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Our end-of-tax-year tick list

The end of the financial year is looming. There are several jobs many of us may need to consider before midnight on April 5th (in practice 1st April, given the early Easter this year). Hopefully, this list will help you.

ISAs

Over 10 million of us subscribe to an ISA each year. The ISA allowance for 2020/2021 is £20,000 per person. You cannot carry any unused ISA allowance forward, so this is a 'use it or lose it' tax benefit. If you want to make the most of this year's allowance but are uncertain as to how to invest, you can put your money in a cash ISA now and transfer it into a stocks & shares ISA later. That way you secure the tax benefits.

The most recent figures suggest that three out of four people buy a cash ISA, even though the best rates are poor at the moment. The Bank of England's decision last week to keep interest rates at 0.1% will not help. One of the best one-year fixed ISA pays 0.55%. You can squeeze out more – 0.75% – if you are willing to sign up to a three-year deal.

Many commentators are concerned that inflation is around the corner – fuelled by economic recovery and central bank stimulus. That might lead to rising interest rates, which could make that 0.75% look poor in 18 months. So check the penalties for withdrawal if tying your money into a long-term savings deal. Some will charge you 270 days' interest for early withdrawal, others 120 days'.

Another complicating factor if you have a lot in cash ISAs is spreading the money around. Check that the organisation you invest in is covered by the Financial Services Compensation Scheme.

There is risk if you hold more than £85,000 in an individual bank or building society. This is the limit of the cover for each licensed UK financial institution. Be careful, as some organisations – HSBC and First Direct, for instance – operate under one licence, so even if you have savings in both institutions the combined total cover will be only £85,000.

Equities or cash?

Exposure to equities may be more appealing for long-term investors notwithstanding the strong recovery in stock markets following the turmoil of last March, when Covid first wreaked havoc on the economy. As ever, if you are investing in equities it should be with the long term in mind.

If you have existing assets – like direct equities or equity funds – sitting outside an ISA and are unable to use all your allowance this year, think about how you might wrap them up within an ISA. It is worth making the most of the ISA perks – no additional tax on income and gains are free of tax. You are also saved the hassle of reporting ISA income and gains on your tax return.

Unfortunately, you will have to sell assets before moving into the ISA wrapper, which may trigger Capital Gains Tax (CGT). You can then repurchase the same investment – or buy something different – within an ISA. Be careful, though – when markets are this volatile, any time out of the market can be costly.

You can also 'Bed & Spouse/Civil Partner', which means that you can sell investments held outside your ISA and rebuy them in an ISA in your spouse or civil partner's name to make the most of their ISA allowance.

Junior ISAs

Children cannot own shares except through a Junior ISA (JISA) or a pension, which has to be opened by the parent or guardian. You can invest £9,000 in a JISA this year – that is more than twice what you could invest last year (£4,368). The money is locked in till the child is 18, at which point they can take control of it.

Pension contributions

Most of us can save up to the Annual Allowance of £40,000 gross into a pension. For every £1 you invest your pension provider will claim back basic-rate tax at from HMRC and add this to the pot. The effect is that if you pay £80 into your pension it is grossed up to £100, an increase of 25%. Higher-rate and additional-rate taxpayers can claim back the further 20% or 25% tax they paid through their self-assessment tax return. This is usually given as a reduction in their income tax bill. Many forget to do this, potentially losing thousands of pounds a year.

There are several caveats. Perhaps the most important is the tapered allowance trap. This reduces your pension contributions allowance by £1 for every £2 that your income – which includes earnings, rental incomes and other investment income – takes you over £150,000 (£240,000 in 2020/21). It can get fiendishly technical, but the tax benefits of paying into a pension can be so substantial that it is worth taking professional advice – and soon.

Subject to HMRC rules, if you have not maximised your pension contributions in the past three years you can carry forward the unused allowance into this year. For high earners who are not close to breaching the £1,073,100 Lifetime Allowance there is much to be said for paying as much as you can into your pension. Those earning over £100,000 should particularly consider this. You lose £1 of your personal allowance for every £2 you earn over £100,000. As a result, your marginal rate of tax between £100,000 and £125,000 is 60%. Putting that money into a pension can potentially save you £15,000 in tax.

You can also make contributions of £3,600 into a pension scheme for a spouse or civil partner (under 75) or child if they have no earnings of their own and still enjoy the basic rate of relief. So a contribution of £2,880 net will be topped up to £3,600 by HMRC.

Capital Gains Tax

We each have a CGT allowance of £12,300. Higher-rate taxpayers pay 20% on gains over the allowance. For basic-rate taxpayers it is just 10% – though gains on property other than the primary residence carry an extra 8% tax. So if you have £50,000 worth of shares that you bought a decade ago for £10,000 the gain is £40,000. Your £12,300 CGT allowance means you will pay tax on just £27,700 – at 10% or 20%.

You can gift assets to a spouse or civil partner without triggering CGT. They can then sell some, too – and, assuming they are not using their allowance with disposals of their own, you have effectively doubled your CGT allowance. In our example this would mean only £15,400 is liable for CGT. Gifting is particularly useful if your partner pays tax at a lower rate.

Of course, you do not have to dispose of assets all in one go. You might sell up to the limit of your CGT allowance and then sort the remainder after April 5th, when you have a fresh allowance.

Giving money away

If you pay sufficient tax and donate to registered charities using gift aid the charity receives a 25% uplift on your donation. On top of that, higher-rate (40%) taxpayers and additional-rate (45%) taxpayers can claim back the difference between the basic rate of tax and the tax they paid (20-25%) – usually by reducing their income tax bill.

You can carry back donations to the previous tax year, which is useful if the top rate of tax you paid in that year was higher.

You can also give money to your family and reduce your Inheritance Tax (IHT) liability. Each of us has an 'annual exemption' that means you can give away up to £3,000 in a tax year. You can exceptionally carry forward the allowance for one year (so a couple who have not used the exemption in the previous year can give £12,000 in one go).

In addition, you can give as many gifts of up to £250 per person as you want during a tax year, as long as you have not already used another exemption on them.

This is a useful way of drip-feeding money down the generations over time without risking running short yourself.

Consult and review

Sensible tax planning can save you thousands, but trying to mitigate tax issues can encourage you to take steps that cost you in other ways. We call it 'letting the tax tail wag the financial planning dog'. Financial and tax planning is often about making sensible compromises.

This is a good time not only to think carefully about making the most of your allowances but to make sure that your money is wisely invested. Have too much sitting in cash and you suffer inflation risk. Too much in high-risk assets can put your whole financial future in jeopardy. If you have significant assets it is well worth taking advice. And you should review your finances at least annually.

We are always happy to have an informal discussion with investors worried about issues like Inheritance Tax, breaching the Lifetime Allowance and investing their wealth wisely and appropriately.