# Moneyworks

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## Pension versus ISA

Both pensions and ISAs offer the opportunity to accumulate growth on your savings in a very tax efficient manner, this article looks at the key differences between the two and considers the timing and appropriateness of each.

**Benefits of a Pension**

For Monies Going In

- Most contributions to a personal pension attract tax relief therefore a gross contribution of £1,000 will consist of a personal contribution of £780 and £220 tax relief added by the Government.
- Higher-rate taxpayers benefit from the same uplift, but can also claim additional income tax relief through their tax coding. This means that paying a gross contribution of £1000 effectively costs £600.
- All personal contributions are tax relievable subject to total contributions not exceeding the greater of £3,600 and 100% of your relevant UK earnings in the tax year concerned. Note though that any contributions in excess of the Annual Allowance (£225,000 in 2007/08) will be taxed at 40%, with the exception being where benefits are taken in full from the arrangements receiving the contributions in the same tax year. In addition, there is also a lifetime limit on the overall value of an individual's pension savings, which in 2007/08 is set at £1.6 million.
- If you are a member of a pension scheme set up by your employer, it is likely that the employer will also be contributing to your plan. It might be the case of course that you can only be a member if you also make contributions to the plan, but, even if this is the case, if your employer is willing to make contributions on your behalf, this is in effect 'free money', which should not be turned down.

For The Investment

- The invested funds benefit from tax free growth (apart from the 10% tax credit on UK equity dividends).

For Monies Coming Out

- You can access up to 25% of your accumulated pension fund as a tax-free lump sum from age 50 (rising to age 55 in April 2010) with income taken taxed at your marginal income tax rate of either 10%, 22% or 40%.

**Benefits of an ISA**

For Monies Going In

- A maxi equity-ISA can be used to shelter up to £7,000 a year in stock market assets from tax. Alternatively, if you do not like to take risks with your money, you can save up to £3,000 a year in a mini cash-ISA, which is effectively a tax-free bank account. These limits are due to change slightly in 2008 to a total of £7,200pa for a maxi equity-ISA and a maximum of £3,600pa in a mini cash-ISA.
- If you open a mini cash-ISA you can also pay another £4,000 into a mini equity-ISA if you are willing to risk some of your savings, but you cannot open both a mini and a maxi ISA in the same tax year. From 6 April 2008 however, the distinction between mini and maxi ISA's will be removed and transfers from cash-ISAs into equity-ISAs will also be permitted.

For The Investment

- Like a pension, the invested funds benefit from tax free growth (apart from the 10% tax credit on UK equity dividends) but you do not get any tax relief on the contribution.

For Monies Coming Out

- You can access the whole of your accumulated ISA funds as tax-free income or a tax-free lump sum.
- You can access your ISA money at any time.
- ISA income does not have to be included on your tax return and does not affect your personal tax allowance.
- Anyone aged between 65 and 74 is entitled to a higher personal tax allowance - called the 'age allowance' - which is set at £7,550 for the current 2007/08 tax year, rising to £7,690 for those aged 75 and over. The amount of age allowance decreases however if an individual receives a total income exceeding £20,900 at a rate of £1 for every £2 of income above this threshold. Importantly ISA income does not count towards the age allowance, but pension income does.

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Authorised and regulated by the Financial Services Authority. The Financial Services Authority does not regulate school fees planning, will writing, taxation and trust advice.

**Which to use and when?**

The priority for a young saver could well be to clear their debts and then use cash ISAs to build up savings for a 'rainy day'. Once a sufficient cash fund has been established, they might then consider investing in an equity-ISA, or commence contributions to a pension plan (assuming that they do not already pay into a pension plan of course - some schemes set up by an employer may stipulate that the employee has to make contributions as a condition of membership).

The ISA v pension decision should take into account the key differences outlined above, but if the objective is planning for retirement the increased annual contribution limits for pensions mean that it is now possible to make substantial contributions to rectify any pension shortfall closer to retirement.

In view of this, younger people in their 20s or 30s might prefer the flexibility of paying into ISAs and waiting until later life to invest their accrued ISA funds into a pension plan. A key attraction of this strategy is that if you defer making any pension contributions until such time as you become a higher-rate taxpayer, then higher-rate tax relief may (subject to future legislation) be available eg; if £5,000 of your earnings are subject to higher-rate tax, £5,000 of your total pension contributions in that tax year will be subject to higher-rate relief. If you pay more, the excess will only attract relief at the basic rate.

