Factsheet 12

Planning your retirement: money and tax

April 2017

Inside this factsheet

This factsheet looks at some common money and tax issues connected with retirement, including dealing with pensions and tax allowances. It also explains about record-keeping and dealing with paperwork.

The information in this factsheet is correct for the period April 2017–March 2018. Benefit rates are reviewed annually and take effect in April but rules and figures can sometimes change during the year.

The information about tax in this factsheet is generally applicable across the UK but there are some variations for Scotland. The information about state benefits is applicable in England, Wales and Scotland. Northern Ireland and the Isle of Man have their own social security systems, but in practice the systems are so similar that most of the information in this factsheet also applies there.

Contact details for any organisation mentioned in this factsheet can be found in the Useful organisations section.

Contents

Glossary

VAT - Value Added Tax

PAYE - Pay As You Earn

NI - National Insurance

DWP - Department for Work and Pensions

HMRC - HM Revenue and Customs

CPI -Consumer Prices Index

1 State Pension

Pensions are the most common way of supporting yourself in retirement. Almost everyone will have some sort of pension, even if they also have other sources of income. Entitlement to the State Pension is based on NI contributions paid during your working life.

If your state pension age fell on or before 5 April 2016, you can receive the full basic State Pension if you had paid 30 years full NI contributions. If your state pension age falls on or after 6 April 2016, a new State Pension requiring 35 years of NI contributions for the full pension has been introduced.

State Pension age is being equalised between men and women and slowly increasing. From April 2017, pension age for men is 65 years and for women 63 and 9 months and rising until it reaches 65 in November 2018. From 2019, pension age for men and women will start to rise to reach 66 years by October 2020 and 67 years by 2028.

For more details see factsheet 19, *State Pension*.

Remember

If you are a woman, from April 2010 your State Pension age has been rising to equal that of men. You should receive a letter from the DWP with your new State Pension age if you were born after 5 April 1950.

Contracting out

Many people coming up to retirement have accrued extra benefits over their working lifetime based on salary, such as graduated contributions, State Earnings-Related Pension Scheme (SERPS) and the State Second Pension (S2P). These can more than double your pension. If you have paid in the maximum possible over your working life, you can have a State Pension of over £13,000 a year.

For most of the last 40 years, it has been possible to contract out of paying into the additional state pension schemes (such as SERPS and S2P) and instead to contribute part of your NI contributions to an occupational or personal pension scheme. These contracted-out schemes are required to pay certain guaranteed minimum pensions in place of what the state would have paid.

When you receive a pension statement (see section 1.1), you may find the additional state pension is reduced by an amount assumed to be provided by what your contracted-out scheme will pay. This involves complex calculations which may be difficult to understand. You have not '*lost*' this amount.

It is paid either through a personal pension plan with a life insurance company or as part of a company pension (although the assumed amount and what you receive may be different). This is particularly true of public-sector pensions. Police, teachers, local authority staff, civil servants and other public sector workers often do not receive much above the basic State Pension but do receive additional pension with their occupational pension. Contracting-out into defined contribution pension schemes was abolished in April 2012 (see section 2) and was abolished for defined benefit schemes with effect from 6 April 2016.

1.1 Pension statements

One of the most important steps in planning for retirement is getting a pension statement to estimate your total retirement income. You can obtain a statement from age 18 until four months before you reach State Pension age. This can be done online or by post from the Pensions Service. The closer you are to State Pension age, the more accurate the statement will be, since earlier forecasts are based on assumptions of your likely NI contributions.

Check your statement to see if it includes credits such as Home Responsibility Protection (replaced by NI credits for parents and carers from 6 April 2010) or credits you might have gained if you worked overseas in a country with mutual social security agreements.

1.2 Boosting your National Insurance contributions

If there are gaps in your NI contribution record, you can usually make up six years by voluntary contributions. Before doing so, seek advice from your local Age UK or an independent advice agency on how much extra pension you might get in return for the outlay. Ask how much more pension you receive for each extra year purchased. You should ask about any deadlines to meet or exceptions to the six year rule.

1.3 Claiming State Pension

You can claim the State Pension as soon as you reach State Pension age, whether you are working or not. You can choose whether to claim by telephone or internet. Alternatively, you can delay claiming ('*defer*') which can increase how much you are paid when you do claim.

Note
The State Pension must be claimed – it is not given automatically when you reach State Pension age.

For full details of how to claim, see www.gov.uk/state-pension/how-to-claim and have a look at factsheet 19, *State Pension.*

1.4 Deferring the State Pension

If you reached state pension age before 6 April 2016 and decided to delay claiming your State Pension, after five weeks it starts to increase at a rate equivalent to 10.4 per cent a year. If you deferred for a year or longer, you have the choice of taking the arrears as a taxable lump sum and your weekly pension at the basic rate in force at the time, or drawing your pension at an enhanced weekly rate. See below if you reach state pension age after 5 April 2016.

Example
If your State Pension was going to be £100 a week and you defer claiming for one year, you can take an enhanced pension of £110.40 (assuming no changes to rates). If you decide to take arrears, you receive a taxable lump sum of a little over £5,200 and State Pension of £100 a week (plus any increase in pension awarded in the intervening year).

There is special tax treatment of the lump sum. It is taxed at your marginal rate of tax, which is the highest rate you are due to pay in that tax year (ignoring any special rates of tax that apply to savings income). If your total taxable income for the year is below your allowances, the lump sum is not taxed, because you are a non-taxpayer. If you are a 20 per cent taxpayer, you pay 20 per cent tax.

It does not push you into the next tax band or over the threshold at which you start to lose personal allowances. Thus, if you are on £35,000 a year, you do not become a 40 per cent rate taxpayer because you receive a lump sum of £15,000.

