Planning your retirement: money and tax

About this factsheet

If you are coming up to retirement, it is probably bringing you a host of new experiences, important financial decisions and a new financial situation. You may find you also have closer contact with government departments as you sort out your tax position and benefit entitlements.

This factsheet examines the most common money and tax issues connected with retirement, including dealing with pensions, tax allowances and paperwork.

The information in this factsheet is correct for the period April 2014 – March 2015.

The information about tax in this factsheet applies across the UK. The information given 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.

If you need further information or advice, see section 14 for details of how to order other Age UK factsheets and information materials. You will also find the telephone numbers for Age UK Advice there.

If you need more detailed advice tailored to your personal circumstances or representation, it is often best to find a local service offering this. Age UK Advice can give you contact details for a local Age UK, or you could contact one of the independent organisations listed in section 13.
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1 Recent developments

- Changes introduced on 6 April 2010 mean that a full basic State Pension requires contributions for only 30 years.

- A slow process of equalisation has started to bring women’s State Pension age (SPA) up to 65.

2 Pensions

Pensions are the most widespread ways of funding retirement: almost everyone will have some sort of pension, even if they also have other sources of income.

The State Pension is based on contributions made to the National Insurance Fund during a working life. Changes introduced on 6 April 2010 mean that a full basic State Pension requires contributions for only 30 years (previously it was 44 years for men and 39 years for women). Furthermore, although the age at which the State Pension could be claimed was previously 65 for men and 60 for women, a slow process of equalisation has started to bring women’s State Pension age up to 65. This will be at the rate of one month’s delay for every two months of age, so that by December 2018 the five-year gap will have been eliminated.

For more details see Age UK’s Factsheet 19, *State Pension*.

Most people now 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), which can more than double their pension. Someone who has paid in the maximum possible over their working life could have a State Pension of over £13,000.

For much of the last 40 years it has been possible to contract out of paying into the additional state pension schemes (eg SERPS and S2P) and instead to contribute a part of National Insurance contributions (NICs) 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.
Remember: If you are a woman approaching 60, from April 2010 your State Pension age started to converge with that of men. You should receive a letter from the DWP giving your new State Pension age if you were born after 5 April 1950.

Thus, when you receive a pension forecast (see 2.1 below) you may find that the additional state pension has been reduced by the amount a contracted-out scheme will pay. You have not ‘lost’ this extra: it is paid either through a personal pension plan with a life insurance company or as part of a company pension. This is particularly true of public-sector pensions for police, teachers, local authority staff, civil servants and so on; they will probably receive not much above the basic State Pension but will receive the additional pension wrapped up in their occupational pension. Contracting-out into Defined Contribution pension schemes was abolished in April 2012. (See 2.6 below).

2.1 Pension forecast

One of the most important steps you can take in planning for retirement is getting a forecast of your State Pension in order to estimate your total retirement income. You can obtain a forecast at any time until four months before SPA online or 30 days before SPA by post or telephone from GOV.UK (See section 13, Useful organisations). The closer you are to SPA, the more accurate the forecast will be as earlier forecasts will be based on assumptions of your likely contributions.

You should check any forecast to see if it includes credits such as Home Responsibility Protection or from working overseas in a country with mutual social security agreements.

2.2 Boosting your National Insurance contributions

If there are gaps in your contribution record, you can make up six years by voluntary contributions, but before doing so you should take advice from an independent advice agency such as the CAB on how much extra pension you might get in return for the outlay (see section 13, Useful organisations). Ask how much more pension you would receive for each extra year purchased.
2.3 Claiming the State Pension

You can claim the State Pension as soon as you reach SPA, whether you are working or not. Alternatively, you can delay claiming (‘defer’) indefinitely. You can choose whether to claim by telephone or internet. Notice that the State Pension must be claimed – it is not given automatically when you reach SPA.

When you claim your State Pension you will need the following:

- your NI number
- your current address and postcode, plus your last two addresses
- your tax reference number
- if you’re married or in a civil partnership (or have been in the past), your husband, wife or civil partner’s details (including their NI number and the date of your marriage or civil partnership) and if you are divorced or widowed, your civil partnership has dissolved or you’re a surviving civil partner, that date as well
- details of any social security benefits or entitlements that you or your husband, wife or civil partner are getting or waiting to hear about
- the address of any employer you have worked for in the last two years, and the dates you worked for them
- if you ever lived or worked abroad, your social security number and the dates you were abroad
- the number for the account you want your State Pension paid into.

The State Pension is paid directly into your bank, building society, Post Office or National Savings account that accepts direct debit payment.

If you cannot open or manage an account, you can request payment by cheque to cash at the Post Office.

For full details of how to claim check GOV.UK on www.gov.uk/state-pension/how-to-claim and have a look at Age UK’s Factsheet 19, State Pension.
2.4 Deferring the State Pension

If you do decide to delay claiming your State Pension, after five weeks it will start to increase at a rate equivalent to 10.4% a year. If you defer it for a year or longer you will 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 of drawing your pension at the enhanced weekly rate.

