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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

	2017/18	2016/17
Personal income tax allowance	£11,500	£11,000
Transferable Tax Allowance	£1,150	£1,100
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	£5,000	£5,000
Capital gains tax allowance	£11,300	£11,100

Tax and dividends

If you own shares in a company you may receive a dividend payment, which will be subject to tax. The rules on the taxation of dividends changed with effect from 6 April 2016: the previous 10% tax credit was abolished and a new Dividend Allowance (DA) of £5,000 per annum was introduced.

The DA means that the first £5,000 of dividends are now charged to tax at 0%. Headline rates of dividend tax also changed, with tax on dividends over £5,000 charged at the following rates:

- 7.5% for basic rate taxpayers
- 32.5% for higher rate taxpayers
- 38.1% for additional rate taxpayers.

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 £5,000 allowance.

In the 2017 Spring Budget, the Chancellor announced plans to reduce the DA to £2,000 from 6 April 2018.

The Personal Savings Allowance

6 April 2016 also saw the introduction of a new Personal Savings Allowance (PSA), meaning 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 this latest measure.

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

When the PSA was introduced, the government estimated that 95% of savers would no longer pay tax on their savings income. That means around 1.4 million people are still expected to have some tax to pay. In most cases, this will be individuals with higher than average savings or additional rate taxpayers.

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 increased to £20,000 for 2017/18 (up from £15,240 in 2016/17). 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.

Following changes introduced on 6 April 2016, ISA savers may be able to 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 £4,128 in 2017/18 (£4,080 in 2016/17). 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

Launched in December 2015, 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 new Lifetime ISA

From April 2017 any adult under the age of 40 will be able to 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 will be able to 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 from April 2017), 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 table below 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.

During the 2017/18 tax year only, savers who already have a Help to Buy ISA will be able to transfer any funds, including interest, built up before 6 April 2017 into a Lifetime ISA without these counting towards the Lifetime ISA contribution limit.

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 will be an 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 was launched on 6 April 2016 with the aim of encouraging peer-to-peer lending. It 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.

In the 2016 Autumn Statement the Chancellor announced that NS&I will offer a new three-year savings bond from Spring 2017. In the 2017 Spring Budget the Chancellor confirmed that the bond will offer a rate of 2.2% and will be available for 12 months from April 2017. The bond will be open to those aged 16 and over, subject to a minimum investment limit of £100 and a maximum investment limit of £3,000.

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 normally £40,000.

As from April 2016, 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.

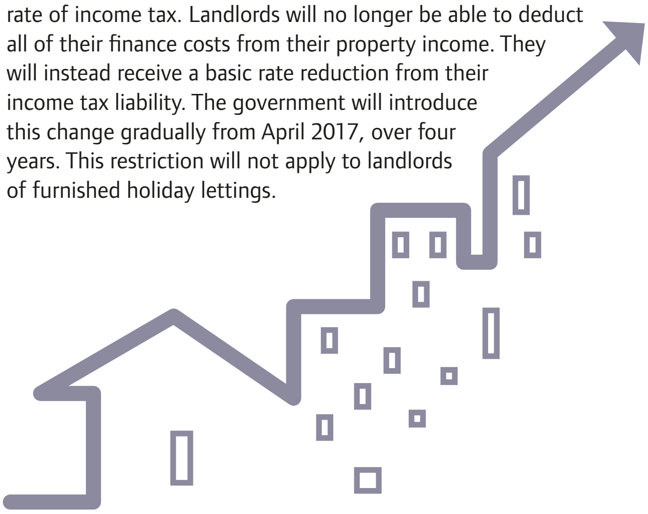
For both employer and personal pensions, there is a limit on the tax-privileged benefits that can be drawn from pension schemes. The limit is known as the lifetime allowance and the standard lifetime allowance is £1 million in both 2016/17 and 2017/18. If the value of the scheme(s) exceeds the limit 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 basic rate of income tax. Landlords will no longer be able to deduct all of their finance costs from their property income. They will instead receive a basic rate reduction from their income tax liability. The government will introduce this change gradually from April 2017, over four years. This restriction will not apply to landlords of furnished holiday lettings.



Venture Capital Trusts

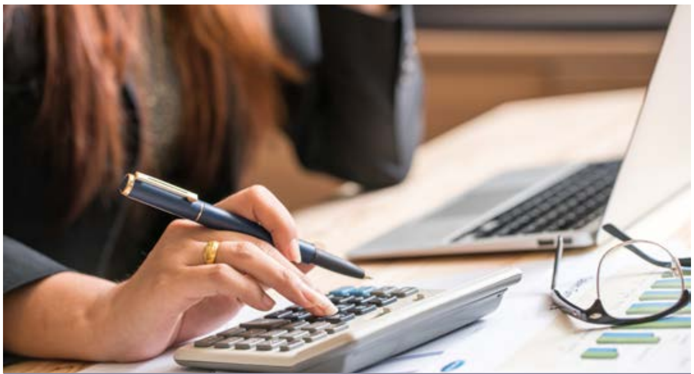
Venture Capital Trusts (VCTs) are designed to encourage private individuals to invest in smaller high-risk unquoted trading companies, and although they carry a greater degree of risk, the associated tax breaks may mean they have a place in your investment strategy.

VCTs themselves are required to hold at least 70% of their investments in shares or securities that they have subscribed for in qualifying unquoted companies. VCTs have a certain time period in which to meet the percentage test.

Although there have been changes to the available reliefs since VCTs were first introduced over 20 years ago, the fundamental characteristics have remained the same. Income tax relief of 30% is currently available on subscriptions for VCT shares, up to £200,000 per tax year, providing the shares are held for at least five years. In addition, an investor in the shares of a VCT will be exempt from tax on dividends and on any capital gain arising from disposal of the shares in the VCT.

Following restrictions to the limits on tax-efficient investments into pensions, and with some VCTs now paying a dividend equivalent to 5% of the initial investment, VCTs have become a popular choice for investors seeking a tax-free source of income in retirement.

If you are considering investing in a VCT and would like more information, please do contact us.



Gains from business investments

Investors' Relief

Investors' Relief (IR) is a new tax relief designed to attract new share capital into unlisted trading companies. It was announced in the 2016 Budget as an extension to Entrepreneurs' Relief (ER), although the potential beneficiaries of IR are different to the shareholders who are entitled to ER.

Both reliefs are similar in providing a 10% CGT rate (rather than a 20% tax rate for higher rate taxpayers) for shareholdings in trading companies. However, ER is aimed at shareholders who own at least 5% of the ordinary share capital of the company and are also officers or employees in that company, whereas IR is designed for non-working investors.

To qualify for the 10% CGT rate under IR, shares must:

- be newly issued and subscribed for by the individual for new consideration
- be in an unlisted trading company, or an unlisted holding company of a trading group
- have been issued by the company on or after 17 March 2016 and have been held for a period of three years from 6 April 2016
- have been held continuously for a period of three years before disposal.

An individual's qualifying gains for IR are subject to a lifetime cap of £10 million.

Remember, returns from investments are not guaranteed and their value can fluctuate. This guide offers basic advice and strategies for tax-efficient personal planning, and we would always recommend that you consult an expert for more detailed advice tailored to your requirements.

As your accountants, we can help you plan for a prosperous future, while keeping the tax bill to a minimum. Please contact us for assistance.