You can start receiving State Pension but defer your lump sum until the following tax year when your marginal tax rate may be lower. If you are working during the year you start receiving State Pension, you may be a basic rate taxpayer. The following year, if your only income is State Pension, you may be below your allowances and therefore pay no tax on the lump sum.

Note
If you reached state pension age after 5 April 2016, the enhancement if you defer is about 5.8 per cent and you no longer have the option to collect a lump sum. You only receive the pension at the appropriately enhanced rate.

1.5 Taxation of State Pension

State Pension is taxable income but, unlike most other pensions, is not taxed at source. You must add it in to all your taxable sources of income to determine whether you are a taxpayer when you retire. If income from all your pensions and any work comes to less than your personal allowances, you do not pay tax on the State Pension. If, however, your total taxable income is above your allowances, tax is collected in one of two ways:

- '*Pay As You Earn*' (PAYE) if that source of income is large enough to bear the tax on both itself and State Pension, or
- annual self-assessment tax return, paying tax by 31 January the following year.

With PAYE, tax is collected by reducing your allowances by the amount of your State Pension. For example, if your allowance is £11,500 and your State Pension is £8,000, only £3,500 of spare allowances is given to any other pension. The tax is collected by reducing your allowances rather than by taking money directly off the state pension.

If you have a small pension that HMRC is not allowed to take more than 50 per cent in tax from or you have no other source of income, you must ask for a self-assessment return and pay the tax each year.

1.6 Other entitlements at State Pension age

Reaching State Pension age, whether you retire or not and whether you are a man or a woman, brings other entitlements.

If you reach State Pension age for women during the week beginning the third Monday in September, you are entitled to a Winter Fuel Payment. Most people are paid automatically but you must claim if you do not receive other benefits such as Pension Credit and have not received a Winter Fuel Payment before. The Winter Fuel Payment is paid to the first person in a household reaching qualifying age. If you and your spouse or partner both reach qualifying age, it is divided between you.

You may be entitled to Pension Credit for people on low incomes and moderate savings. If you retire with only your State Pension, your income is brought up to a minimum guaranteed level. The Savings Credit has been removed for people reaching pension age on or after April 2016. Receiving Pension Credit can entitle you to other benefits such as Council Tax Support (sometimes called Council Tax Reduction) and Housing Benefit. For more details, see factsheet 48, *Pension Credit.*

Pension Credit rules cover a range of situations, especially if you are disabled. If you have a low income, phone the DWP or an independent advice agency such as Age UK to see if you are eligible for help

If you are an unemployed man, you receive automatic NI credits once you reach the women's State Pension age, even if do not claim Jobseeker's Allowance. These count towards your State Pension.

2 Occupational and private pensions

2.1 Occupational pensions

Occupational pensions, also called works pensions, are schemes run by private and public sector employers. They vary widely in the benefits they provide and you can ask your scheme managers or trustees for details.

In a defined benefit (DB) scheme, where the pension depends on a combination of your length of service and final salary or average salary, it is fairly easy to calculate what your pension will be.

In a defined contribution (DC) scheme, where the 'pot' depends on how much you have contributed and how well the investments have performed over the years, your pension depends on what you decide to do with it at retirement. The earlier you draw it, the smaller the pension because you are likely to live longer and you have stopped paying into it. You may also lose valuable extras like life insurance.

2.2 Personal pensions

Personal pensions are similar to DC schemes but the money is invested in a life insurance company of your choice. A pot builds up out of your contributions and attracts tax relief, which is collected by the insurance company from the government. You do not have to do anything about the tax relief, unless you are a higher rate taxpayer, in which case you collect the extra 20% rebate through your tax return. You can decide at retirement, or earlier, what to do with your pension pot.

2.3 Options for defined contribution pensions

You have some decisions to make with most pension schemes, whether occupational or personal. The earliest age you can normally do this is 55 years. Note, with the pension reforms introduced in April 2015 you are able to nominate beneficiaries to whom your pension savings or annuities pass when you die. They need not be members of your family.

2.4 Annuities

Recent pension reforms mean it is no longer compulsory to buy an annuity with your pension pot at retirement. There are other options available if you have a DC pension. An annuity provides you with a guaranteed income for the rest of your life, meaning you can budget more effectively.

Some older pension plans offer a valuable benefit called a Guaranteed Annuity Rate. This was often a rate of 10 per cent or more fixed at the beginning of the plan, much more than the current typical 4.5 per cent. If you have one of these, think carefully before going for any other option.

There are different types of annuities available:

- Do you want a policy covering only you or one that pays out to your partner when you die (known as a joint annuity)? Joint annuities start at a lower level because they are probably going to pay out for longer. If joint, you must decide whether to allocate half the full amount to the survivor, a third, or the entire amount. This affects the starting point.
- Do you want a fixed rate for life (starts at a higher level but loses real value against inflation over time) or an increasing rate (indexed) to compete with inflation (starts at a lower rate)? Early retirement reduces the size of the annuity you can purchase as the policy needs to cover a longer period of time and so monthly payments are likely to be lower.

You can shop around for a better annuity – you do not have to buy your annuity from the company with whom you have built up your pension. This includes company defined contribution schemes. You may shop around using the '*Open Market Option*' to see what offers you get for the amount of money quoted by your pension company – some companies are not very forthcoming about the Open Market Option. You can do the search yourself or go to a specialist broker.

You can buy an impaired life annuity if your health is poor or, for example, you smoke and you are therefore unlikely to live as long as the average man or woman. These can boost your annuity by up to 30 per cent. It is best to go to a specialist adviser for these annuities.

2.4.1 Income drawdown

Income drawdown is a way of drawing income from your pension fund without buying an annuity. Since April 2015, it has been possible to set up a '*flexi-access drawdown scheme*'. You leave some, or all, of your pension fund invested with the pension company, avoid paying income and capital gains tax, and draw from your investment as much or as little income as you wish.

