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Saving with a Tax Advantage

The past few years have seen households focus on reducing household debt and increase their savings. Tax advantaged saving still provides a valuable boost to the saving regime and so in this update we look at some of the opportunities for you to consider together with your professional advisers.

Saving for retirement

The Government encourages pension savings by providing income tax relief on pension contributions via a reduction in your tax bill and/or an increase in your pension fund. Pension fund profits are free of income tax and capital gains tax (CGT). Your pension fund may even be able to acquire commercial property with the rent received being tax-free in the fund.

With the top rate of tax in the UK at 50 per cent (ignoring any effective rates), there is a substantial tax advantage because it is possible to invest up to £50,000 - although a contribution of up to £200,000 is available where previous years' allowances are unused - subject to the overriding limit of 100% of your annual 'net relevant earnings'. The relief is achieved firstly by the pension provider claiming 20 per cent back from the Government and the remainder is received through a reduction in your income tax liability.

Upon retirement 25 per cent or possibly more of your total pension pot can be withdrawn as a tax-free lump sum. Annuities can be purchased with the remaining fund to provide a guaranteed income stream, normally at retirement when your other income is lower, and thus you may be subject to a lower rate of tax. Further options are also available, which your professional adviser will be able to discuss with you.

Individual Savings Accounts (ISAs)

ISAs have widespread appeal. Investments can be made on an annual basis with all income and gains arising exempt from taxation.

The current ISA annual subscription limit for stocks and shares is £11,280, of which up to £5,640 can be invested in a cash deposit.

Junior ISAs

A Junior ISA is a long-term saving plan for children under the age of 18. The annual investment limit is £3,600 which, if invested outside of a Junior ISA, could be subject to tax. Maybe a possibility for saving for future children/grandchildren costs?

Seed Enterprise Investment Schemes (SEIS)

SEIS were launched from 6 April 2012 and act alongside the existing EIS framework. The scheme will allow up to £100,000 to be invested in the first year, with an additional £50,000 available for subsequent years subject to a total limit of £150,000.

In return, tax relief at 50 per cent will be provided to the investor regardless of any marginal tax rates and any chargeable gains occurring in the 2012/13 tax year may be rolled over into SEIS and attract full CGT exemption. To reflect the smaller nature of the scheme, qualifying companies must be a start-up UK company with fewer than 25 employees and gross assets under £300,000.

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Enterprise Investment Scheme (EIS)

EIS is an investment vehicle offering numerous tax reliefs to the investor in order to attract investment into unquoted companies.

There are numerous restrictions and conditions to each of the available reliefs, but the main constant is that the shares in an EIS-registered company must be held for three years from the latter of the date the shares were issued or the date the qualifying trade started. Investment can be directly into the company or through an EIS Fund.

Income tax relief

Individuals investing into an EIS-registered company will be entitled to income tax relief of 30 per cent of their investment. There is also a 'carry back' facility, which allows all or part of the cost of shares acquired in one tax year to be treated as though those shares had been acquired in the preceding tax year (at the rate for that year). For example:

EIS investment of £20,000

2011/12:	Gross salary	£30,000		
	Income tax liability		£4,705	
	EIS relief		(£1,495)	£4,984 EIS carried back
	Income tax due		£3,210	
2012/13:	Gross salary	£30,000		
	Income tax liability		£4,505	
	EIS relief		(£4,505)	£15,016 EIS utilised
	Income tax due		£ nil	

The tax treatment can be complicated – please ask us for more information.

CGT

There is also a CGT exemption, so that any gain made on your EIS investment is completely free from CGT.

The payment of tax on a gain can be deferred where the gain is invested in shares of an EIS qualifying company. The gain can arise from the disposal of any kind of asset, but the investment must be made within the period one year before or three years after the gain arose.

There are no minimum or maximum amounts for deferral.

Venture Capital Trusts (VCTs)

Similar to the EIS, VCTs are part of a scheme that provides tax relief to individuals on investments made in small businesses not listed on a recognised stock exchange.

Income tax relief is available where you subscribe up to a maximum of £200,000 of shares in any given tax year and these are held for a period of at least five years. In this case, income tax relief of 30 per cent will be applied to the investment and any dividends received throughout will not be taxable at all. The sale of shares in a VCT after this period will be exempt from CGT.

CGT exemption

Perhaps the most frequently overlooked and unused tax-free allowance available to individuals is the annual CGT exemption, currently £10,600. This tax-free amount is in addition to your income tax personal allowance. Consequently, turning income-generating assets into capital assets is an essential tax planning consideration.

Making use of this allowance will require the investment in capital assets which can include land and property, shares, unit trusts and other miscellaneous assets. One such opportunity to use this tax-free exemption may be to invest in a collective fund managed by a professional manager. Both open ended investment companies and unit trusts exist for this specific purpose.

Subject to gains successfully being realised on the investments, careful planning of disposals over a number of tax years to utilise the annual exemption will significantly reduce and often eliminate any CGT liability arising.

Investment bonds

An investment bond is a vehicle offered by life assurance companies and, although strictly an investment, it is deemed to be a life policy and thus outside the scope of the traditional CGT framework.

UK investment bonds are often used for tax deferral, as income or gains received from the bond will only be subject to taxation once a chargeable event is triggered. Nevertheless, investment bonds are also used as a tax mitigation tool for those who may be a higher or additional rate tax payer on the investment date but only a basic rate tax payer when the bond is surrendered. As the investment is deemed to have been subject to basic rate tax already it may mean that there will be no further tax to pay.

Each policy year carries an entitlement to withdraw up to 5 per cent of the initial investment without becoming subject to income tax immediately, thus allowing for tax due to be deferred until the bond is surrendered or matures. Withdrawals do not have to be made every year to maintain this entitlement as you are allowed to withdraw the total amount unclaimed for previous year's tax free in addition to your current year's 5 per cent allowance. When considering retirement to a country which provides specific tax exemptions for overseas income and gains, this could potentially mean that relief at 100 per cent is achieved.

Your next step

We are only able to provide a brief overview of the tax-advantaged savings opportunities.This factsheet is for information only, please seek professional advice before taking any action.