Money Wise

CYGNET
WEALTH MANAGEMENT

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Targeting the right ISA

How to make the most of your tax-efficient savings allowances

Inside...

A new era for VCTs and EISs

There has been a major overhaul for venture capital trusts (VCTs) and enterprise investment schemes (EISs).

The changes come as a response to a government consultation paper published last summer on "patient capital". The paper criticised some EIS and VCT providers, saying, "Industry estimates suggest that the majority of EIS funds … had a capital preservation objective in tax year 2015/16, and around a quarter of VCTs have investment objectives characteristic of lower risk capital preservation".

Two key points emerged from the new rules:

- **'Risk to capital' condition** VCT and EIS investments must now be made in companies that have objectives to grow and develop, and where there is a significant risk of loss of capital, after allowing for tax relief. This is to prevent an emphasis on capital preservation that was criticised in the consultation paper.
- **Tax reliefs** There were no changes to the levels of tax reliefs given to VCTs and EISs. The main rate of income tax relief for subscriptions remains at 30%. The relief can be clawed back if the investment is sold prematurely or ceases to qualify, with clawback periods remaining at five years for VCTs and three years for EISs. Similarly, the capital gains tax advantages of VCTs and EISs were left intact.

These reforms and other technical changes have added greater risk to VCT and EIS investments, making it more vital than ever to take expert advice before committing your capital to such schemes.


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The value of your investment can go down as well as up and you may not get back the full amount you invested.

Past performance is not a reliable indicator of future performance.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Some VCT and EIS investments may be difficult to sell and tax benefits depend on maintaining qualifying conditions.

Levels and bases of taxation and tax reliefs are subject to change and their value depends on individual circumstances.

The Financial Conduct Authority does not regulate tax advice.

Reduced protection for **mortgage payments**

What would happen if you were unable to pay your mortgage?

Changes to the government's scheme supporting people unable to make their mortgage repayments – Support for Mortgage Interest or SMI – could have significant consequences for struggling home-owners. From 6 April 2018 SMI ceased to be a benefit payment and became a loan secured against the mortgaged property.

That SMI loan carries interest which is rolled up at a rate linked to government borrowing costs (currently 1.5%). It becomes repayable if the recipient moves home, dies or transfers the property in any way. SMI only helps to pay mortgage interest – no support is given for the capital repayments of the amount borrowed.

Before the changes SMI was a means-tested social security benefit. Under the new rules, SMI:

- Covers a maximum mortgage amount of £200,000, a figure set in 2009.
- Pays a 'standard rate' of interest, currently 2.61%, based on Bank of England average mortgage rate data. This means the interest on many mortgages will not be fully covered.
- Payments generally only begin after a waiting period of 39 weeks (13 weeks prior to April 2016).

Reduced protection

The new form of SMI will leave recipients with a debt to pay, so it could be wise to arrange your own cover. You may not have such protection in place, particularly if your mortgage is more than two years old and started when the waiting period was 13 weeks. If so, it may be time to review your mortgage protection arrangements.

> *From 6 April 2018 SMI ceased to be a benefit payment and became a loan secured against the mortgaged property.*

Your home may be repossessed if you do not keep up repayments on your mortgage or other loans secured on it. Think carefully before securing other debts against your home.

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Which ISA is right for you?

You can maximise your tax-efficient savings through a range of Individual Savings Accounts (ISAs) and the earlier you start the better.

You can invest up to £20,000 in the 2018/19 tax year under your main ISA allowance using a mix of different types. Each has its own terms and conditions including limits, investment vehicles and access rules.

Regular ISAs

An ISA is a tax-wrapper, through which you can invest in cash, stocks and shares, or a mixture. You don't pay UK tax on interest earned on cash, or on income or capital gains derived from funds or other investments in a stocks and shares ISA. Nor do you have to include these accounts on a self-assessment form.