Unlike annuities, where you give your capital to the pension provider in exchange for a guaranteed income, you retain control and ownership of the capital. These are complicated arrangements with risks because the income can depend on the ups and downs of the stock market, depending on what your fund is invested in.

You should always take expert financial advice before setting up a drawdown scheme. The tax on the income is the same as for other income.

2.4.2 Treating the pot like a bank account

Using your pension pot liked a bank account means you withdraw money from it when you need to. The technical term for this process is UFPLS – '*Uncrystallised Funds Pension Lump Sum*'. This was introduced by the pension reforms from April 2015 and not all pension companies have systems in place to handle random withdrawals.

You may have problems with taxation of these withdrawals. Unless a Pay As You Earn (PAYE) code is provided to the pension company, withdrawals will almost certainly be taxed on an emergency code which usually overtaxes the payment. Refunds of overpaid tax are possible but sometimes not until the annual reconciliation process takes place at HMRC the following tax year. See section 8.1 for the forms on which to make a claim for repayment.

The PAYE code depends on whether HMRC can create an accurate code in year for that source of income and whether it was a total withdrawal, a one-off partial withdrawal or if there will be further withdrawals in that tax year. There are likely to be charges for accessing money in this way and you should take tax advice before proceeding.

2.4.3 Trivial commutations

The '*trivial commutations*' option was previously available if you had pension pots of less than £30,000 in total. You could withdraw it as a lump sum because the annuities they would buy would be trivial.

They have now been almost entirely abolished because the new pensions regime means you can do whatever you like with funds in a defined contribution scheme, where the size of the pot depends entirely on the money you, your employer and the government have put into it.

Trivial commutations now only exist in practice within defined benefit schemes, which are schemes that do not accumulate discrete pots of money solely in your name but rather pay out pension benefits depending on your length of service and salary. Regardless of the scheme, the '*small pot*' rules continue. If you have isolated pots with a notional value of under £10,000, you can take them as a lump sum with 25 per cent tax-free and the remainder taxed at your marginal rate. The tax-free treatment is only available if you have not yet started to receive your pension. If you have, all of it is taxed at your marginal rate.

2.4.4 The tax position

Contributions to defined benefit and defined contribution pensions attract tax relief while you are working, so they are taxable when you receive payment. Some state benefits are not taxable and should not be included in your calculations (see section 5). Continuing to work, whether part-time or full-time, has no effect on these pensions; it merely increases your taxable income.

Note
Free guidance on private pensions can be given face-to-face by some Citizens Advice, by telephone by The Pensions Advisory Service and online. Tax Help for Older People offer tax advice. More information is available on www.pensionwise.gov.uk

2.4.5 Effect on benefits

If you currently claim means-tested benefits, you may find you are no longer eligible if your income and/or savings increase. The information below gives you some idea of how benefits may be affected. However, if this applies to you, seek advice. There is more information in factsheet 91 *Pension freedom and benefits*.

If you are under Pension Credit age (63 and 9 months at April 2017)

- The value of a fund held in a personal or occupational pension scheme is ignored completely for benefit purposes. However, if you choose to withdraw money or get a regular income from this fund, that money is taken into account when calculating your benefit entitlement.

If you are over Pension Credit age (63 and 9 months at April 2017)

- Money left untouched in the pension fund is treated as producing a notional income of the amount you would receive if you bought an annuity with that capital, based on current annuity rates.
- Money taken out of the pension fund is usually treated as capital and is taken into account when calculating means-tested benefit entitlement.
- Money taken out regularly from the pension fund can be treated as income and taken into account when calculating your benefit entitlement.

Any benefits you claim in the future may also be affected. If you withdraw all of your pension pot and spend it, the DWP can decide you have deprived yourself of that money and treat you as if you still had it. This could mean they refuse to pay any means-tested benefit such as Pension Credit for a number of months or years.

3 Working in retirement

HMRC usually allocates your personal allowances against your State Pension and other pensions, so any income from work is usually taxed at the basic rate. If you change job mid-year, pass the P45 from your old employer to your new one as this enables them to continue to deduct tax at the appropriate rate.

If you start work again after the end of the tax year, your new employer should ask you to fill in a new starter declaration and report the information given on that form to HMRC, who then work out the correct code to give to your employer.

Until the employer receives that code, they operate an emergency code, based on the personal allowance and the week/month when it starts. If that turns out to be too high when the new code arrives, you are refunded through your next payslip.

Remember

Once you reach State Pension age, you no longer pay NICs but your employer does. Be wary of employers who suggest you work for them with self-employed status - they may be trying to avoid paying employer's contributions.

Working fewer or variable hours does not necessarily make you genuinely self-employed. If you carry on working after State Pension age, provide proof of age to your employer such as birth certificate or passport or phone the HMRC National Insurance Contributions helpline on 0300 200 3500 for an age exception certificate and give this to your employer. Your employer should stop deducting NIC's.

4 What to do about tax

At retirement, your financial circumstances usually alter quite significantly. Your income often drops and your sources of income probably change quite a lot. While you work with one source of income, you are taxed quite easily and usually correctly under PAYE.

Once retired, you may have two or more sources of income, often quite small and including the taxable State Pension from which tax is not deducted before it is paid to you. In many cases, savings interest makes up a substantial portion of your taxable income. All these factors combine to make it harder for HMRC to get your tax right.

You should expect to get a coding notice showing each source of income and how your tax-free allowances have been allocated. State Pension is taxed by reducing your allowances and the rest are given to other sources of income until they are used up.

Thereafter, anything else is taxed at the basic rate. If you do not receive a coding notice (P2) showing all your income sources, check what is happening with HMRC. Be ready when you contact them with your National Insurance number and details of all your income sources.