Of course, you would need to have sufficient relevant earnings in the tax year in question to benefit from tax relief on the whole of the contribution, although staggering the contribution over more than one tax year would get round this problem if the ISA fund values exceeded your relevant earnings at that time.

The main argument against delaying pension contributions, especially for those who are already higher-rate taxpayers, is that there is no guarantee that the Government will not cut tax relief and/or the maximum permissible tax relievable contributions in the future. Paying into a pension also locks your money away for the purpose for which it is intended, whereas funding an ISA that can be accessed at any time would evidently require discipline.

Either way, it is important to remember that there is nothing to stop you from paying into both a pension and an ISA. It is for this reason that, subject to affordability, people should try and utilise both their ISA and pension allowances as much as possible whilst the tax relief is available. Levels, bases of, and relief's from, taxation may be subject to change. If you are interested in either of these options talk to your Independent Financial Adviser.

## Honesty is the best policy!

Given the recent win by the Taxman (HMRC) in a legal battle against Barclays in May last year the big 5 banks - Barclays, HSBC, HBOS, Royal Bank of Scotland and Lloyds TSB - were obliged to hand over details of customers with offshore accounts.

The reasoning behind this is that UK residents (Non–UK domiciles need only be concerned if the monies are in Ireland, or they have brought any offshore gain/income into the UK or encashed an offshore bond) who hold offshore bank accounts are subject to tax on any interest earned in the year it is paid; even if this is left offshore in the account. As well as the many people who have unknowingly not declared this; there are those who have deliberately not declared it in order to hide it from the taxman.

To assist in the situation the taxman has announced a recent disclosure period which some commentators are referring to as an amnesty for UK residents, where if they declare past earnings before the 22nd June 2007 then the penalty will be 10% of the undeclared tax/duties, plus interest as well as the tax owing being paid.

For those who do not declare the taxman will try and catch these tax evaders and have set up a new hit squad within the Special Civil Investigations Unit for this purpose– importantly they know who the people are that have not declared the interest as they have their bank account details. For these people the taxman will try and enforce the maximum penalty they can with the anticipation of a minimum 30% penalty up to 100% and potential criminal investigation for the more exceptional cases.

The important matter to understand is that this disclosure period does not apply merely to interest in offshore bank accounts, but to any non-disclosed offshore income or gains which could include rent from a holiday home, the gain on the sale of such a house, or encashment of an offshore bond etc. This gives people the opportunity to come clean on their overseas transactions without incurring excessive penalties.

Unless your case is a very simple affair then it may be imperative that advice is sought preferably from your tax adviser or financial adviser. You can obtain more information at the HMRC website https://disclosures.hmrc.gov.uk/oaics

As with any financial dealing it is important to get the right advice not only at the beginning, but also at the end to ensure maximum benefit and minimum tax, so make sure before you encash or change any investments that your advisers are aware of what you are doing so that you do the right thing.

## Is a Good Education a Lottery?

Getting the best education for their child has been high on the list of importance for a number of parents. The options are usually a fee paying school (with a 2006 national average cost of £8,910* p.a.), a good free school, or private tuition.
*Based on the ISC 2006 census.

For most the free education system is the obvious and only financial choice, but with such a wide variation in the results of schools, the best performing schools have moved to the top of a wish list for parents. To help guarantee entry to the school of choice the family usually have to consider a move to ensure they are in the school's catchment area. Over time this has meant that these areas have become property hotspots, commanding up to £100,000 (in certain areas of London) more than equivalent houses outside the catchment area and is an average premium of 8% nationwide (The Times March 2007).

The expectation is that the school will retain its reputation with the result that the premium paid will be recouped when selling on to the next set of parents wishing to assist their child on the educational ladder.

Recently Brighton and Hove City Council have introduced a new secondary school admissions policy whereby catchment areas are being replaced by a lottery system to help increase the opportunity of those living a distance from the more popular schools.

This change has been allowed due to the recently revised version of the national code for schools' admissions, which now explicitly permits selection by lottery. If Brighton and Hove's example is followed by other authorities then there could be a dramatic change in parents views with a potential detrimental effect on house prices in the old catchment areas.

So, assuming you have young children or are planning for children and wish to consider that it could potentially be selection by lottery in your area the following are the main options available:

a. Avoid paying a premium for your property by not moving and rely on the lottery selection basis applying.

b. Decide now to start saving so that you can afford to put your child through private school (see comments below).

c. Obtain the best mortgage you can and buy a house in a 'good school' catchment area in the hope the lottery scheme is not extended, or if it is that any savings made on the new mortgage will offset any lack of rise/fall in value should this happen.

d. Obtain private tuition for your child either with the hope of getting a scholarship, or just to ensure the highest level of education.

e. Try to win a scholorship.

