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a fresh look at accountancy

Your guide to tax-efficient savings and investments

You may wish to save for a number of reasons, whether it's buying a first home, saving for your children's education or preparing for retirement. With careful planning it is possible to minimise the tax due on your savings and maximise the returns.

This guide outlines the current tax treatment for savings income, and introduces some of the key options that you might want to consider as part of your savings and investment strategy.

Tax and your savings

Paying tax on your savings and investment earnings is obviously to be avoided if at all possible. The good news is that the government has introduced changes which mean the majority of people will no longer be required to pay tax on their savings income.

Some key tax-free allowances

	2018/19	2017/18
Personal income tax allowance	£11,850	£11,500
Transferable Tax Allowance	£1,190	£1,150
Starting rate limit (savings income)	£5,000	£5,000
Personal Savings Allowance	£1,000 (basic rate taxpayers); £500 (higher rate taxpayers)	£1,000 (basic rate taxpayers); £500 (higher rate taxpayers)
Dividend Allowance	£2,000	£5,000
Capital gains tax allowance	£11,700	£11,300

Tax and dividends

If you own shares in a company you may receive a dividend payment, which may be subject to tax. The rules on the taxation of dividends have changed significantly over recent years. The Dividend Allowance (DA), which was introduced in 2016, fell from £5,000 to £2,000 from 6 April 2018.

The DA means that the first £2,000 of dividends are now charged to tax at 0%. The rates of tax on dividends over £2,000 are charged at the following rates:

- Dividend ordinary rate – 7.5%
- Dividend upper rate – 32.5%
- Dividend additional rate – 38.1%.

Dividends within the allowance still count towards an individual's basic or higher rate band and so may affect the rate of tax paid on dividends above the allowance.

The Personal Savings Allowance

The Personal Savings Allowance (PSA) means that many individuals are now exempt from paying tax on their savings income. A 0% rate, known as the 'savings nil rate', is applied to savings income within an individual's PSA. The amount of PSA an individual is entitled to will depend on his or her adjusted net income. The PSA allows basic rate taxpayers to earn up to £1,000 each year in tax-free savings income (such as interest), while higher rate taxpayers can receive up to £500 before paying tax on their savings income. However, additional rate taxpayers have a PSA of nil, meaning they do not benefit from the allowance.

Following the introduction of the PSA, banks and building societies no longer automatically deduct tax from the account interest they pay to customers.

The 0% starting rate

The PSA operates alongside the 0% starting limit for savings. The 0% starting rate applies for savings income up to the starting rate limit of £5,000. However, the rate is not available if taxable non-savings income (broadly earnings, pensions, trading profits and property income) exceeds the starting rate limit.

The starting rate does not use up any part of an individual's PSA, so there is a potential £6,000 of tax-free savings for some. However, the starting rate for savings does use up part of the basic rate limit.

When tax is due

Savings income exceeding the PSA is taxed at 20% (basic rate taxpayer), 40% (higher rate taxpayer) or 45% (additional rate taxpayer). Where there is tax to pay, HMRC prefers to collect this tax through the PAYE system, on the basis of information supplied by account providers to HMRC.

A NEW GENERATION OF ISAS

Despite currently offering relatively low interest rates, cash Individual Savings Accounts (ISAs) remain a popular tax-efficient savings vehicle for many people. The rules for cash and stocks and shares ISAs have been subject to reform over recent years, and the government has also introduced a number of new ISA products to target particular groups of savers.

An introduction to ISAs

ISAs are tax-exempt savings accounts available to individuals, generally aged 18 or over who are resident in the UK. ISAs are only available to individual investors and cannot be held jointly. The income from ISA investments is exempt from income tax and any capital gains made on investments held in an ISA are exempt from capital gains tax (CGT).

The overall annual subscription limit for ISAs remains at £20,000 for 2018/19. Individuals are allowed to invest in a cash ISA, a stocks and shares ISA, an Innovative Finance ISA, or a combination of the three, subject to not exceeding the overall annual investment limit.

ISA savers can now withdraw and replace money from their cash ISA without it counting towards their annual ISA subscription limit for that year if the ISA provider allows this flexibility.