Example: If your State Pension was going to be £100 a week and you deferred claiming for one year, you could draw a weekly pension of £110.40 (assuming no other changes to the rates). If you decided to take the arrears as a lump sum, you would receive a taxable lump sum of a little over £5,200 and draw a weekly State Pension of £100 (plus any increase in pension that had been awarded by the government in the intervening year).

There is special tax treatment of the lump sum:

● In the first place it is taxed at your marginal rate of tax – that is, the highest rate you are due to pay in that year. So if your total taxable income for the year is below your allowances, the lump sum will be taxed at zero, because you are a non-taxpayer. If you are a 20% taxpayer, you will pay 20% tax on it.

● The second special treatment is that it does not push you into the next tax band or over the threshold at which you start to lose increased personal allowances. Thus, someone on £35,000 a year will not become a 40% rate taxpayer because they receive a lump sum of £15,000, nor will someone on £20,000 a year start losing their increased personal allowances at £27,000 because they collect a lump sum of £8,000.

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

The 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 or not when you retire.

If income from all your pensions and any work comes to less than the personal allowances for your age (see section 5.3 for figures), you do not need to worry about paying tax on the State Pension. If, however, your total taxable income is above your allowances, then tax will be collected in one of two ways:

- either you have another ‘Pay As You Earn’ (PAYE) source of income, which is large enough to bear the tax on both itself and the State Pension or
- you complete a self-assessment return each year and pay the tax by 31 January the following year.

In the first situation the tax is collected by reducing your allowances by the amount of your State Pension. For example, if your allowance is £10,000 and your State Pension is £7,000, only £3,000 of spare allowances is given to any other pension. Thus the tax is collected by reducing your allowances rather than by taking more money off another pension.

If, however, you have only a small other pension from which HM Revenue & Customs (HMRC) is not allowed to take more than 50% in tax or indeed you have no other source of income, you need to ask them for a self-assessment return and pay the tax that way each year, even if it is only £25.

2.6 Occupational pensions

Occupational pensions, also called works pensions, are schemes run by private and public employers. They vary widely in the benefits they provide and you must ask your scheme managers or trustees for details. Do you, for instance, have the option of a lump sum and a lower lifetime pension or a higher lifetime pension with no lump sum?

In a defined benefit 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 scheme where the ‘pot’ depends on how much you have contributed over the years, your pension will depend on what annuity the pot will purchase at the age at which you draw it. 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 or pension rights for your children if still young or in full-time education, because they are often wrapped up in the pension scheme.

2.7 Personal pensions

Personal pensions are similar to the defined contribution schemes mentioned above 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 don’t 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 use the accumulated fund to buy an annuity, not necessarily from the same company. The earliest age at which you can do this is 55.

You have some decisions to make with most pension schemes whether they are work or personal.

● Single life or joint annuity where the pension continues for the surviving partner after one dies? Joint annuities start at a lower level because probably they are going to be in payment for longer. If joint, then you’ll need to decide whether to allocate half the full amount to the survivor, a third, or even the entire amount. This will affect the starting point.

● Then decide, do you want a flat rate for the rest of time (starts at a higher level but loses real value with inflation over time) or an increasing rate (indexed) to compete with inflation (starts at a lower rate)? If indexed, do you want a fixed rate or the Retail Prices Index? Again, early retirement will reduce the size of the annuity you can purchase because you are likely to live longer.
There are two other points to consider with personal pensions. One is that you can shop around for a good annuity – you do not have to buy your annuity from the company with whom you have built up your pension. You may exercise the Open Market Option (OMO) to see what offers you get for the amount of money quoted by your pension company – some companies are not very forthcoming about OMO. You can do the search yourself or go to a specialist broker.

The second is that you can buy an impaired life annuity if your health is poor and you are therefore unlikely to live as long as the average man or woman. These can boost your annuity by up to 30%. It is best to go to a specialist broker for these annuities.

**Income drawdown**

Since April 2011 it has ceased to be compulsory to buy an annuity by age 75 and the rules for income drawdown have been relaxed. Income drawdown is a scheme whereby you can leave your accumulated pension fund invested and draw down an income stream from it not exceeding 150% of the amount which would have been produced by the purchase of a single life annuity. This maximum is set by the Government Actuary’s Department (GAD) and is reviewed every three years up to 75 and annually thereafter. They are complicated arrangements with some risks so you should always take expert financial advice before making them – not to mention the need for a pension fund of at least six figures. The tax on the income is the same as for any other income.

2.8 **Trivial commutations**

If your accumulated pension pots do not exceed £30,000 in total, you have another choice. You can draw them as a lump sum because the annuities they would buy would be trivial.
There had been two recent improvements to the rules. For the last couple of years occupational pensions not exceeding £2,000 could be commuted as a lump sum regardless of the £18,000 limit, and with effect from 6 April 2012, the same applied to personal pension pots not exceeding £2,000. With effect from 27 March 2014 these £2,000 pots have been increased to £10,000. There is, however, a restriction of no more than three of these latter in your lifetime.

In both cases you can receive 25% as a tax-free lump sum while the remaining 75% is taxable at your marginal rate. This 25% tax free treatment, however, is only available if you haven’t yet started to receive your pension. If you have, then all of it is taxed at your marginal rate.

