAYE (see p16) after deducting any tax due on the earnings and other taxable income you receive gross. Your employer should give you a P60 after the end of the tax year showing your total pay for the year and tax deducted.

As soon as you reach state pension age, you no longer pay Class 1 (employee) or Class 2 (self-employed) National Insurance. Class 4 contributions (paid by self-employed people whose profits reach a certain limit – see p38) stop at the end of the tax year in which you reach state pension age – so, depending on your accounting year end (see p27), some profits earned before state pension age may escape contributions.

If you are an employee, give your employer the certificate of age exception (which you are sent automatically on claiming your state pension). If you're self-employed, your tax or contribution office should automatically stop your Class 2 payments without any action from you.

HOW YOUR INCOME IS TAXED

You usually have new sorts of income in retirement. We explain how they are taxed, and warn against those that give a poor tax deal.

State pension and benefits

The state basic, additional and graduated pensions are taxable but paid to you without any tax deducted. To check how much state pension you received during the tax year, ask The Pension Service for form BR735. If your income is high enough for tax to be due, it will be collected through PAYE if you are still working or get an occupational or personal pension (see right) or through your tax return. Note that, if your tax affairs are straightforward, you might be sent the short, four-page tax return (form SA200) – see p12 – or not have to fill in a tax return at all.

State pensions are taxable but paid without any tax deducted

You might receive other state benefits along with your pension. Some of these are tax-free, in particular:

- £10 Christmas bonus
- attendance allowance available if you need help with your personal care or mobility
- war widow's pension
- pension credit. This may be made up of one or two parts – a sum to bring your income from all sources up to a guaranteed minimum level (£109.45 a week for a single person and £167.05 for a couple in 2005-2006) and/or the savings credit designed to reward you for having made your own savings for retirement
- a winter fuel payment of £100 to £300 in winter 2004, depending on your circumstances
- payments to the over-70s to help with council tax bills (£50 or £100 in winter 2004).

Occupational and personal pensions

Occupational and personal pensions are normally taxable. Exceptions are any extra pension you receive because you were injured at or disabled by work and 10 per cent of most foreign pensions.

Retirement pension, widow's pension or other income from an occupational scheme or personal pension is paid through PAYE where possible. This means that any tax due on these pensions and on income you get from other sources without tax deducted (such as any state pension and interest on National Savings & Investments income bonds) is deducted from the occupational or personal pension before you get it.

Your tax office will send you a coding notice before the start of the tax year. Check this is correct (see p17) to make sure that your pension provider deducts the right amount of tax. In particular, check that you are being given age allowance if this applies to you. The organisation paying you will give you a P60 shortly after the end of the tax year summarising the amount of pension you received and the total tax deducted.

If you get more than one occupational and personal pension, often PAYE will collect all the tax due out of your main pension and the others will be paid gross.

PAYE does not apply to a pension from a retirement annuity contract (the sort of personal pension scheme available before 1988). Tax will be deducted at the basic rate – though if you are a non-taxpayer, you can arrange with the provider to pay you gross (form R89). If you have paid too much tax, claim a refund – you can use form R40 (see p48).

Savings and investments

Savings interest is usually paid net but you can arrange to have it paid gross if you are a non-taxpayer (see p48). Not all banks and building societies will split interest from a joint account if only one of you is a non-taxpayer. In that case, you will have to reclaim tax on your half of the interest – use form R40.

If you have a purchased life annuity and you are a non-taxpayer, you can arrange to receive the income (or your share of it in the case of a joint annuity) net by completing form R89. Part of the income is normally treated as return of your capital and is tax-free. But if the annuity was bought by executors under terms of a will or by trustees from a trust, the whole of the income is taxable at the savings rate.

Insurance

Take care with life insurance bonds, such as with-profits bonds. You can draw a limited income

OVERTAXED?

Because PAYE is used to collect tax on other income, it may look as if your occupational, personal pension or earnings are being taxed at an unusually high rate. For example, suppose you are 67 in 2004-2005 and get a state pension of £7,000 a year plus an occupational pension of £8,000. Tax comes to £1,555 and is all deducted through PAYE from the occupational pension, so you get a net amount of £6,445. Nearly a fifth of your occupational pension has been lost in tax, but this is correct because it includes tax on your state pension as well.

AGE ALLOWANCE CALCULATOR 2004-2005

PART 1: YOUR TOTAL INCOME		
Add together your before-tax income from: jobs (including taxable perks but less pension contributions, payroll giving to charity and allowable expenses) business profits pensions taxed and taxable investments property and any other sources	A	£
Add together the gross amount of any payments you make to: charity using the Gift Aid scheme personal pensions and retirement annuity accounts qualifying loan interest (for example, loan to buy a stake in certain types of business)	B	£
Deduct B from A. This is your 'total income'	C	£
The age allowance income limit 2004-2005	D	£18,900
Subtract D from C	E	£
PART 2: YOUR PERSONAL AGE ALLOWANCE		
If E=0 or less, your personal age allowance is: if you are aged 65 to 74: **£6,830** if you are aged 75 and over: **£6,950** If E is greater than 0, write down your personal age allowance before any reduction (£6,830 or £6,950 depending on your age – see above)	F	£
Work out E divided by 2	G	£
Subtract G from F	H	£
If H is £4,745 or less, your personal allowance is **£4,745**.		
If H is more than £4,745, your personal allowance is **amount H**		
If you are a married man AND either you or your wife was born before 6 April 1935, continue with Part 3[a]. Otherwise, you have finished the calculator		
PART 3: MARRIED COUPLE'S ALLOWANCE		
If amount H is £4,745 or more, your married couple's allowance is: if you are both under age 75: **£5,725** if either you or your wife is aged 75 or over: **£5,795** If amount H is less than £4,745, write down the married couple's allowance before any reduction (£5,725 or £5,795 depending on the age of you or your wife – see above)	I	
Work out £4,745 minus H	J	
Subtract J from I	K	
If K is £2,210 or less, your married couple's allowance is £2,210.		
If K is more than £2,210, your married couple's allowance is amount K		

a Younger married couples cannot claim married couple's allowance.
The allowance is always worked out using the husband's total income even if part of the allowance is transferred to the wife

without it affecting your age allowance at the time, but you could lose age allowance in the year the bond matures or is cashed in. The return from these bonds is not tax-free (see p51) and they are not usually a suitable investment unless you are a higher-rate taxpayer. If you take out an equity release scheme (lifetime mortgage or home reversion scheme), the lump sum released is tax-free but any income from investing it (if you buy an annuity, for instance) is taxed in the normal way. Some lifetime mortgages release the loan in periodic payments which mimic an income but are tax-free. If you took out a lifetime mortgage before 9 March 1999 and you (and any joint annuitant) were 65 or over at that time, the interest may be reduced by tax relief (23 per cent in 2004-2005). But this applies only to the first £30,000 borrowed and is not available for schemes started later. If you have lifetime care insurance, any payout is normally tax-free as long as you took the policy out before you started to need care. Payouts from a lifetime care annuity (bought with a lump sum when you already need care) are tax-free only if paid direct to the care provider. ■

MORE HELP

Inland Revenue leaflet
- IR121 Income tax and pensioners

DWP leaflet
- NP46 A guide to retirement pensions

Websites
- Department for Work and Pensions www.dwp.gov.uk
- The Pension Service www.thepension service.gov.uk
- Low Income Tax Reform Group www.litrg.org.uk

Helpline
- Tax help for older people (if you are on a low income) 0845 601 3321