Chiene + Tait
CHARTERED ACCOUNTANTS

Comment on...

Savings and Investments

Tax advantages?

Many investments claim to have tax advantages – but tax breaks alone do not turn a poor investment into a good one. A tax-free return only saves tax if there is a return in the first place, so it's important to take proper investment advice before taking investment decisions. But it's also important to understand the tax treatment of what you put your money into, and how much any advertised tax breaks are worth.

The main tax advantages available for different types of investment are:

- No tax on income and/or gains
- Lower rate of tax on income and/or gains
- Tax deduction for investment in the product
- Deferral of tax for investment in the product

Tax-free income or gains

One of the most common tax-free investment products is the Individual Savings Account (ISA). The maximum investment for 2018/19 is £20,000, all of which can be in cash. For small investments, the tax break is not worth much – a deposit of £5,000 might earn £150 a year, but interest from any savings account is tax free up to £1,000 for a basic rate taxpayer and up to £500 is tax free for a higher rate taxpayer.

Thus the tax advantages of an ISA are not necessarily worthwhile. However, someone who has built up a large fund by investing as much as possible for many years will enjoy a substantial tax shelter.

Where the Government adds 25% a bonus to ISA savings such as in the Help to Buy ISA, and the Lifetime ISA, the investment product becomes far more attractive. However, only certain individuals are permitted to open those specialised ISAs.

Lowering the tax rate

For many investments capital gains are taxed at lower rates than income – 10% against 20% for basic rate taxpayers, 20% against 40% or 45% for higher or top-rate taxpayers. But most taxpayers only make a capital gain when they sell a second home or investment property, which is taxed at 18% and 28% in place of 10% and 20%.

Taxpayers who can organise their investments to make gains can take advantage of the annual exempt amount for gains (£11,700) which applies in addition to the £11,700 tax-free personal allowance for income. Although investing for returns in the form of capital gains has tax advantages, it also means more risk – the value may fall as well as rise.

Some investment products are in effect a ‘wrapper’ which changes the tax treatment. Some life insurance policies are in reality investments in Open-ended Investment Companies (OEICs) rather than true insurance. Investing in this way means that any higher rate tax charge on the income and gains arising in the investment can be deferred until it is eventually cashed in – and 5% of the initial amount can be withdrawn each year without triggering a tax charge at all. These investments are often sold as conferring a tax advantage, but it is important to understand them properly to make sure that this advantage is a real one.

Tax deduction for investment

Investment in registered pension schemes currently attracts tax relief at the taxpayer’s marginal tax rate for up to £40,000 a year, and also enjoys tax exemption while the money is in the fund.

Subscribing for shares in Enterprise Investment Scheme (EIS) companies qualifies for a 30% Income Tax deduction – so £1,000 invested generates a £300 tax rebate. Up to £1m can be invested in a tax year for Income Tax relief. Gains on EIS shares are exempt from CGT provided the investment is held for at least three years, but any dividends are taxable. Similar tax reliefs apply if you invest in a ‘Social Enterprise’ either by way of shares or a loan.

Subscribers for shares in a Seed Enterprise Investment Scheme (SEIS) company will enjoy a 50% Income Tax rebate (i.e. more than the 45% top Income Tax rate), but the maximum investment under SEIS is £100,000 per tax year.

Gains reinvested in SEIS reduce the tax due on the gain by 50%. Both EIS and SEIS companies have to be small unquoted trading businesses, so they are relatively high-risk investments. There are age limits on the trades operated in EIS and SEIS companies, which increases the risk.

Subscribing for shares in approved Venture Capital Trust companies (VCT) also qualifies for a 30% Income Tax deduction, and gains and dividends are exempt from tax. Up to £200,000 can be invested in a tax year. VCTs are quoted companies, but they have to invest in small unquoted trading companies, so they are also relatively high risk.

Tax deferral for investment

When you invest in EIS shares or in a Social Enterprise, you can make a claim to defer CGT on any asset sold within three years before and one year after the subscription date. The deferred gain will be chargeable to CGT when the EIS shares or social enterprise investment is eventually disposed of. Where certain trading assets are sold and replaced, it is possible to defer the gain until the replacement asset is sold. This applies in particular to land, buildings, farm payment entitlements and goodwill.

Key planning points

Investment income and gains are the most common opportunity for tax saving by married couples and civil partnerships.

If the partner with a higher tax rate makes an outright gift to the other, that gift will be exempt from CGT, and the receiving partner may:

- Pay a lower rate of Income Tax on income
- Pay a lower rate of CGT on gains

For example, a spouse earning £170,000 will save £450 a year by transferring an investment paying interest of £1,000 a year to a spouse with income of less than £43,000.

Any such transfer has to be genuine and outright. However, any gains on the asset are transferred between spouses on a sale as well as a gift – so it's possible for the one who owned the asset originally to realise the value and not be charged on the gain. If the asset is chargeable to stamp taxes, there may be a small cost in selling rather than giving.

For further information, please contact the Private Client Team:

Gavin Morton at gavin.morton@chiene.co.uk
Hazel Gough at hazel.gough@chiene.co.uk
Helen Mackenzie at helen.mackenzie@chiene.co.uk
Moira McMillan at moira.mcmillan@chiene.co.uk

- Information correct at April 2018