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**Note:** you do not have to commute all your pots. You may, for example, wish to purchase an annuity with a pot of £10,000 and commute a couple of other pots of maybe £3,000 and £1,500 as lump sums. However, you must commute all the pots you intend to within twelve months of starting the process.

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**Note:** final salary schemes and trivial commutations. Final salary schemes are not based on a discrete pot of money like defined contribution schemes, so to calculate a figure equivalent to that which would have provided a similar pension under defined contributions, you should multiply the pension amount by at least 20. For example: if your pension from a final salary scheme is £1,500 a year, a pot that would have notionally provided this sum would have been at least £30,000 and therefore you would not be eligible for trivial commutation of any other pots because you are already at the £30,000 limit (although the “small pot” exemptions might apply).
2.9 The tax position

Contributions to both types of the above pension schemes attract tax relief while you are working, so they will be taxable when you receive payment. However, some state benefits are not taxable and should not be included in your calculations (see section 6, Calculating your taxable income). Continuing to work, whether part-time or full-time, has no effect on any of these pensions; it merely increases your taxable income.

3 Working in retirement

HMRC usually allocates your personal allowances against your State Pensions and other pensions, so that any income from work will almost certainly be taxed at the basic rate. If you change job mid-year, you simply pass the P45 from your old employer to your new one, and this will enable 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 will ask you to complete a P46 on which you will tick the box certifying that you have other income, i.e. your State Pension and/or other pensions. From this, HMRC can work out the correct code to give to your employer. Until the employer receives that code, the basic rate should be the default code. If that turns out to be too high, you should be refunded through your next payslip.

Note: the P45 & P46 paper procedures are currently being replaced with new payroll reporting under an IT system called Real Time Information (RTI) but the underlying process has the same effect.
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 are simply trying to avoid paying employer’s contributions.

Working fewer or variable hours does not make you genuinely self-employed. If you intend to carry on working after State Pension age, phone the HMRC National Insurance Contributions helpline on 0845 302 1479 for a certificate of age exception that authorises the employer not to deduct NI contributions.

4 Other entitlements at State Pension age

Reaching the current women’s State Pension age, whether you retire or not, and whether you are a man or a woman, brings other entitlements.

If you have reached the current State Pension age for women by the end of the week beginning with the third Monday in September, you are entitled to Winter Fuel Payment (WFP), which is a non-means-tested benefit. Most people are paid automatically but you will need to make a claim if you are not receiving any other state benefits and you have not received the WFP before. The WFP will be paid to the first one in a household to reach the qualifying age. If two members in a household have reached the qualifying age, it is divided between them.

You may also be entitled to Pension Credit, a non-taxable support for those on low pensions and with only moderate savings. People retiring on just their State Pension can have their income brought up to a minimum guaranteed level and there is a savings element that can enhance a small pension on top of the State Pension. Receiving Pension Credit can also entitle you to other benefits such as Council Tax Benefit and Housing Benefit. For more details you could look at Age UK’s Factsheet 48, Pension Credit.

The rules cover a range of situations, especially if disability is involved, so if you are on a low income you should phone the Department for Work and Pensions (DWP) or an independent advice agency such as Age UK or CAB to find out if you are eligible for any help (see section 13, Useful organisations).
If you are an unemployed man you will also receive automatic NIC credits once you reach the women’s State Pension age, even if you are not registered for Jobseeker’s Allowance. These will count towards your basic State Pension.

5 What to do about tax

At retirement your financial circumstances usually change quite significantly, not just because your income drops but also because your sources of income probably change quite a lot. While you are working with just one source of income, you are taxed without any difficulty under PAYE. Once retired you may have two or more sources of income, generally quite small and including the taxable State Pension from which tax is never deducted before it is paid to you. In many cases savings interest makes up a substantial portion of your taxable income. Personal allowances for those born before 6 April 1948 increase up to a certain level of income. All these factors combine to make it harder for HMRC to get your tax right.

You should expect to get a coding notice for each source of income, showing how your tax-free allowances have been allocated. As you have seen above, the State Pension is taxed by reducing your allowances and the rest will then be given to other sources of income until they are used up. Thereafter, anything else will be taxed at the basic rate. If you do not receive a coding notice (P2) for all your sources, you must ask HMRC for them, otherwise you will not be able to work out if the tax is correct. You may wish to seek help from Tax Help for Older People if you find this difficult (see section 13, Useful organisations).

5.1 Increased personal allowance

Increased personal allowance is an additional tax-free allowance to which you are entitled from the year in which your 65th birthday fell. It is not related to drawing the State Pension. Even if your 65th birthday fell on 5 April, your entitlement dates from 6 April at the beginning of that tax year.
Note: An important change was announced in the Budget of 2012. The age-related allowances are to be frozen at their current levels and can only be claimed by those born before 6 April 1948. So those becoming 65 since 6 April 2013 will only be entitled to the basic personal allowances.