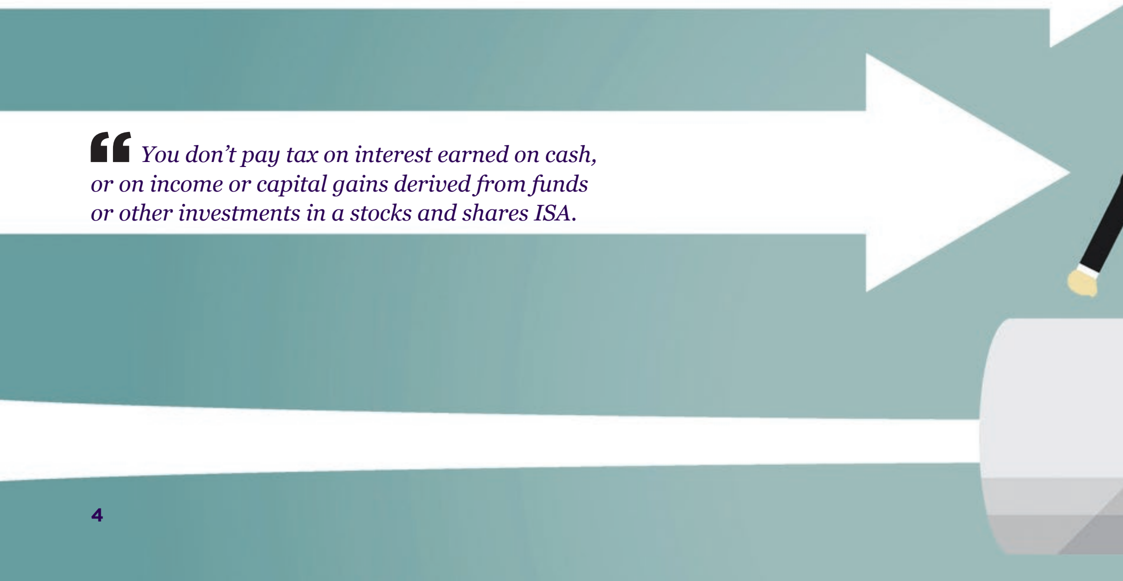
There are no general restrictions on when you can withdraw funds, but special terms may apply for individual providers – for example with fixed-rate cash ISAs.

Innovative Finance ISAs

This ISA allows investment in peer-to-peer lenders or crowdfunding activities. These may offer attractive interest rates, but be aware that these higher-risk investments are not covered by the Financial Services Compensation Scheme.

Lifetime ISAs

You can put up to £4,000 a year into a Lifetime ISA and receive a 25% government-funded bonus, but you must be under 40 when you start. You can contribute until your 50th birthday and contributions are part of your main ISA allowance. The funds can be used to help buy your first home or save for retirement and there are investment and cash options.



"You don't pay tax on interest earned on cash, or on income or capital gains derived from funds or other investments in a stocks and shares ISA.

If you withdraw funds before the age of 60, and are not buying your first home, there will be a withdrawal charge equivalent to 25% of the amount you withdraw, unless you are terminally ill.

Help to Buy ISAs

These cash accounts are for first-time buyers, but you can only open a new one until November 2019. You can save up to £200 a month, and add in an extra £1,000 in the first month. The government adds a 25% bonus, up to a maximum of £3,000, in addition to any interest earned. There is no age restriction on starting, but you will lose the bonus payments if you use the savings for other purposes.

Junior ISAs

Parents and others can save up to £4,260 tax free for a child, each year. Junior ISAs (JISAs) work in a similar way to regular ISAs, with similar cash and investment options available. The key difference is that the child cannot withdraw the funds until their 18th birthday. At this point they can convert it into a regular ISA.

You can contribute to a child's JISA in addition to investing in your own ISA. It's a great way to help a child build up assets for the future.

If you would like advice about which ISA is right for you, please get in touch.

