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Smarter planning for the tax year ahead

Tax year 2021/22

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Start planning now

It can be easy to neglect planning until the end of the tax year comes round.

However, we believe that the earlier you start planning, the better your chances of achieving your ambitions. Setting a plan that enables you to make the most of the tax allowances that are available can help your finances stay tax-efficient.

There are plenty of opportunities out there. Government-endorsed allowances, reliefs and exemptions remain both legally and reputationally safe. The government offers these reliefs to encourage investment and they are designed to be beneficial.

This guide aims to highlight the main tax-planning opportunities for the coming year. However, while tax efficiency is an important part of financial planning, it is not the only part.

At Brewin Dolphin, our experts can work with you to incorporate tax-efficient investing within a broader tailor-made financial plan to make sure the allowances work best for you.

The value of investments, and any income from them, can fall and you may get back less than you invested.

Tax treatment depends on the individual circumstances of each client and may be subject to change in the future.

Information is provided only as an example and is not a recommendation to pursue a particular strategy.

Information contained in this document is believed to be reliable and accurate, but without further investigation cannot be warranted as to accuracy or completeness.

Five areas for action this tax year

On April 6, the 2021/22 tax year began and with it came the beginning of many tax allowances being frozen. To mark the occasion, here are five things to consider that can make your finances and investments more tax efficient this tax year.

1. Your ISA allowance: don't wait to use it

The Individual Savings Account (ISA) annual subscription limit remains at £20,000 in 2021/22, and the annual allowance for Junior ISAs and Child Trust Funds is frozen at £9,000 – and it could be more beneficial to make use of these allowances sooner rather than later.

Although the value of your portfolio can go up and down, utilising your ISA allowance earlier in the tax year means that your investments will have the chance to benefit from tax-free returns for longer.

2. Top up your pension: but watch out for the annual and lifetime allowances

The annual allowance – the limit on the amount of pension contributions that can be made each year and qualify for tax relief – remains at £40,000, but note that this may be lower depending on your individual circumstances.

Last tax year saw significant uplifts to the 'threshold' and 'adjusted' income limits for tapered annual allowance purposes, but for 2021/22 the limits remain at £200,000 and £240,000 respectively.

When considering how much you can save it is important to be aware that there is a limit on the size of overall pension savings you can accumulate without facing a hefty tax charge of up to 55% on the excess. This is known as the lifetime allowance, and will remain frozen at £1,073,100 for the next five years.

3. Make use of gift allowances

If you are looking to reduce your estate for inheritance tax purposes you can give away up to £3,000 worth of gifts (assets or cash) each tax year and they will be immediately excluded when the value of your estate is calculated. This is known as the annual exemption and applies to individuals, so a couple can make £6,000 worth of gifts. If you didn't make use of this exemption last tax year, you can double up this tax year.

You can also give as many gifts of up to £250 per person as you want during a tax year, as long as you haven't used another exemption on the same person. Any amount of surplus income can be gifted provided you can maintain your standard of living after making the gift.[1]

[1] Gov.uk: Inheritance Tax.

4. The personal allowance: how to keep it

The personal allowance – the amount you can earn before paying income tax – has slightly increased to £12,570 for this tax year. The threshold for the start of the higher-rate 40% tax band also slightly increased to £50,270[2].

However, higher earners start to lose their personal allowance when they earn over £100,000. The personal allowance is reduced by £1 for every £2 of income above £100,000. This means your allowance is zero if your income exceeds £125,140.

If you are caught by this rule, you may be able to claw back some or all of your personal allowance by trading-off taxable earnings for certain benefits. Making additional pension contributions is one option. But whether this is appropriate will depend on your individual circumstances and we strongly recommend you seek advice from a tax professional.

5. Don't forget capital gains

One allowance many people forget is the 'annual exempt amount' for capital gains tax, which also remains at £12,300 for the 2021/22 tax year[3].

If you have a large portfolio of shares or collective investments held outside an ISA or other tax wrapper, it's worth using as much of this allowance as possible each year – by selling assets that have risen in value – or you could be storing up a large exposure to capital gains tax for the future. It is worth remembering that the allowance is for individuals, so couples have a combined allowance for 2021/22 of £24,600.

[2] Gov.uk: Income tax: rates and allowances. The £50,270 threshold only applies in England, Wales and Northern Ireland. In Scotland the 41% higher-rate band starts at £43,662. Source: Scottish Government: Scottish income tax: 2021/22.