Increased personal allowance is gradually withdrawn when your income exceeds a certain threshold, currently £27,000, until it is reduced to the basic personal allowance (PA). The withdrawal is at the rate of £1 of allowance for every £2 of excess income. Thus if your taxable income is, say, £28,000, that is £1,000 over the threshold, you will lose £500 of allowances. At age 67, you would get an allowance of £10,000, not £10,500. However, your PA cannot be reduced below the basic allowance of £10,000 unless your income is over £100,000.

See section 6, Calculating your taxable income, for more examples.

5.2 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
- dividends from investments
- income from lettings

You do not have to pay tax on:

- Pension Credit
- lottery or Premium Bonds wins (or any other gambling wins)
- Winter Fuel Payments
- Attendance Allowance/Disability Living Allowance
- war pensions
Capital itself does not attract tax but the interest or income it generates does, as does the gain if you buy an asset with it and later sell for a profit. See the chapter below on Capital Gains Tax. If you win £100,000 on the lottery and keep it (somewhat unwisely) under the mattress, it is of no concern to the taxman. If you put it in a savings account and get 2.5% interest, that interest will be taxable. The lump sum may, however, affect your entitlement to benefits such as Council Tax Benefit or Pension Credit.

Contact HMRC or Tax Help for Older People for further information about which types of income are taxable and which are non-taxable (see section 13, Useful organisations).

5.3 **Should I be paying tax?**

Everyone, except for those on very high incomes over £100,000, has a tax-free personal allowance (PA). If your total taxable income is greater than your personal allowance, you will have to pay some tax. If not, you are a non-taxpayer.

Your personal allowance depends partly on your age.

In 2013/14 the levels for PA are:

- Born after 5 April 1948: £10,000
- Born before 6 April 1948: £10,500
- Born before 6 April 1938: £10,660.

Remember, the higher allowances take effect from the beginning of the tax year in which your 65th or 75th birthday fell, not from the date of your birthday, even if your birthday fell towards the end of the tax year. But also remember the withdrawal of increased personal allowance once you exceed a certain income threshold (see section 5.1, Increased personal allowance).

Two other major 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 PA, check your payslips, bank statements and P60s to make sure that no one is deducting any tax from anywhere, and read the section on savings and investments on calculating taxable income below.

5.4 **Blind Person’s Allowance**

The Blind Person’s Allowance (BPA) increases your tax-free allowance by £2,230.

In England and Wales you have to be registered as a blind person with the local authority (or have made an application) to qualify for the BPA. Contact your local authority for details of the registration procedure. You do not have to be totally without sight to meet the criteria but you do need to show that your sight impairment is of sufficient severity. A consultant ophthalmologist applies the tests and provides a certificate for you to take to your local social services. 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 BPA but loss of sight is often progressive. Once your eyesight has started to deteriorate, have it tested regularly in case you become eligible for the allowance.

Once the registration process is complete, phone the HMRC helpline on 0300 200 3301 and ask for the BPA – it is not added automatically. As many as 300,000 registered blind people may not have claimed the BPA, so if you qualify, make sure you take up this allowance.

If your income is too low for you to benefit from the BPA, you can transfer it to your spouse or civil partner regardless of the state of their eyesight and ensure the allowance is not wasted.

5.5 **Married Couple’s Allowance**

You can only claim the Married Couple’s Allowance (MCA) if you are a married couple or civil partners and one of you, it doesn’t matter which, was born before 6 April 1935. If this does not apply to you, skip this section.
MCA does not increase your tax-free allowance, like the personal allowance and the Blind Person’s Allowance, but is deducted from your tax bill. It is only worth 10% of its face value – your bill is reduced by 10% of the amount of the MCA. In 2014/15 the MCA is given at £8,165, which in practice means that up to £816.50 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 have it allocated to the wife if she is the higher earner. For couples married after December 2005, the higher earner claims the MCA. The claimant can allocate some of the allowance to their spouse/partner.

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 he or she is a taxpayer.

6 Calculating your taxable income

- Assemble a list of all your sources of income including any work, pensions, savings, benefits and property lettings, then cross-check with the list for any non-taxable sources, such as war pensions, Disability Living Allowance, industrial injuries benefit, etc.

- Then add up the gross income from the remaining taxable sources from the same tax year. It is no use adding the amount of the State Pension for next year to the P60 figure for last year’s pension. Nor should you use the figure for a works pension from a bank statement – that is the net which has been paid in. You need the gross figure from the P60 or your pay slips.

- Interest from savings accounts must be calculated gross – so divide the net by 80% on a calculator or manually divide by 4 and multiply by 5.

- For dividends add the tax credit to the amount actually paid. The figures are on the warrant you received and that you should keep in case you need to complete any tax forms.

- 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

<table>
<thead>
<tr>
<th>Pension Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Pension</td>
<td>£6,674</td>
</tr>
<tr>
<td>Teacher’s pension</td>
<td>£9,872</td>
</tr>
<tr>
<td>Personal pension</td>
<td>£1,790</td>
</tr>
<tr>
<td>Savings interest</td>
<td>£127</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£18,463</strong></td>
</tr>
</tbody>
</table>

At age 63, you have tax-free allowances of £10,000. Subtract that from the gross taxable income of £18,463, and it leaves you with £8,463 to be taxed. At 20% that means you would pay £1,692.60 tax over the year on all these sources of income.