Option B is an expensive option, but working on the following:

- A hypothetical premium of £100,000 for a London property
- Annual cost for a year's day school fees of £10,020 for Greater London (2006 average based on the ISC 2006 census).
- School fees increase over the last 6 years have been 60%* (or 8.15% p.a.)
  * Based on the ISC 2006 census

Then the cost to provide secondary schooling over a 5 year period assuming the same level of annual increases would be £58,959. This could still prove less costly over the term than a potential loss of growth/value of up to the £100,000 premium - as the old adage goes saving early pays dividends especially with the help of an independent financial adviser.

Overall, widespread adoption of the new placement option could change the mindset of parents looking to ensure the best education for their children, there may be an increase in private schooling, or parents may just accept the inevitable. It is possible that there may be a levelling of house prices with a potential lowering of those close to certain prime schools. The expected winners from this lottery will be those in less affluent areas who would not previously have had access to these 'better' schools. As always when a new approach is brought in, other local authorities will no doubt wait to see how successful the Brighton and Hove change is before contemplating adopting the approach themselves. Indeed, it may never happen in your area.

## Who Do You Trust?

We are constantly being told that it is important to ensure we have life cover so that our loved ones are not disadvantaged by our death. It is easy to see the importance of having life cover, it can mean your mortgage being repaid, financial security for your dependants and the cost of your funeral being covered, but few think beyond having the policy in place. In fact, once the policy is in place there are a number of strong arguments for ensuring it is written in trust and the following provides a summary of the reasons why you should consider placing a life insurance policy in trust:

1. Beneficiaries - The life insurance proceeds can be paid directly to the intended beneficiaries.

2. Speed - Beneficiaries can receive the monies before the Grant of Probate has been applied for and received.

3. Tax - The life insurance proceeds are paid to the intended beneficiaries outside the person's taxable estate, therefore saving potential Inheritance Tax.

   Most life insurance policies should be written in trust unless it is deemed not to be necessary, for instance, if the policy can be assigned to a lender for mortgage purposes. However, many lenders do not now allow assignment of policies to a mortgage and therefore this reason may have diminished in recent years. Assistance should be sought from your financial adviser.

Whilst life policies can be in place to repay a mortgage, there are many other uses for life policies such as:

- Protection - term and other life insurance policies can be written under trust for partners, spouses and children to aim to secure their financial future.

- Inheritance Tax planning - term insurance under trust can be used to protect potentially exempt transfers and whole-of-life insurance placed under trust can be used to fund an Inheritance Tax bill on death. This allows the rest of the estate to pass intact to the intended beneficiaries.

- Partnership protection - life insurance policies under trust payable to other partners in the business with the aim of providing sufficient funds to buy the share of the partnership from the deceased's estate.

- Directors share protection - term insurance placed under trust with the aim of providing the surviving directors with sufficient funds to buy the deceased director's shareholding from the estate.

- Protection from creditors - a trust policy is not owned by a bankrupt so may not be affected by bankruptcy. Writing the policy in trust enables protection to continue despite bankruptcy and is popular for individuals in business.

- Savings - savings plans written under trust allow monies to be paid outside the estate, this can reduce tax bills when beneficiaries become entitled to the monies.

It is important that trusts are regularly reviewed to fit in with changing individual circumstances and requirements. Consideration should be given to:

- Any change of address for Trustees, Settlors or Beneficiaries.

- The beneficiaries' circumstances. For example, would the trust documentation affect the person's ability to receive State Benefits?

- Flexibility - changes in law and taxation may mean that trustees need professional advice and added flexibility.

- Trustees responsibilities:

  A decision should be made as to how and when you want the trustees to distribute the assets held within the trust. Should a lump sum be provided, or should the trustees control distribution of capital eg; to fund education? In the case of minor children, a decision needs to be taken as to what age they should be given the trust assets.

  Other trustee responsibilities include administering the trust in accordance with the trust deed, ensuring they act impartially (or fairly) between different beneficiaries and different classes of beneficiary, and ensuring that they obtain advice on matters that they are not competent to deal with themselves.

- Suitability of trustees - the choice of trustees should be reviewed as relationships change. Professional trustees such as solicitors and accountants may also change as retirements occur and successors are appointed.

- Trust documentation - the associated documents are important and should be stored safely, along with the policy document or schedule.

Should you wish to discuss any of these issues in further detail you should contact your Independent Financial Adviser who will be able to discuss your particular circumstances with you.