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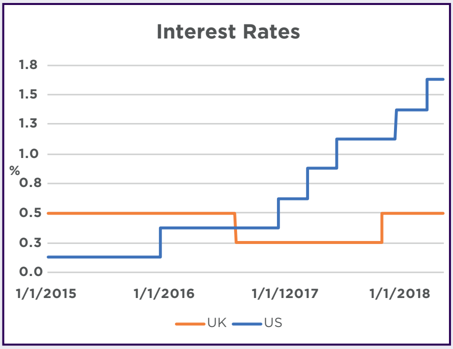
Interest rates are set to rise

The Bank of England is indicating the interest rate will increase in the coming months, so it may be a good time to review your investments.

The Bank of England held the interest rate at 0.5% in May, but its Governor, Mark Carney, reiterated that rates will probably need to increase if the inflation goal is to be met. Interest rates are already rising in the US, with further increases expected in 2018.



The economists' term for what is happening is 'normalisation', which for the rest of us means a steady increase in interest rates.

The Federal Reserve has been raising US rates since December 2015. Despite many threats to do the same, the Bank of England cut rates in August 2016, after the Brexit vote, but then reversed that change last November.

Impacts

Increases in short-term interest rates could have a variety of consequences:

- The values of fixed interest securities, such as government bonds (gilts), could fall. Much will depend upon how long-term interest rates react – these do not necessarily follow the short-term path.
- Share values could fluctuate further. Banks traditionally benefit from rising interest rates, while companies that have borrowed heavily can suffer.
- The value of commercial property could come under pressure, although rental yields are currently comfortably above the income available from gilts.

If you have not done so already, it may make sense to review your investments now in preparation for rising interest rates.

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Stuck in frozen tax thresholds?

The value of key tax thresholds is being eroded as elements of the income tax system lag behind inflation. How can you escape the freeze?

Freezing tax thresholds has been one of the most widely-used stealth taxes by successive Chancellors. Three key thresholds relating to income tax have been subject to this treatment:

- *High income child benefit tax charge* This tax charge, introduced in January 2013, effectively claws back child benefit at the rate of 1% for each £100 of income over £50,000 (based on the higher of the two parental incomes). That £50,000 threshold has not changed since its introduction.

- *Personal allowance tapering* The personal allowance is reduced by £1 for every £2 you earn over £100,000. The £100,000 threshold was announced by Alastair Darling in 2009 and neither of his successors have revised it.

- *Additional rate tax starting point* The additional tax rate started in 2010/11 with a threshold of £150,000. Whilst it has since been reduced from 50% to 45% (or the 46% top rate in Scotland), the threshold has not increased.

The primary way to limit the effect of these income-driven thresholds is to reduce the income being measured. For example:

- **Independent tax planning** You may be able to reduce your income by transferring investments to your spouse or civil partner.

- **Make pension contributions** Personal pension contributions reduce your income for tax purposes. Because of the way the tax relief operates, you could find a 60% marginal tax rate means 60% tax relief on pension contributions.

- **Use income shelters** ISAs and some other investment products can shelter your income and prevent it counting towards the threshold.

As it is early in the tax year, there is more scope for reducing the effect of these freezes in 2018/19, with professional advice.

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Pros and cons **of joint finances**

There are benefits and risks for couples who decide to manage their money together.

Many couples maintain independent finances, but operate one or more joint accounts to save or cover bills. But differing attitudes to spending and saving can be a source of tension.

Once you buy a home together, or just open a joint account, your finances become inter-linked. You will then be 'co-scored' when applying for credit, and a partner's poorer credit score can impact on your rating. If you have a shared mortgage or loan, you will also be liable for the whole debt if your partner can't, or won't, contribute to the repayments.

Switching investments

If one partner is a basic rate taxpayer or non-taxpayer and the other pays income tax at a higher rate, it could be worth switching savings or investments to the lower earner to reduce the overall tax payable. Husbands, wives and civil partners can normally transfer assets freely between each other without incurring tax on any gains realised by the gift.

Higher earners can choose to contribute to the pension of a lower-earning spouse, subject to the annual allowance, with the amount of tax relief available the greater of £3,600 or the lower earner's relevant UK earnings. This could help couples make best use of both of their personal allowances for income tax in retirement.

One word of warning: if an account is also in a partner's name, they are then legally entitled to the money. Trust is key for shared finances.

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