They may be unaware of a source of income, either because the income provider has not notified HMRC or because of a technical glitch in their systems. Seek help from Tax Help for Older People if you have problems.

Note

An online Personal Tax Account is available which lets you monitor and manage your tax affairs e.g. you can claim the Marriage Allowance, check your codes or notify HMRC of a change of address. More services are being added over time. Go to www.gov.uk/personal-tax-account for more information.

4.1 Increased personal allowance

Everyone receives the same basic personal tax allowance, £11,500 for 2017/18, regardless of date of birth. If your income is over £100,000, you lose your personal allowance at a rate of £1 for every £2 of income above the threshold.

4.2 Taxable income

Not all income counts towards Income Tax. The tax rules are not necessarily the same as those for benefits or local council services.

You may have to pay tax on:

- earned income from employment or self-employment
- pensions, including State Pension, and annuities (except war pensions)
- interest from savings accounts (see below)
- dividends from investments (see below)
- income from lettings
- some state benefits.

You do not have to pay tax on:

- Pension Credit
- Lottery or Premium Bonds wins (or other gambling wins)
- Winter Fuel Payments
- Attendance Allowance, Disability Living Allowance, Personal Independence Payment
- war pensions
- industrial injuries benefits
- Individual Savings Accounts (ISAs)

- some National Savings and Investments products.

Capital assets do not attract tax but the interest or income generated does, as does the gain if you buy an asset and later sell for a profit (see section 9).

If you have £100,000 and put it in a savings account, the interest may be taxable. The savings can affect entitlement to benefits such as Council Tax Support or Pension Credit.

Contact HMRC or Tax Help for Older People for further information about which types of income are taxable and which are not.

Savings and dividends

New rules on the taxation of savings interest and dividend income came into effect on 6 April 2016.

All basic rate taxpayers have a Personal Savings Allowance (PSA) of £1,000. This means you pay no tax on the first £1,000 of interest from your combined savings interest. Higher rate taxpayers have a PSA of £500 (additional rate taxpayers have no allowance). Banks and building societies no longer deduct tax at source as they did in the past.

A zero percent band of £5,000 on savings interest above your personal allowance continues, so most people are unlikely to have to pay any tax on their savings.

Examples

With earned income (including pensions) of £9,000, you have £2,500 of unused personal allowance, followed by £5,000 of zero percent savings interest plus PSA £1,000 tax-free.

With earned income (including pensions) of £14,000, you only have £2,500 of zero rated savings interest plus PSA £1,000.

With earned income (including pensions) of £18,000, you have no zero-rated savings interest because your income exceeds the personal allowance of £11,500 + £5,000 zero band. Only PSA of £1,000 is available.

If your savings interest exceeds the PSA, you must notify HMRC and pay tax on the excess. If possible, this is by HMRC collecting it via PAYE, i.e. reducing allowances on your code against a suitable source of income. If that is not possible, you may have to complete a self-assessment return.

You do not need to take any action to claim this new allowance. Banks and building societies started paying gross interest from 6 April 2016. Any R85s you had in place automatically ended.

Dividends

Shareholders receive an allowance of £5,000 tax-free dividend income. Thereafter, if you are basic rate taxpayer, you have to pay 7.5 per cent, higher rate 32.5 per cent and additional rate 38.1 per cent tax.

Note

Income from savings and dividends in ISAs continue to be ignored for tax purposes, so do not include them in calculations or tax forms.

Income from savings and dividends even from the tax-free allowances (but not ISAs) are included in your gross taxable income and can push you into the next tax band.

4.3 Should I be paying tax?

Everyone, unless your income is over £100,000, has a tax-free personal allowance. If your total taxable income is greater than your allowances, you have to pay some tax. If not, you are a non-taxpayer.

In 2017/18 the personal allowance is £11,500.

Two other allowances that can affect your tax bill are the Blind Person's Allowance and the Married Couple's Allowance (see below).

If your gross taxable income falls below your personal allowance, check your payslips, savings statements and P60s to make sure no one is deducting any tax. You should read the section below on savings and investments when calculating taxable income.

4.4 Individual Savings Accounts (ISAs)

ISAs provide a shelter from tax for your savings and shares. There are now 6 different types of ISAs into which you can save according to the different rules and your needs. The overall maximum for the year is £20,000. (If you make contributions to your grandchildren's Junior ISAs, annual limit £4,128, this does not reduce your own annual limit.)

The rules on death have changed. Normally ISAs fall into the estate and are included in Inheritance Tax, losing their tax-free status. If, however, they are passed to a surviving spouse or civil partner, they retain that status and are allocated as an additional allowance for that year to the legatee on top of their own £20,000. All accounts and investments have to be changed to their name within 24 months. They also remain tax-sheltered during the period of administration of the estate.

Another recent benefit is the ability to make a withdrawal from a "flexible" ISA – ask your provider – and repay it back in during the same tax year.

Since you now have the new PSA of £1,000 or £500, you no longer need to use ISAs to shelter savings income from tax up to this limit. You can use normal savings accounts equally according to the best interest rate combined with your needs, i.e. easy-access, two-year bond, regular saving etc. without having to worry about tax deductions.

4.5 Blind Person's Allowance

The Blind Person's Allowance increases your tax-free allowance by £2,320 a year.

In England and Wales, you have to register as a blind person with your local authority (or have made an application) to qualify for the Blind Person's Allowance. Contact your local authority for details of the registration procedure.

You do not have to be totally without sight but you do need to show your sight impairment is sufficiently severe. A consultant ophthalmologist applies the tests and provides a certificate for you to take to your local authority. In Scotland and Northern Ireland, you must be unable to perform any work for which eyesight is essential to qualify.