[3] Gov.uk: Income tax: rates and allowances.

What to do with this year's ISA

Making use of your annual Individual Savings Account (ISA) allowance is one of the first boxes to tick when embarking on your financial planning for the tax year ahead.

ISAs are at the core of most tax-efficient portfolios. Invest in an ISA and you don't have to pay any income tax or capital gains tax on any investment returns achieved. You don't pay income tax on interest income, nor do you have to declare ISA savings on your tax return.

This tax year adults can put up to £20,000 a year into ISAs. So, for a couple that is £40,000. You can also put up to £9,000 into a Junior ISA on behalf of your child.

Don't delay

Many people don't use their ISA allowances until the end of the tax year, but it could be more beneficial to make use of these allowances sooner rather than later. Of course, stock markets can go down as well as up and so investing early in the tax year doesn't necessarily produce better results. But being an early-bird investor will give your investments the opportunity to grow tax-free over a longer period.

You could invest the full £20,000 allowance in one go as a lump sum investment. But if you don't feel ready or able to invest a lump sum, 'drip feeding' your money into the stock market on a monthly basis could be a smart way to make the most of your ISA allowance over the whole tax year. Whichever approach you prefer, it is a good idea to have a plan in place that ensures you make as much use of your ISA allowance as possible. Setting up a standing order so that your ISA is added to monthly throughout the year can make the whole process simpler, meaning there is one less thing to need to remember.

Working harder

There are two main types of ISAs – cash ISAs and stocks and shares ISAs. Cash ISAs have historically been the more popular[4], though they are not the risk-free choice that some people believe. Cash ISAs have been paying less interest than the rate of inflation in recent times, meaning they have not kept up with rising prices and have therefore lost value in 'real' terms.

[4] Gov.uk: Individual Savings Account (ISA) Statistics, 31 August 2018.

We think that savers with a longer time horizon and appropriate risk profile should be looking to make their money work harder. Stocks and shares ISAs invested in the stock market offer the potential to earn higher returns than cash ISAs, to offset the impact of inflation and hopefully increase the 'real' terms value of the investment.

There is a trade-off: shares can be volatile and values can vary from one day to the next. However, investing over a longer-term period reduces the risk of making an overall loss. History shows that over periods of 10 years or more shares tend to be more profitable than cash or bonds.

There are other ways to reduce the risk you are taking with stock market investments. Investing in a fund or portfolio of funds, often holding dozens of individual shareholdings, reduces your exposure to losses from any one company. If you already have money in cash ISA that's earmarked for your long-term future, transferring it to a stocks and shares ISA can be a straightforward way to help your money work harder.

Children can benefit too

While you are thinking of ISAs don't forget the junior variety. Junior ISAs (JISAs) are open to all under-18s who are resident in the UK – although if your child already has a Child Trust Fund (CTF) you would need to transfer its contents into a JISA and close the CTF account to be able to make JISA contributions. The JISA allowance for the 2021/22 tax year is £9,000.

With a JISA, the money is locked away until the child's 18th birthday, at which point it converts to an adult ISA and they can access the funds. Only parents or guardians with parental responsibility can open a JISA on behalf of a child, but anyone can contribute, be they grandparents, godparents or family friends. Children aged between 16 and 18 can apply for a JISA themselves and become the registered contact. They can also invest up to £20,000 into an adult Cash ISA on top of their JISA allowance.

Tax allowances you don't want to forget

Alongside ISAs, pensions are most likely to spring to mind when thinking about tax-efficient investing.

The amount of tax relief you receive on pension contributions is normally at the highest rate of income tax you pay – 20%, 40% or 45%[6]. The tax relief means, for example, that a £10,000 contribution costs a basic-rate taxpayer £8,000, whereas it could cost a higher-rate taxpayer as little as £6,000 or an additional-rate taxpayer just £5,500.

But how much you can contribute to a pension without incurring a tax charge is normally limited to the lower of your earnings or £40,000, a limit known as the annual allowance. The annual allowance applies to all pension contributions – including those made by your employer – and for the 2021/22 tax year is £40,000[7].

Pension allowances

However, it is important to bear in mind that the £40,000 annual allowance may be tapered for those with adjusted income of over £240,000. The £40,000 allowance goes down by £1 for every £2 of income above £240,000 until it reaches a lower limit of £4,000. The money purchase annual allowance (MPAA) – currently £4,000 – limits tax relief on contributions by those who have already accessed their taxable pension benefits flexibly.