### Example 2

<table>
<thead>
<tr>
<th>Pension Type</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Pension</td>
<td>£8,396</td>
</tr>
<tr>
<td>Savings interest</td>
<td>£1,285</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>£9,681</strong></td>
</tr>
</tbody>
</table>

At age 67 your allowances are £10,500, so the taxable income of £9,681 is £819 below allowances, so no tax is payable. Note that the person in Example 2 should register to receive savings interest gross by completing form R85 (see below section 10 on paperwork and forms) because s/he is not a taxpayer.

### 7 PAYE codes

PAYE is the system that collects tax weekly or monthly throughout the year as you get paid, rather than you paying a lump sum at the end of the year as you do with self-assessment. The codes are the instructions given to employers and pension providers as to how much tax to deduct.
Employers and pension providers can only do what HMRC instruct because they do not know the rest of your financial circumstances, so if you disagree with, or don’t understand your codings, there is no point asking your own payrolls. They can only confirm what code they have been instructed to operate. You must ask the issuing tax office for explanations.

7.1 How to understand your codes

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

Your copy shows the personal allowances to which you are entitled (check it shows the higher level of allowance if you were born before 6 April 1948) from which are taken any amounts that cannot be taxed at source, such as the State Pension. What is left forms the basis of your code number.

Example: Someone aged 68 on an income below £27,000 would have personal allowances of £10,500 from which their State Pension of, say, £5,000 would be deducted, leaving allowances of £5,500 available to set against the occupational pension. The last digit of the number is removed and replaced by the letter P, so the code of 550P is notified to their pension provider.

If you have more than one taxable pension or source of income, such as part-time work, you should receive a separate P2 for each of them. Following the example in the previous paragraph, if the occupational pension is £6,000 the code 550P will be applied to that pension by the company paying the pension and tax will be charged at 20% on the £500 of income after the tax-free allowance of £5,500 has been 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 the person in question also does some part-time work, they would receive a P2 saying that the income will be taxed at basic rate (BR) as all their allowances have been used elsewhere.
It is important that you check every notice you receive because they dictate the amount of tax you will pay. If you disagree with the facts on the notice or fail to receive one for a source you think is taxable under PAYE, query it with HMRC on 0845 300 0627 or write to the address on the coding notice.

**Note:** Sometimes the State Pension exceeds the allowances available. For example, a personal allowance of £10,000 may be exceeded by a State Pension of £10,460. This would result in a negative code of 460; the last digit is dropped as before 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 it accordingly. Again, the overall tax collected by the end of the year should be correct.

### 8 Paying tax through self-assessment

There is only one alternative to paying personal tax through PAYE and that is paying it through self-assessment (SA). So, if you cannot meet all your tax liability via PAYE, you need to complete an SA tax return. This is quite possible when you retire even if you have been taxed under PAYE all your life.

#### 8.1 Possible reasons for inclusion in self-assessment

You will 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 a tax liability but no PAYE source of income
• have an income higher than the threshold of £27,000 at which the age-related allowances begin to be withdrawn.

8.2 **Full return (SA100) and additional information (SA101)**

You will normally be sent both the full return and additional information pages 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 also supplementary pages for all sorts of extras like Capital Gains, employment, self-employment and overseas earnings.

At the front of the tax return there is a checklist of extra sections you might need. You can get them from the order line or print them from the HMRC website. Do not panic at the vast array of boxes! The chances are that you will only have to fill in a few of them. You are unlikely to need to complete the additional information pages unless you are entitled to the Married Couple’s Allowance (see section 5.5) when the claim is made on page Ai3 in Additional Information.

8.3 **Short return (SA200)**

The short return is a four-page document designed for those with very straightforward tax affairs. Many pensioners will receive this but your tax office will decide if you are a suitable candidate; you cannot choose. There are no supplementary pages to the short return but you can fill in an extra page if you have capital gains to declare. Not everyone can use the short return and you need to check the notes that come with it to make sure that you qualify. If you don’t, you will need to ask HMRC for a full return, or file online.

**Note:** If HMRC asks you for a return, you have to do one. If they don’t ask you to do one, but you need to do one for some reason, then it is your responsibility to request a return if you think you have income that is not being taxed or should be declared. The deadline is 5 October following the year in which the tax charge arose.
8.4 **Deadlines and Penalties**

New rules were introduced in 2008, which are designed to encourage taxpayers to file self-assessment returns online wherever possible.

If you are unable to file online or prefer to submit the paper version of either the full or short return, you must complete and submit it before 31 October. After that date penalties will be charged for any late filing of paper returns, regardless as to whether any tax is due. Returns can be filed online up until the following 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 the return in by 31 October, HMRC promise to calculate tax due or repayable in good time. After that date, you will 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 that are more than 28 days late. Interest is also charged on any late payments in addition to penalties.

If you want tax of under £3,000 to be coded out in the next year, you must submit your online return by 31 December.

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**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.