Partially sighted people do not qualify for Blind Person's Allowance but loss of sight is often progressive. Once your eyesight starts to deteriorate, have it tested regularly in case you become eligible for the allowance. Once the registration process is complete, phone HMRC's helpline on 0300 200 3301 and ask about the Blind Person's Allowance – it is not added automatically.

As many as 300,000 registered blind people may not have claimed, so if you qualify, make sure you take up the allowance. If your income is too low to benefit from the Blind Person's Allowance, you can transfer it to your spouse or civil partner regardless of the state of their eyesight and ensure it is not wasted.

4.6 Married Couple's Allowance

You can only claim a Married Couple's Allowance (MCA) if you are a married couple or civil partners and one of you was born before 6 April 1935. It does not increase your tax-free allowance like the Blind Person's Allowance, but is deducted from your tax bill. It is worth 10 per cent of its face value, so your bill reduces by 10 per cent of the total amount. In 2017/18, this is £8,445, which means up to £844.50 is taken off your tax bill.

For couples married before December 2005, the husband must claim the MCA, although it is possible to choose to allocate it to the wife if she is a higher earner. For couples married after December 2005, the highest earner claims it. If the first person's total tax bill is less than the full amount of the MCA, any remaining allowance can be transferred to the partner to reduce their tax bill, if they are a taxpayer.

4.7 Marriage Allowance

The Marriage Allowance, available since 6 April 2015, should not be confused with the Married Couple's Allowance. If you are entitled to the Married Couple's Allowance, you cannot claim this as well.

Marriage Allowance can be claimed by married couples or civil partners where one partner is no more than a basic rate taxpayer and the other has unused allowances. The lower earner can transfer £1,150 of unused 2017/18 allowances to the other. You can register by telephoning HMRC or at www.gov.uk/marriage-allowance

Example
Melinda earns £6,000 a year working part-time, so has £5,500 of unused personal allowance. She can transfer £1,150 to her husband Gary so long as his taxable income does not exceed £45,000 (£43,000 in Scotland).

Note
As with the Married Couple's Allowance, the Marriage Allowance tax reduction is given by taking £230 (£1,150 x 20 per cent) off the recipient's tax bill. It does not reduce their actual taxable income in the same way their own personal allowance does.

5 Calculating your taxable income

Assemble a list of all your sources of income including earnings, pensions, savings, taxable benefits and property lettings, then cross-check with the list of non-taxable sources, such as war pensions, Disability Living Allowance, Industrial Injuries Benefit, etc.

Add up the gross income from the taxable sources from the same tax year. Do not use the figure for a works pension from a bank statement – that is the net which has been paid. You need the gross figure from the P60 or your pay slips.

Work on annual figures. If you are paid weekly for part-time work or draw your State Pension weekly, multiply by 52. If your State Pension is paid '*monthly*', remember that means every four weeks, so multiply by 13.

Example 1

State Pension	£6,674
Teacher's pension	£14,872
Personal pension	£1,790
Savings interest	£127
Total	**£23,463**

You have tax-free allowances of £11,500. You are a basic rate taxpayer, so remove the savings interest from the calculation as it is lower than the PSA. Subtract your allowance from the gross taxable income of £23,336 and you have £11,836 to be taxed. At 20 per cent, you pay £2,367.20 tax on these sources of income.

Example 2

State Pension	£8,396
Savings interest	£1,285
Total	**£9,681**

Your allowances are £11,500, so your taxable income of £9,681 is £1,819 below allowances, so no tax is payable. You do not need to notify HMRC of excess savings interest over the £1,000 PSA, because your total taxable income does not reach the level of personal allowances.

6 PAYE codes

PAYE is the system that collects tax weekly or monthly through the year as you get paid, rather than paying a lump sum at the end of the year as with self-assessment. PAYE codes are instructions given to employers and pension providers as to how much tax to deduct.

Employers and pension providers only do what HMRC instruct because they do not know the rest of your financial circumstances. If you disagree with, or do not understand your coding, contact HMRC for explanations, not your employer.

6.1 How to understand your codes

State Pension is taxed by reducing your tax-free allowance and any allowance left over can be used against other sources of income. The coding notice, known as a P2, is a copy of the notice issued to your employer and/or pension provider.

Your copy shows the personal allowances you are entitled to, from which are taken any amounts not taxed at source, such as State Pension. What is left forms the basis of your code number.

Example
You are aged 68 with an overall income of £20,000. You have a personal allowance of £11,500. Your State Pension of £5,000 is deducted, leaving an allowance of £6,500 available to set against your occupational pension. The last digit of the number is removed and replaced by the letter L, so the code of 650L is notified to your pension provider.

Note. Scottish taxpayers will have an S prefixing the digits, for example S650L.

If you have more than one taxable pension or source of income, such as part-time work, you have a separate code for each, but all code numbers should be shown on a single HMRC coding notice. Following the example above, if the occupational pension is £6,900 the code 650L is applied to that pension by the company paying the pension and tax is charged at 20 per cent on the £400 of income after the tax-free allowance of £6,500 is given.

The overall effect is to collect the tax due, after allowances, on the combined income of the two pensions, although all the tax is taken from the one source. If you also do some part-time work, you should receive a P2 saying the income is taxed at basic rate, as all your allowance has been used elsewhere.

It is important to check every notice you receive because they dictate the amount of tax you pay. If you disagree with the facts on the notice or fail to receive one for a source you think is taxable, query it with HMRC on 0300 200 3300 or write to the address on the coding notice. HMRC has introduced a system of combining all your codes onto one sheet so you can see the distribution of your allowances at a glance.

Note
Sometimes State Pension exceeds available allowances. For example, a personal allowance of £11,500 is exceeded by a State Pension of £11,960. This results in a code of 460; the last digit is

dropped and the code is expressed as K45 (the final digit of the code is reduced by 1 and the letter K comes before the digits). This tells the pension company to treat the annual pension as though it has £460 added to it and tax accordingly.