There is no minimum investment period for funds invested in ISAs – withdrawals can be made at any time without loss of tax relief. However, many plan managers offer incentives, such as better rates of interest, in return for a commitment to saving for a fixed term.

Junior ISAs

A tax-free Junior ISA (JISA) is available to all UK resident children under the age of 18 as a cash or stocks and shares product, or both. Total annual contributions are capped at £4,260 in 2018/19 (£4,128 in 2017/18). Funds placed in a JISA will be owned by the child but investments will be locked in until the child reaches adulthood.

A transfer of savings from a Child Trust Fund (CTF) to a JISA is permitted at the request of the registered contact for the CTF.

The Help to Buy ISA

The Help to Buy ISA is a tax-free savings account designed for first-time buyers wishing to save for a home.

The scheme provides a government bonus to each person who has saved into a Help to Buy ISA, at the point that they use their savings to purchase their first home. Savings are limited to a monthly maximum of £200, although there is an opportunity to deposit an additional £1,000 when the account is first opened.

The government provides a 25% bonus on the total amount saved, including interest. The maximum government bonus available is £3,000 – to receive this amount an individual will need to have saved £12,000, which is tax-free. Interest received on the account will also be tax-free.

The accounts are limited to one per person rather than one per home, so those buying together can both receive a bonus. Savers must be aged 16 or over and resident in the UK.

The bonus can only be put towards a first home located in the UK with a purchase value of £450,000 or less in London, and £250,000 or less in the rest of the UK.

Help to Buy ISAs will be open to new savers until 30 November 2019. Existing account holders will still be able to keep saving into their account after this date, up until 30 November 2029. The bonus must be claimed by 1 December 2030, subject to a minimum bonus amount of £400.

The Lifetime ISA

Since April 2017 any adult under the age of 40 can open a Lifetime ISA, into which they can deposit up to £4,000 each tax year. They will then receive a 25% bonus from the government on any savings put into the account before their 50th birthday.

Both the tax-free savings and the government bonus can be used for a deposit for a first home in the UK worth up to £450,000 at any time from 12 months after first saving into the account. Alternatively, the funds, including the government bonus, may be withdrawn from the Lifetime ISA from age 60 tax-free for any purpose. Lifetime ISA holders can also access their savings if they become terminally ill.

Savers can withdraw money before their 60th birthday for other purposes, but a 25% government charge will be applied to the amount of the withdrawal. This returns the government bonus element of the fund (including any interest or growth on that bonus) to the government with a 'small additional charge' applied.

New amounts contributed to a Lifetime ISA will count against the overall ISA limit for the year (£20,000 in 2018/19), as well as the Lifetime ISA limit. An individual will only be able to pay into one Lifetime ISA each tax year, as well as a cash ISA, a stocks and shares ISA and an Innovative Finance ISA.

Lifetime ISA versus Help to Buy ISA

Individuals intending to use the savings to purchase a first home may be wondering whether it is better to invest in a Lifetime ISA or a Help to Buy ISA, and this decision will, of course, depend on their individual circumstances. The following table highlights some of the key differences between the two accounts.

	Lifetime ISA	Help to Buy ISA
Savings limit	£4,000 a year with no monthly maximum amount	£200 a month, with the option to invest an additional £1,000 in the first year
Bonus	25% – worth £1,000 a year if the maximum amount is saved. There is no minimum contribution limit that must be met before the bonus is paid	25% – capped at a maximum of £3,000. Total contributions of £1,600 must be invested before the bonus can be claimed
When is the bonus paid?	Shortly after the end of 2017/18 and monthly from 2018/19	At the point of purchase (usually between exchange and completion)
Maximum property price	£450,000 anywhere in the UK	£250,000 or £450,000 in London
Eligibility	Anyone aged 18-40	Any first-time buyer aged 16 and over

As a general point, the Lifetime ISA is intended as a long-term savings product, whereas the Help to Buy ISA is designed to be a short-term savings product.

What about pensions?