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8.5 **Record-keeping**

You are not asked to send in any supporting evidence with the tax return, although you can if you want to explain something in more detail to HMRC, but you must keep records for at least 12 months after the tax return deadline of 31 January in case HMRC wish to enquire into your return. You need to keep them for five years after the deadline if you are self-employed or have income from property.
Note: Make sure you are well organised and can show receipts, invoices, mileage records, pension contributions, credit card payments, etc, to prove your claims. Also remember to keep a copy of your tax return or a note of all the entries you made on it.

9 Escape from self-assessment

In recent years HMRC has been taking people out of the self-assessment system where their tax can be collected by other means (through PAYE or deducting at source) and there is no other reason why HMRC need to see an annual return.

If they decide to do this with you, they will write to you, but equally, if you think there is no longer any need for you to complete an SA return, ask your tax office to remove you from the system. If they refuse, ask them to justify it under their guidelines. Sometimes you are issued with an SA return in the year following retirement because it is an easy way for HMRC to establish your circumstances. Don’t, however, let them persist with issuing one thereafter. Write to them asking to be taken out of self-assessment and extract a written promise.

Even once you are out of self-assessment, you cannot forget about tax altogether. It is your responsibility to tell HMRC of any new income or capital gains on which you need to pay more tax and you must do this by 5 October after the end of the tax year in which you get that income or gain.

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

Although it is a huge relief for most people to come out of the SA system, you can choose to submit SA returns if you wish, even if HMRC offer to take you out of the system. You might consider it because your tax is paid later in self-assessment (31 January after the tax year) than it is via PAYE or deduction at source (paid as you go along). But for many people that is not worth the burden of coping with the SA system.
10 Paperwork and forms

You are about to 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. These are some of the most common forms you may be asked to complete.

10.1 R85 – Form to stop interest being taxed by the bank or building society

Since you have almost certainly been a taxpayer, you won’t have needed an R85 before. This form, obtainable from your bank or building society, certifies that you are not a taxpayer and can therefore receive the interest without deduction of tax. You can only sign an R85 if the total of all your taxable income (including the gross interest from the savings accounts) is below your personal allowances. The form should come with a help sheet to help you calculate whether you are a taxpayer. Make sure that it is up to date. You will have to sign one for each account that you hold. Don’t forget to revoke all of them if your income rises above your allowances.

10.2 R40 – Tax repayment form

R40 is an important form if you have overpaid tax on your savings. For instance, you may only be liable for tax on your savings at 10% but your savings account will have had tax deducted automatically at 20%, so you will want to reclaim the overpayment. This form is obtainable from your tax office and you need one for each year for which you wish to make a claim, up to the maximum of four previous years. On this form you list all your sources of taxable income and the tax you have already paid, so that HMRC can work out how much you should have paid and therefore how much to repay you. You can also download this form from the HMRC website.

(This form is no longer used for reclaiming overpaid tax on your PAYE income. To reclaim this, you should simply write a letter to your main tax office, including the P60s for the relevant year.)
10.3 **SA100 – The self-assessment tax return form**

If your tax affairs are at all complicated, you may need to complete an annual tax return. On this form, you enter all the information required for HMRC to collect the right amount of tax: your various incomes, any tax already paid, your claims for reliefs and allowances, expenses, pension contributions, etc. You may have to ask for additional pages if you have, say, capital gains, rental income or a foreign pension. It is your responsibility to tell HMRC if you think you need to complete a tax return. Conversely, if HMRC have issued you with a tax return, you must complete it.

Unless you intend to file online, you must return the form to them by 31 October following the tax year being assessed and they will tell you how much to pay. This payment should reach them by 31 January of the next year without fail, otherwise you will be charged interest on your outstanding tax as well as late payment penalties.

10.4 **SA200 – The short tax return form**

This is a simplified, four-page return for people whose affairs are reasonably straightforward. The tax office will decide if you are able to use this. Conversely you might need to request a long return if the short one doesn’t cater for your needs, for example if you have a foreign pension. The form should be completed and sent back by 31 October for the tax office to prepare the tax calculation. Payments of tax and interest charges are exactly as for the full self-assessment tax return form.
10.5 **P2 – PAYE coding notice**

You may be familiar with this form if you have previously been employed. HMRC send out notices of coding every year but they generally do not send them to people with simple affairs where there has been no change to the individual's allowances beyond any annual increase announced in the Budget. You should, however, insist that they send you one every year if you have more than one source of PAYE income so that you can check whether you are being given the right allowances and that your employer/pension providers are using the correct codes. It is especially important when you have more than several sources of income apart from your State Pension, because all too often the PAYE system and multiple tax offices fail to cope with this situation, although a new computer system is steadily getting to grips with this.

The P2 should make clear what allowances are being given against each source of income, as well as how much State Pension they are taxing. If you think anything is wrong or you do not understand it, you should take it up with your tax office and get it explained or corrected. Otherwise HMRC will assume that all is well, and if the code turns out to be incorrect they may, at a later stage, want you to pay tax arrears on the grounds that you should have known your tax was wrong.