7 Paying tax through self-assessment

The alternative to paying personal tax through PAYE is paying through self-assessment (SA). If you cannot meet all your tax liability via PAYE, you need to complete an SA tax return. This is possible when you retire, even if you were taxed under PAYE all your life.

If you need help with self-assessment, there is information and guidance available at www.gov.uk/topic/personal-tax/self-assessment

Note
If HMRC asks you for a SA return, you have to do it unless there is no valid reason for it being issued. You can ask HMRC if they will agree to cancel it. If they do not ask you to do one, it is your responsibility to request a SA return if you think you have income not being taxed or that should be declared. The deadline is 5 October following the year in which the tax charge arose.

7.1 Possible reasons for inclusion in self-assessment

You probably have to complete a self-assessment return if you:

- have complicated affairs
- are self-employed, in partnership or a company director
- are a higher rate taxpayer with annual income of £100,000 or more
- have investment income of £10,000 or more
- have taxable income which has not had tax taken off it
- have capital gains in excess of the exempt amount
- have foreign income
- have rental income
- have a tax liability but no PAYE source of income.

7.2 Full return (SA100) and additional information (SA101)

You are normally sent a "*notice to file*". HMRC want people to file online but if you cannot or do not want to, you can phone HMRC and ask for the SA return to be sent you or you download from the HMRC website. You usually complete a full return initially. The '*full*' return covers income from pensions, taxable benefits and investments, plus the opportunity to claim a variety of reliefs and allowances. There are supplementary pages for extras like Capital Gains, employment, self-employment, Married Couple's Allowance and foreign income.

At the front of the SA return, there is a checklist of extra sections you may need. Do not panic at the quantity of boxes - chances are you only have to fill in a few. You are unlikely to need to complete the additional information pages unless entitled to the Married Couple's Allowance.

7.3 Short return (SA200)

The short return is a four-page document designed if you have very straightforward tax affairs. Many pensioners receive this but HMRC decide if you are a suitable candidate; you cannot choose. There are no supplementary pages but you can fill in extra pages if you have capital gains or a foreign pension to declare. Not everyone can use a short return and you need to check the notes to make sure you qualify. If you do not, ask HMRC for a full return, or file online.

7.4 Deadlines and penalties

If you cannot file online or prefer to submit a paper full or short return, you must complete and submit before 31 October. After that date, penalties are charged for late filing of paper returns, regardless of whether tax is due. Online returns can be filed up to 31 January.

Whether you file online or use the paper version, any tax you owe must be paid by the following 31 January. If you send your return by 31 October, HMRC promises to calculate tax due or repayable in good time. After that date, you have to file online and send the correct payment in by 31 January. There are automatic penalties for returns filed after 31 January and surcharges for final payments more than 28 days late. Interest is charged on late payments in addition to penalties.

Remember
When you fill in the return, you are showing a complete picture of your income – not just untaxed income but all income – whether or not it has been taxed at source and whether it comes from the UK or abroad.

7.5 Record-keeping

You are not asked to send in supporting evidence with your tax return, but you should keep records for at least 12 months after the tax return deadline of 31 January. HMRC can enquire into your return. You need to keep the records for five years after the deadline if you are self-employed or have income from property.

Note
Be organised and keep receipts, invoices, mileage records, pension contributions, credit card payments etc. to prove your claims. Remember to keep a copy of your tax return or a note of the entries you made. If you post a paper return, be sure to obtain a certificate of posting as proof that you sent it to the right address in good time.

7.6 Escape from self-assessment

Recently, HMRC has taken people out of the self-assessment system where their tax can be collected by other means (PAYE or deducting at source, for example) and there is no other reason why they need an annual return.

If they decide to do this with you, they will write. If you think there is no longer a need for you to complete an SA return, ask HMRC to remove you from the system. Once out of self-assessment, you cannot forget about tax altogether. You have responsibility to tell HMRC of any new income or capital gains you need to pay tax on. You must do this by 5 October after the end of the tax year that you get that income or gain in.

You cannot assume that HMRC automatically get your tax right through PAYE, so keep an eye on tax codes and other deductions to make sure you pay the right amount overall. You might want to contact HMRC to tell them about tax reliefs you are entitled to, such as relief for Gift Aid donations or pension contributions if you are a higher rate taxpayer.

In order to reduce the burden of self-assessment, HMRC has introduced a Simple Assessment procedure. Where the tax due is fairly small and relatively predictable or perhaps there is no liability to tax at all, HMRC will simply send an annual assessment of what they think is due and either request a lump sum payment or will code it out of another source of income.

8 Paperwork and forms

When you approach retirement, you enter a new period of your life involving dealing direct with HMRC to a greater or lesser extent. This is partly because you may no longer be shielded by an employer and payroll office and partly because of your changing financial circumstances. HMRC are trying to reduce the amount of paper contact by receiving more information electronically from employers, pension providers, banks etc. and not asking for information they already hold.

8.1 R40 – tax repayment form

R40 is the form if you overpaid tax on your savings. For instance, in the past you may have been liable for tax on your savings at 10 per cent but your savings account had tax deducted automatically at 20 per cent, so you want to reclaim the overpayment. You may have had tax deducted at source on the income element of a purchased life annuity, but are able to claim the Personal Savings Allowance or zero savings rate on this income.

On the form, list all sources of taxable income and tax already paid, so HMRC can work out how much you should have paid and how much to repay you. You can get an R40 from HMRC, PAYE, BX9 1AS and you need one for each year you wish to claim for, up to the maximum of four previous years. You can download it from the GOV.UK website.

This form generally applies only to years prior to 2016. You can go back four years. This is because, as noted above, all savings interest is now paid without any tax deducted.

