KNIGHT & COMPANY
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Tax efficient savings and investments

With interest rates at rock bottom and with people now saving more, we look here at a range of tax advantaged savings options.

Pension savings

The Government encourages pension savings by providing tax relief on pension contributions.

Tax relief reduces your tax bill and/or increases your pension fund. The profits made whilst within the pension fund are free of income tax and capital gains tax. Your pension may even be able to acquire commercial property with the rent received by the pension fund being tax free.

With the top rate of tax at 45 per cent (ignoring any effective rates), it is prudent to consider maximising the opportunities for full pension relief. The current annual allowance is set at £50,000, although a contribution of up to £200,000 can be made where previous years' allowances are unused. However the restriction to only 100 per cent of net relevant earnings for personal pension contributions must also be considered.

As relief on pension contributions is made at an individual's marginal rate, any individual with a marginal rate of 45 per cent will find that a contribution of £20,000 per annum will have a net cost of just £11,000. Similarly, for a 40 per cent taxpayer the contribution will cost just £12,000.

In most cases, upon retirement 25 per cent of your total pension contributions made can be withdrawn as a tax-free lump sum leaving the remaining 75 per cent at your disposal for future years. Annuities can then be purchased 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.

Individual Savings Accounts (ISAs)

The ISA annual subscription limit for 2013/14 is £11,520, of which up to £5,760 can be provided in cash savings.

Junior ISAs

A Junior ISA is a long-term saving plan for children under the age of 18. With the current difficulties for the younger generation getting on the housing ladder and the increase in further education costs, it has become common practice for parents to start a regular saving plan for their children from a young age.

Where money is given by a parent to a child and it produces a gross income of more than £100 a year, the parent is liable for tax on all the income earned. Even with the low interest rates in 2013, savings of just £4,000 can trigger tax payments.

Both cash or stocks and shares accounts are available and no further income or capital gains tax will arise; however, the annual limit available for investment is £3,720 and there is no other restriction on cash savings.

Enterprise Investment Scheme (EIS)

The EIS is an investment vehicle offering numerous tax reliefs to the investor in order to attract investment into small 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 in the shares of an EIS-registered company will be entitled to income tax relief of 30 per cent of their investment. Consequently, an investment of £10,000 can result in a reduction of £3,000 in your tax bill, providing you have a sufficient income tax liability to cover it. 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).

Capital gains tax (CGT) exemption

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

Capital gains tax deferral

The payment of tax on a capital 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. One important point to note is that it does not matter whether the investor is connected with the company or not for CGT deferral relief. This provides a significant and often overlooked opportunity for individuals with their own unquoted trading company.

Seed Enterprise Investment Scheme (SEIS)

This scheme sits alongside the EIS and allows 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. As with the EIS there are several restrictions and conditions to be met in order to benefit from the reliefs available.

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. For gains accruing in 2013/14 up to half of the amount invested in 2013/14 or 2014/15 can shelter the gains from CGT. The relief for CGT is only available if some income tax relief has been claimed. 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 £200,000.

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. Although relief is more advantageous than that offered under ISAs, the use of such vehicles is inherently more risky and the rules governing them more complex.

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. Additionally, the sale of shares in a VCT after this period will be exempt from CGT.

Capital gains tax exemption

Perhaps the most frequently overlooked and unused tax-free allowance available to individuals is the annual capital gains tax exemption, currently set at £10,900 for the 2013/14 tax year. This tax-free amount is in addition to your income tax personal allowance.

Consequently, turning income-generating assets into capital assets has become an essential tax planning consideration.

Making use of this allowance will require the investment in capital assets which would 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, whereby a group of individuals pool together their money in a fund managed by a professional manager. Both open ended investment companies (OEICs) and unit trusts exist for this specific purpose, offering either shares or units in the fund to investors which can be easily bought and sold as for other listed companies.

Subject to capital 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.

Each policy year carries an entitlement to withdraw up to five 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 years tax free in addition to your current year's five 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.

We can advise on the best tax efficient savings option for you. Please talk to us to find out more.