11 **Other taxes**

There are three other taxes worth a brief mention here because they may become more relevant at retirement. We will just look at the most probable aspects of each.
11.1 **Capital Gains Tax**

The first thing to say about Capital Gains Tax (CGT) is that your home, provided that you have lived in it throughout your ownership, is exempt. In fact, if you move but have difficulty selling the old house, you have a period of up to eighteen months before the Principal Private Residence (PPR) exemption lapses on your old home. This new exemption period was introduced in April 2014. It was previously three years. If the person selling the home or her/his spouse or civil partner is disabled or has moved into a care home, the final period exemption will still be three years after 6 April 2014.

The rule on other assets is that tax for basic rate taxpayers is due at 18% on net gains (basically sale proceeds less costs) in excess of the current exemption allowance of £11,000. Higher rate taxpayers will pay 28%. You should add the gain onto your other income to see if it takes you into the higher tax band. If it does, you pay 28% tax on the amount of the gain above the higher rate threshold, not on the whole gain. Some types of assets are completely exempt, such as private motor cars and yachts; other items, such as antiques and fine art, have special rules.

If you do make gains in excess of the exemption in any tax year, you will need to 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, again, special rules apply regarding the sequence of purchases and other reliefs. In short, CGT is a very complex tax, so if you sell assets resulting in gains exceeding £11,000, or realise losses, get professional advice. The Chartered Institute of Taxation (see section 13, Useful organisations) can provide a list of advisers in your postcode area.

11.2 **Inheritance Tax**

When you retire, you may well rewrite your will. Inheritance Tax (IHT) is a tax that applies not to you but to your estate. The value of all the assets you own on the day after death are calculated, gifts made in the previous seven years are included, then debts such as mortgages are deducted to arrive at the value of your estate.
The first £325,000 is treated as taxable at 0% (the nil rate band, NRB) and the rest is taxed at 40%. 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 NRB first. The main gift limit is an annual one of £3,000; but there are some 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. So, if you gave away £200,000 three years before your death, that would absorb most of the current NRB, leaving only £125,000 to set against the value of assets you owned at death. Where the value of gifts from the estate exceeds the NRB, the rate of Inheritance Tax payable is tapered so that less tax is paid on any gifts made more than 3 years before death. After seven years gifts are excluded from the estate for IHT purposes.

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. Do not, however, worry too much about IHT. Last year only some 3% of estates attracted the tax.

The rich can afford to pay advisers to help them mitigate or avoid this tax but for most people there are few ways of escaping it. The most frequently asked question is: ‘Can I give my house to the children and continue to live in it?’ The answer is ‘Yes – but only if you pay a commercial rent’. Remember you may well pay more in rent than you save in IHT, and, of course, your children will pay tax on the rental income.

Spouses and civil partners can reduce IHT liability by becoming ‘tenants in common’ of their property. This means that each one owns half the property. On death, therefore, only half the house will be considered for IHT and it can be left in a will to whomever the owner chooses and in most cases the value will be beneath the threshold. The drawback is that the surviving spouse or partner only owns half the house and the inheritor of the other half could force a sale. Professional advice from a solicitor or member of the Society of Trust & Estate Practitioners (STEP) is strongly recommended. See Useful Contacts.
A significant change made in October 2007 was that a surviving spouse can now claim the unused part of the deceased partner’s NRB 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 NRB

Mr A died in 2006/07 and left everything to Mrs A. She therefore acquired 100% of his NRB (currently £325,000). Thus on her death, her estate will have an NRB of twice the current rate. If she were to die this year 20014/15, her NRB would be 2 x £325,000, total £650,000.

If Mr A had left £160,000 to his children, i.e. almost half his NRB, his widow would only be able to add just over 50% of the NRB in force at the time of her death. So if, as above, she died this year she would only have 1.51 x £325,000 available (£490,000), before IHT kicked in.

**Note:** It is only the unused percentage of the NRB 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.

Inheritance tax should not be confused with deprivation of assets and income rules, which relate to the means test for the provision of residential care by a local authority. Further information about this can be found in Factsheet 40, *Deprivation of assets in the means test for care home provision*.

### 11.3 Value Added Tax

The relevant part of Value Added Tax (VAT) that may arise at retirement is its application to disability. There are two main points:
If goods or services are bought solely because of need through disability, they will be VAT-free. You must sign a declaration with the supplier beforehand and you will then be 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 counts; building a new doorway probably doesn’t because it may just be a convenience for everyone in the household.

The second point is that VAT is reduced to 5% for mobility aids for cases of general frailty in anyone over the age of 60. The rules here are a little less rigorous, so putting in a handrail up the stairs, for example, may qualify. Again, you’ll need to sort it out with the supplier first.