As we mentioned earlier, there is also the lifetime allowance, which is the maximum amount of pension savings you can amass over a lifetime without incurring a tax charge. This is currently £1,073,100 and any excess over this limit is subject to tax at either 25% or 55%, depending on how the excess is taken.

Capital gains

There are several other less well-known reliefs and allowances that can also be extremely useful. If you have a decent-sized investment portfolio held outside of an ISA or other tax wrapper, and capital gains tax (CGT) is an issue, there is the annual exempt amount (AEA) to consider. CGT is charged annually on gains made between 6 April and 5 April the following year that exceed the AEA. The AEA this tax year is £12,300 per individual. Sharing the ownership of assets with a spouse or civil partner can enable couples to make full use of this allowance. Capital losses brought forward from previous years can also be used to offset gains, provided they have been reported to HMRC.

[6] These rates only apply in England, Wales and Northern Ireland. For income tax rates in Scotland see https://www.gov.scot/publications/scottish-income-tax-2021/22/

[7] The annual pension allowance is dependent upon several factors and the £40,000 limit may not apply, depending on individual circumstances.

Dividends and savings

The dividend allowance makes the first £2,000 of dividend income you receive a year tax-free. This is on top of the existing personal allowance for income. Dividends over £2,000 are taxed at 7.5% if you are a basic rate taxpayer, 32.5% at the higher rate and 38.1% if you are an additional rate taxpayer.

Another allowance not to forget is the personal savings allowance. This allows basic rate taxpayers to earn up to £1,000 of savings interest a year without having to pay tax. Higher rate taxpayers can earn up to £500 of interest tax free, but additional rate taxpayers do not benefit from this allowance.

There's also the starting rate for savings which could allow you to receive up to £5,000 of savings interest tax free.

Marriage allowance

Where an individual has income below the personal allowance limit of £12,570 and their spouse or civil partner does not pay higher or additional-rate income tax, they may be able to transfer up to £1,260 of their unused personal allowance to their spouse or civil partner. This allowance can result in a tax saving of up to £252 in the 2021/22 tax year.

Offshore bonds

Offshore bonds are a type of investment that can offer substantial tax benefits to the long-term investor. These are investment wrappers set up by a life insurance company in an offshore jurisdiction, such as the Isle of Man or Ireland. Although gains on offshore bonds are subject to income tax when a 'chargeable event' occurs, they enable you to invest in a range of assets in a tax-efficient way.

Higher earners may be able to use offshore bonds to defer tax until they are in a lower tax band, perhaps in retirement. Offshore bonds can also be useful for investors who are able to be flexible in where they take their income. However, it is important to stress that these are complex investments, so it is unwise to invest without seeking professional advice.

VCTs and EISs

Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) offer further ways to invest and cut your tax bill, but are very high risk.

VCTs are listed investment companies which invest in a spread of smaller high-risk companies. They offer tax-free dividends and growth as well as 30% income tax relief when you invest in a new VCT provided the shares are held for five years. You can invest up to £200,000 in VCTs each tax year and benefit from these reliefs.

EISs also offer 30% income tax relief on investments in growing companies, as long as the shares are held for at least three years. There is also no capital gains tax on the sale of your holding provided you have held the shares for this three-year minimum. If capital gains on another asset are realised, the gain can be deferred if reinvested into an EIS, though only if strict rules are followed.

It is possible to invest up to £1m in an EIS this tax year (£2m if at least £1m is invested in knowledge-intensive companies). You can also put up to £100,000 in a Seed Enterprise Investment Scheme (SEIS) for start-up and early stage firms and receive income tax relief at 50%[8].

However, it is important to remember that investing in smaller and fledgling businesses through a VCT or EIS is high risk and the availability of tax reliefs depends on the companies the schemes invest in maintaining their qualifying status.

[8] Gov.uk: Tax relief for investors using venture capital schemes, 2021/22 tax year.

How we can help

Ultimately, selecting the right investments to hold is far more important than tax efficiency. Without good investments, the tax breaks are worth very little, and that's where we can really help. Brewin Dolphin is an expert at creating portfolios that have the right mix of investments and asset classes to match a client's risk profile and help them meet their investment goals.

If you would like to discuss how to invest your ISA allowance for this tax year, transfer an existing ISA from elsewhere, or understand how to make your investments more tax efficient please call 020 3201 3900 or contact your local Brewin Dolphin office.

Let's start a conversation.

Visit us online at www.brewin.co.uk

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