Some commentators have suggested that taxpayers in their 20s and 30s could opt to save into a Lifetime ISA rather than into a pension. However, there is still a lot to be said for pension contributions if you are a higher rate taxpayer. The government top up for a 40% taxpayer is effectively 67%, i.e. £6,000 of pension contribution after full tax relief provides an investment of £10,000.

It is also important to consider the age at which withdrawals can be made. Individuals who are currently eligible for a Lifetime ISA will be able to take money from their pension at age 57 (the minimum pension access age is set to rise from 55 to 57 by April 2028). Yet they will need to wait until age 60 before they withdraw their money from a Lifetime ISA without losing the bonus, the accrued income associated with it, and incurring a penalty.

The biggest constraint on the Lifetime ISA is the annual investment limit of £4,000. Those who can afford to contribute more than this may want to utilise their Lifetime ISA alongside making payments into a pension scheme.

The Innovative Finance ISA

The Innovative Finance ISA, which aims to encourage peer-to-peer lending, can be offered by qualifying peer-to-peer lending platforms. Loan repayments, interest and gains from peer-to-peer loans are eligible to be held within an Innovative Finance ISA, without being subject to tax. Returns on Innovative Finance ISAs have the potential to be significantly greater than on cash ISAs, but they will carry a greater degree of risk.

Innovative Finance ISAs are available to any UK taxpayer aged 18 or over.

Additional ISA allowance for spouses on death

An additional ISA allowance is available for spouses or civil partners when an ISA saver dies. The additional ISA allowance is equal to the value of a deceased person's accounts at the time of their death and is in addition to the normal ISA subscription limit. There are time limits within which the additional allowance has to be used. In certain circumstances an individual can transfer to their own ISA non-cash assets such as stocks and shares previously held by their spouse.

The tax advantaged treatment of ISAs continues whilst an individual's estate is in administration.

Other saving and investment options

National Savings

Premium Bonds offer a modest 'interest equivalent', but there is a chance of winning a tax-free million! The Premium Bonds investment limit is £50,000.

Investment bonds

If you have a lump sum to invest long term, you might consider an investment bond. An annual sum equal to 5% of the original investment can be taken for 20 years without triggering an immediate tax liability. However, income and gains accumulating within the fund are subject to tax (equivalent to basic rate tax). On maturity, usually after 20 years, any surplus is taxable, but with a credit for basic rate tax. Higher rate tax might be payable, but a special relief (known as 'top slicing' relief) may be available to reduce or eliminate the burden.

Personal pensions

Personal pensions provide an ideal way to save for retirement, as contributions may attract generous tax breaks.

To qualify for income tax relief, investments in personal pensions are limited to the greater of £3,600 and the amount of your UK relevant earnings, but subject also to the annual allowance. The annual allowance is currently £40,000 for most people.

The £40,000 allowance is tapered for individuals who have both income over £110,000 and adjusted annual income (their income plus their own and their employer's pension contributions) over £150,000. For every £2 of adjusted income over £150,000, an individual's annual allowance will be reduced by £1, down to a minimum of £10,000.

Where pension savings in any of the last three years' pension input periods (PIPs) were less than the annual allowance, the 'unused relief' is brought forward, but you must have been a pension scheme member during a tax year to bring forward unused relief from that year. The unused relief for any particular year must be used within three years.

For both employer and personal pensions, there is a limit on the tax-privileged benefits that can be drawn from pension schemes. The limit is known as the lifetime allowance and the standard lifetime allowance increased from £1 million in 2017/18 to £1,030,000 for 2018/19.

If the value of the scheme(s) exceeds the limit when benefits are drawn there is a tax charge of 55% of the excess if taken as a lump sum and 25% if taken as a pension.

We can help you plan for a comfortable retirement – please speak to us for advice.

Property investment

Property is normally considered a long-term investment. 'Buy-to-let' mortgages will generally be available to fund as much as 75% of the cost or property valuation, whichever is the lower. Those investing in property seek a net return from rent which is greater than the interest on the loan, while the risk of the investment is weighed against the prospect of capital growth.

However, there are new restrictions on the amount of income tax relief landlords receive on residential property finance costs, to the ba
of income tax. Landlords are no longer able to dedu
costs from their property income. They will ins
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