NEWSLETTER

ISA Investment Options

The annual ISA allowance is a “use it or lose it” investment opportunity. Hence the proliferation of press advertisements exhorting investors to utilise the allowance before the tax year end.

The allowance currently stands at a very meaningful £20,000, which compares with £15,240 maximum investment in the tax year 2016/17 and just £7,000 in 2006/7.

However, instead of being shoe-horned into the tax year-end window, investors might benefit from choosing their own time to invest, earlier in the tax year, and thereby taking advantage of a longer period of tax-free potential returns.

Until now, the great majority of ISA investments (77% of the total) have been made into cash ISAs, but investors are starting to favour stocks and shares ISAs. In 2016/17 new investments in cash ISAs fell by nearly £20 billion to £39 billion, while investment in stocks and shares ISAs increased to £22.3 billion.

A half-way house could be to mix and match within the £20,000 allowance, investing partly in cash and partly in stocks and shares.

The relative decline in popularity of cash ISAs is due not only to unattractively low interest rates but also the introduction of the Personal Savings Allowance, which undermines ISAs’ tax advantage by permitting basic rate taxpayers to receive up to £1,000 of savings income each year free of tax.

Investors with existing cash ISAs are able to switch from cash to stocks and shares funds within their existing ISA wrapper; although interest rates are set to rise this might well make sense for those with a longer time horizon.

It is vital, however, that the existing ISA should not be closed, otherwise the tax wrapper will be lost. Instead, the holdings within the wrapper must be transferred.

If the existing provider offers both cash and stocks and shares funds the move will be straightforward. But it is highly desirable to take the opportunity to shop around and consider the universe of funds available. In such a situation, however, the existing provider may levy a transfer charge.

Encouraging Enterprise

In his Spring statement, Chancellor Philip Hammond announced that consideration was being given to introducing a new higher-risk variant of the Enterprise Investment Scheme (‘EIS’), to encourage investment in new “knowledge intensive” technology companies.

EIS was introduced in the 1990s and offers investors in companies that meet the criteria and have assets of less than £15 million a range of tax reliefs:

- 30% up-front income tax relief on investments up to £1 million p.a.

- Exemption from CGT on the disposal of shares in respect of which income tax relief has been granted, after these have been held for 3 years

- Deferral of capital gains tax (‘CGT’) on gains of unlimited amounts from other investments which have been realised within the previous 3 years and reinvested into the EIS

- If the business qualifies for Business Property Relief an EIS holding will, after two years, be exempt from inheritance tax.

The new EIS variant could offer four different forms of tax relief, including allowing gains made on the sale of property to be off-set against a CGT bill. This would be attractive to property investors because property gains are subject to CGT at the higher rate of 28%

Other possibilities being considered are the exemption from tax of dividends from qualifying EIS holdings and enabling the investor to decide when to apply income tax credits, which could be either in or before the year in which the EIS investment is made. Currently, tax relief applies when the EIS invests in the underlying company whether or not this suits the individual investor.

To be eligible for the proposed new benefits the EIS would have to be confined to investing in companies that commit significant expenditure to research and development at an early stage in their lives. Such companies would necessarily involve higher risk and longer time-spans in establishing their viability. Hence the adoption of the expression ‘patient capital’ in relation to such investments.

Britain has in fact become a world-leader in technology, ahead of all other countries with the exception of the US and China. In 2017 twice the amount of capital was raised in London to fund digital companies than any other city in Europe during the period 2012 to 2016 total investment in Britain amounted to £28 billion, equivalent to our closest rivals France, Germany and the Netherlands combined.

The Chancellor’s thinking reflects not only the importance of technological development to the future of the UK economy but also the government’s crack-down on investment schemes which it considers are based on an unfair manipulation of the tax laws.

This, combined with restrictions on the amounts that can be invested in pensions, is causing investors to favour not only EIS but also other less adventurous approved savings media such as ISAs and Venture Capital Trusts (VCTs).

VCTs offer 30% income tax relief on investments of up to £200,000 p.a. and tax-free dividends but are not confined to high-tech investments. However, the range of eligible companies is being pruned and will in future probably exclude pub chains and crematoria.

Pension Tax Relief

Pensions have always been and still are the most tax-efficient form of investment, but limits on contributions and total savings have been reduced dramatically.

A major part of the reason is that higher rate tax relief on pension contributions is costing the Exchequer £38 billion annually and questions remain as to how long the government can continue to ignore calls for the standardisation of relief at a lower level, perhaps 30%.

It was chancellor George Osborne who initiated research into the issue and insiders report that the Treasury has a large file the conclusions from which would enable it to act at fairly short notice.

For the time being, pre-occupation with the fallout from Brexit is likely to delay reform, but the writing is on the wall and as ever the clear message is to take full advantage of existing reliefs while they are available.

April 2018

No responsibility can be accepted for the accuracy of the information in this newsletter and no action should be taken in reliance on it without advice. Please remember that past performance is not necessarily a guide to future returns. The value of units and the income from them may fall, as well as rise. Investors may not get back the amount originally invested.

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