P50Z – reclaim overpaid tax on UFPLS when your pension pot is empty.

P53 – reclaim tax after a trivial commutation.

P53Z – reclaim overpaid tax when your pot is empty but you are still working or receiving taxable benefits.

P55 – reclaim overpaid tax when you have only partially emptied your pot.

9 P800 – tax calculation

At the end of a tax year, HMRC do a reconciliation of the tax a PAYE taxpayer has actually paid with the tax that HMRC reckon you ought to have paid. If there is a discrepancy, under or over, they send you a P800 calculation which explains how they reached their conclusion as to whether you owe them tax or they owe you a repayment.

It is not a demand for tax, though it could turn into one if HMRC convert it to a Simple Assessment (see section 7.6). If you disagree, tell them. If you agree, they either code out the underpayment in the following year or automatically repay you if there is an overpayment.

10 Other taxes

There are three taxes that may become more relevant at retirement.

10.1 Capital Gains Tax

The rule on most other assets is that tax for basic rate taxpayers is due at 10 per cent on net gains (basically sale proceeds less costs) in excess of the current exemption allowance of £11,300. Higher rate taxpayers pay 20 per cent. Add the gain to other income to see if it takes you into the higher tax band. If it does, you pay 20 per cent tax on the amount of the gain above the higher rate threshold, not on the whole gain.

Scottish taxpayers should note Capital Gains Tax continues to operate as a '*reserved*' tax at normal UK rates and bands. Therefore with different bands for basic and higher rate taxes between Scotland and the rest of the UK, the point at which 20 per cent kicks in is lower.

Some types of assets are completely exempt, such as private cars, while others, such as antiques and art, have special rules.

Your home, provided you have lived in it throughout your ownership, is exempt from Capital Gains Tax. If you move but have difficulty selling it, you have a period of up to 18 months before the Principal Private Residence exemption lapses on your old home.

The main exception to the above is the sale of residential property (for example, a flat that you let out but later sell). Those gains are taxed at 18 per cent within the basic rate and 28 per cent within the higher rate band.

If you make gains in excess of the exemption in any tax year, you must complete a tax return and pay the tax due along with any Income Tax liability by the following 31 January.

The sale of stocks and shares may attract a Capital Gains Tax charge on profits but special rules apply regarding the sequence of purchases and other reliefs. Capital Gains Tax is very complex; so if you sell assets resulting in gains exceeding £11,100, or realise losses, get professional advice. The Chartered Institute of Taxation can provide a list of advisers.

10.2 Inheritance Tax

When you retire, you may rewrite your will. Inheritance Tax (IHT) is a tax that applies not to you but your estate. The value of your assets owned on the day after death is calculated. Gifts made to others in the previous seven years are included. Debts such as mortgages are deducted, to arrive at the value of your estate.

The first £325,000 is treated as taxable at 0 per cent (the nil rate band) and the rest may be taxed at 40 per cent (but see below about the residence nil rate band which may apply for deaths on or after 6 April 2017). It is important to note that lifetime gifts, in excess of the various gift limits, made in the previous seven years are applied against the nil rate band first. The main gift limit is an annual one of £3,000; but there are others relating to small gifts, regular gifts made out of income (not capital) that do not reduce your normal standard of living, and gifts on marriage to certain relatives.

For example, if you gave away £200,000 three years before your death, that absorbs most of the current nil rate band, leaving £125,000 to set against the value of assets owned at death.

Where the value of gifts from the estate exceeds the nil rate band, the rate of Inheritance Tax payable is tapered so less tax is paid on gifts made more than three years before death. After seven years, gifts are excluded from the estate for IHT.

For most people, their house is likely to be the main part of their estate and these days can push even low-income pensioners into the IHT bracket. However, last year only 6 per cent of estates attracted the tax.

One of the most frequently asked question is: '*Can I give my house to the children and continue to live in it to avoid inheritance tax?*' The answer is '*Yes – but only if you pay a market rent*'. You may pay more in rent than you save in IHT and your children may pay tax on the rental income. Seek advice if you are thinking about this.

There may be no need to do this as, with the gradual introduction of the residence nil rate band for deaths on or after 6 April 2017, more estates should be free from IHT. It is very important to note that this residence nil rate band does not apply to lifetime gifts.

Spouses and civil partners can reduce IHT liability by becoming 'tenants in common' of their property. This means each one owns half the property. On death, therefore, only half the house is considered for IHT and can be left in a will to whoever the owner chooses and in most cases the value is beneath the threshold.

The drawback is the surviving spouse or partner only owns half the house and the inheritor of the other half can force a sale. Professional advice from a solicitor or member of the Society of Trust & Estate Practitioners (STEP) is strongly recommended.

A significant change in October 2007 was that a surviving spouse can claim the unused part of a deceased partner's nil rate band and add it to their threshold at the rate in force at the time of second death. See the example below. This change was backdated to 1972 where one spouse died before 9 October 2007 and the second survived at that date or after.

Example

Claiming the unused part of the nil rate band
Mr Allan died in 2006/07 and left everything to Mrs Allan. She therefore acquired 100 per cent of his nil rate band (currently £325,000). Thus on her death, her estate has a nil rate band of twice the current rate. If she died in 2017/18, her nil rate band is 2 x £325,000, total £650,000.

If Mr Allan left £160,000 to his children, i.e. almost half his nil rate band, his widow can only add just over 50 per cent of the nil rate band in force at the time of her death. If as above, she died this year, she has £490,000 available (1.51 x £325,000), before Inheritance Tax is applied.

Note
It is only the unused percentage of the nil rate band at the time of the first death, which is carried forward but that percentage is applied to the rates in force at the time of second death.