12 Rates and allowances 2014/2015

12.1 Personal allowances

<table>
<thead>
<tr>
<th>Born after 6 April 1948</th>
<th>£10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Born before 6 April 1948</td>
<td>£10,500 (increased PA available for whole of the year in which 65th birthday fell)</td>
</tr>
<tr>
<td>Born before 6 April 1948</td>
<td>£10,660</td>
</tr>
<tr>
<td>Blind Person's Allowance</td>
<td>£2,230</td>
</tr>
<tr>
<td>Married Couple's Allowance (either one born before 6 April 1935)</td>
<td>£8,165 (MCA only worth 10% of face value and reduces tax due, not tax-free income.)</td>
</tr>
<tr>
<td>Income threshold before age allowances reduce</td>
<td>£27,000</td>
</tr>
</tbody>
</table>

Note: Once all the age allowance has been lost at an income of £28,000, then the same process of reduction applies to the MCA until it is down to a minimum of £3,140.
12.2 **Rates and bands**

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>First £31,865 of taxable income</td>
<td>20%, thereafter 40%</td>
</tr>
<tr>
<td>But first £2,880 of savings interest</td>
<td>10% if other income at or below personal allowances</td>
</tr>
<tr>
<td>Otherwise standard savings rate</td>
<td>20% (higher rate taxpayers have a further 20% to pay)</td>
</tr>
<tr>
<td>Dividends tax credit</td>
<td>10% (Note higher rate taxpayers have a further 22.5% to pay.)</td>
</tr>
<tr>
<td>Capital Gains Tax</td>
<td>Basic rate taxpayers 18% above annual exemption of £11,000. Higher rate taxpayers 28%</td>
</tr>
<tr>
<td>Inheritance Tax</td>
<td>40% above Nil Rate Band of £325,000</td>
</tr>
</tbody>
</table>

13 **Useful organisations**

**Association of Taxation Technicians**

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

First Floor, Artillery House, 11–19 Artillery Row, London SW1P 1RT
Tel: 020 7340 0551
Email: info@att.org.uk
Website: www.att.org.uk
Citizens Advice Bureau (CAB)
National network of free advice centres. Depending on available resources may offer benefits check and help filling forms.
Tel: 020 7833 2181 (for local contact details only – not telephone advice)
Tel: 08444 70 20 20 (for Wales)
Website: www.adviceguide.org.uk for online information
Website: www.citizensadvice.org.uk for local CAB details

Chartered Institute of Taxation
First Floor, Artillery House, 11–19 Artillery Row, London SW1P 1RT
Tel: 020 7340 0550 or 0844 579 6700
Website: www.tax.org.uk

Department for Work and Pensions
The official government website for citizens with easy access to and information about public services including money, tax and benefits and a specific section for the over-50s. It also offers information about pensions and retirement planning.
Website: www.gov.uk/government/organisations/department-for-work-pensions

Her Majesty’s Revenue & Customs (HMRC)
Contact HMRC for more information about taxes. You should find your local Tax Enquiry Centre in your local phone book.
Website: www hmrc.gov.uk

Low Incomes Tax Reform Group
A wealth of information and research on tax and tax credits
Website: www.litrg.org.uk
Pension Service (The)

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

Tel: 0845 60 60 265
Tel: 0845 60 60 275 Welsh speaking
Tel: 0845 60 60 285 textphone
Website: www.gov.uk/state-pension

Pensions Advisory Service (The) (TPAS)

11 Belgrave Road, London SW1V 1RB
Tel: 0845 601 2923
Website: http://www.pensionsadvisoryservice.org.uk/

Society of Trust & Estate Practitioners (The) (STEP)

Artillery House (South), 11 – 19 Artillery Row, London SW1P IRT
Tel: 020 7340 0500
Website: www.step.org

Tax Help for Older People

Offers independent help and advice from qualified tax advisers for people in later life who have a modest income.

Pineapple Business Park, Salway Ash, Bridport, Dorset DT6 5DB
Tel: 0845 601 3321 or 01308 488066 if cheaper for your telephone service
Website: www.taxvol.org.uk
Further information from Age UK

Age UK Information Materials

Age UK publishes a large number of free Information Guides and Factsheets on a range of subjects including money and benefits, health, social care, consumer issues, end of life, legal, employment and equality issues.

Whether you need information for yourself, a relative or a client our information guides will help you find the answers you are looking for and useful organisations who may be able to help. You can order as many copies of guides as you need and organisations can place bulk orders.

Our factsheets provide detailed information if you are an adviser or you have a specific problem.

Age UK Advice

Visit the Age UK website, www.ageuk.org.uk, or call Age UK Advice free on 0800 169 65 65 if you would like:

- further information about our full range of information products
- to order copies of any of our information materials
- to request information in large print and audio
- expert advice if you cannot find the information you need in this factsheet
- contact details for your nearest local Age UK
Age UK

Age UK is the new force combining Age Concern and Help the Aged. We provide advice and information for people in later life through our, publications, online or by calling Age UK Advice.

Age UK Advice: 0800 169 65 65
Website: www.ageuk.org.uk

In Wales, contact:
Age Cymru: 0800 022 3444
Website: www.agecymru.org.uk

In Scotland, contact:
Age Scotland: 0845 125 9732
Website: www.agescotland.org.uk

In Northern Ireland, contact:
Age NI: 0808 808 7575
Website: www.ageni.org.uk

Support our work

Age UK is the largest provider of services to older people in the UK after the NHS. We make a difference to the lives of thousands of older people through local resources such as our befriending schemes, day centres and lunch clubs; by distributing free information materials; and taking calls at Age UK Advice on 0800 169 65 65.

If you would like to support our work by making a donation please call Supporter Services on 0800 169 87 87 (8.30 am–5.30 pm) or visit www.ageuk.org.uk/donate

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