IHT should not be confused with deprivation of assets and income rules, which relate to the means test for the provision of social care by a local authority. For more information, see factsheet 40, *Deprivation of assets in the means test for care home provision*. In Wales, see Age Cymru factsheet 40w and in Scotland, see *Care homes: funding*.

Additionally, a new residence nil rate band is being introduced. It applies where the deceased left any residential property which is, or was once, their home or where they had downsized (moved to a smaller home or went into residential care) prior to death. It starts at £100,000 for 2017/18 and increases each year by £25,000 until it reaches £175,000. It is available to both members of a marriage or civil partnership and is transferable to the survivor on first death in the same way as the existing nil rate band.

If the couple or survivor downsizes to a more modest dwelling, the tax relief of the previous house still applies, so there is no need to keep the larger house because of fears of losing the allowance.

The major qualification is the inheritance is received by direct descendants, i.e. children (or step-children) or grandchildren and does not apply to, for example, nephews and nieces. The executors of the estate must claim it. There is a taper applied to estates over £2 million.

10.3 Value Added Tax

The relevant part of VAT that may arise at retirement is its application to disability. There are two main points.

Many goods or services bought solely because of need through disability (such as items specially designed for people with disabilities) are VAT-free. You must sign a declaration with the supplier and you are invoiced only for the net amount. Do not pay the whole bill and then try to recover the VAT – sort it out first.

The rules can be complicated: widening a doorway to enable wheelchair access is covered. Building a new doorway may not, if it is just a convenience for everyone in the household.

The second point is that VAT is reduced to 5 per cent for mobility aids for cases of general frailty for people over the age of 60. The rules are a little less rigorous, so putting in a handrail up the stairs may qualify. Again, you need to sort it out with the supplier first, as the goods have to be fitted by the supplier – you cannot get the reduced rate on DIY items.

11 Rates and allowances 2017/2018

11.1 Personal allowances

Income below £100,000	£11,500
Blind Person's Allowance	£2,320
Married Couple's Allowance (either one born before 6 April 1935)	£8,445 (worth 10 per cent of face value and reduces tax due, not tax-free income)
Marriage Allowance	£1,150

Note
Once you reach an income of £28,000, the MCA reduces by £1 for every £2 over the threshold until it is down to a minimum of £3,260.

11.2 Rates and bands

First £33,500 of taxable income	20 per cent, thereafter 40 per cent In Scotland first £31,500 – only applies to earned income, including pension income
First £5,000 of savings interest	0 per cent if other income at or below personal allowances First £1,000 of savings interest 0 per cent for basic rate (BR) taxpayers, £500 for higher rate (HR)
Otherwise standard savings rate	20 per cent (HR taxpayers have further 20 per cent to pay)
Dividends tax allowance	First £5,000 0 per cent, thereafter 7.5 per cent for BR taxpayers, 32.5 per cent for HR
Capital Gains Tax	BR taxpayers 10 per cent above annual exemption of £11,300 (18 per cent on residential property). HR taxpayers 20 per cent (28 per cent on residential property)
Inheritance Tax	40 per cent above nil rate band of £325,000 (which may be increased by £100,000 if the residence nil rate band applies)

Useful organisations

Association of Taxation Technicians
www.att.org.uk
Telephone 020 7340 0551

The ATT is the leading professional body for those providing tax compliance services and related activities in the UK.

Citizens Advice
England or Wales go to www.citizensadvice.org.uk
Northern Ireland go to www.citizensadvice.co.uk
Scotland go to www.cas.org.uk
In England telephone 0344 411 1444
In Wales telephone 0344 477 2020
In Scotland telephone 0808 800 9060

National network of advice centres offering free, confidential, independent advice, face to face or by telephone.

Chartered Institute of Taxation (CIOT)
www.tax.org.uk
Telephone 020 7340 0550

The CIOT website contains an area for people looking for general tax information or a professional tax adviser.

Department for Work and Pensions
www.gov.uk/government/organisations/department-for-work-pensions

The part of the official government website GOV.UK with information about money, tax and benefits and a specific section for the over-50s. It also offers information about pensions and retirement planning.

Her Majesty's Revenue & Customs (HMRC)
www.gov.uk/hmrc
Telephone 0300 200 3310

Contact HMRC for more information about taxes.

Low Incomes Tax Reform Group
www.litrg.org.uk

The LITRG website contains a wealth of information on matters concerning all people on low incomes and guidance on taxation as it affects them.

Pension Service (The)
www.gov.uk/browse/working/state-pension
Telephone 0345 60 60 265
State Pension Forecasting Team 0345 3000 168

For details of state pensions, including forecasts and how to claim your pension.

Pensions Advisory Service (The) (TPAS)
www.pensionsadvisoryservice.org.uk/
Telephone 0300 123 1047

TPAS is an independent voluntary organisation grant-aided by DWP to provide information and guidance to the public on state, company, personal and stakeholder pensions.

Society of Trust & Estate Practitioners (The) (STEP)
www.step.org
Tel 020 3752 3700

Tax Help for Older People
www.taxvol.org.uk
Tel 0845 601 3321 or 01308 488066

A national charity that provides free professional help on personal tax to older people on low incomes who would not otherwise be able to afford it. Appointments are offered at tax surgeries in Age UKs and similar venues. Home visits are available for those with disability or other difficulties.

Age UK

Age UK provides advice and information for people in later life through our Age UK Advice line, publications and online. Call Age UK Advice to find out whether there is a local Age UK near you, and to order free copies of our information guides and factsheets.

Age UK Advice
www.ageuk.org.uk
0800 169 65 65
Lines are open seven days a week from 8.00am to 7.00pm

In Wales contact

Age Cymru
www.agecymru.org.uk
0800 022 3444

In Northern Ireland contact

Age NI
www.ageni.org
0808 808 7575

In Scotland contact

Age Scotland
www.agescotland.org.uk
0800 12 44 222

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