Tax-Free Savings **Guide**

It was Benjamin Franklin who said "in this world nothing can be said to be certain, except death and taxes". One half of the statement is certainly true; and in fairness to Mr Franklin, the Personal Savings Allowance and ISAs were not around in the 18th century.

When Chancellor George Osborne announced that a new tax-free Personal Savings Allowance would be introduced in April 2016, it was a move widely lauded as the biggest shake-up to savings in a generation. Since that date, basic rate taxpayers have been able to earn up to £1,000 savings interest a year without having to pay tax on it, while higher rate taxpayers have an allowance of £500. Additional rate taxpayers do not get an allowance.

As a result of the changes, 95% of people now do not pay tax on their savings. It seemed obvious, therefore, that at the same time, the banks and building societies should stop automatically taking 20% in income tax from interest earned; instead, interest is now paid gross.

Anyone who does exceed the allowance will have to pay the necessary tax to HM Revenue & Customs. Banks and building societies provide HMRC with information about the account interest they pay in order to help identify those with tax to pay. According to HMRC, around two in three of those with tax to pay already complete a tax return each year and should report their savings income in this way. The one in three who do not complete tax returns will see the tax they owe taken out of their PAYE income automatically, by an adjustment in their tax code, spread across the year. Those people who have tax to pay but do not currently complete a tax return or have little or no PAYE income will be contacted by HMRC with a view to settling the tax due, typically by a direct payment.

Savings income includes account interest from bank and building society accounts, and from providers such as credit unions and NS&I. It also includes interest distributions from authorised unit trusts, open-ended investment companies and investment trusts, income from Government or company bonds, and most types of purchased life annuity

continued overleaf

Key Facts

- **The Personal Savings Allowance introduced in April 2016 means that basic rate taxpayers can earn up to £1,000 in savings interest tax-free.**
- **Cash ISAs are tax-free savings accounts available to UK residents. Anyone over the age of 16 can open a cash ISA.**
- **There are still good reasons to use the annual ISA allowance, despite the introduction of the Personal Savings Allowance.**
- **NS&I offers a number of tax-free savings vehicles, including Premium Bonds, an ISA and Junior ISA.**

Useful Links

See latest Cash ISA rates

- Easy Access
- Notice Variable
- ◄1 Year Fixed
- 1 Year Fixed
- 2 Year Fixed
- 3 Year Fixed
- 4 Year Fixed
- 5 Year Fixed

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payments. However, interest from ISAs doesn't count towards an individual's Personal Savings Allowance because it's already tax-free.

ISA appeal

Since the introduction of the Personal Savings Allowance, some have questioned whether there is any value in continuing to use an ISA going forward. However, for the vast majority of people, making use of their annual ISA allowance still makes sense.

Originally introduced in April 1999, cash ISAs can be opened by UK residents aged over 16, while the age rises to 18 for a stocks & shares ISA. Any returns and capital growth are free from income tax and capital gains tax. A limit is imposed on the amount that can be saved in an ISA each tax year, and for the 2018/19 tax year this stands at £20,000, which can be split between cash, stocks & shares, an Innovative Finance ISA, and a Lifetime ISA.

The main reason most savers should still be taking advantage of their ISA allowance is that the tax benefits in an ISA are cumulative, meaning savers can ensure that ever larger sums are sheltered from tax year-on-year. While the low interest rate environment means the Personal Savings Allowance is currently adequate for most to avoid paying tax on their savings without using an ISA, when savings rates start to rise, tax may become an issue. For instance, if rates were to reach 5%, non-ISA balances of £20,000 and over would become taxable for basic rate taxpayers (£10,000 and over for high rate taxpayers). Once money is in an ISA, it is protected from tax, regardless of rates.

It is also worth considering the amount of tinkering that can occur with the tax system; if changes were to be made to the way savings are taxed in the future, it seems far more likely that the Personal Savings Allowance would be lowered or scrapped than changes made to the more established ISA regime. It would also be extremely difficult for the Government to suddenly strip the tax advantages from money already held in ISAs. So a place should, in most circumstances, remain for the ISA in people's savings arrangements.

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NS&I

Further savings options to keep the taxman at arm's length are available from National Savings & Investments. As well as offering an ISA and Junior ISA, the state-backed provider also has Premium Bonds on its roster of products. However, rather than pay interest, each bond number is entered into a monthly prize draw. Two £1 million top prizes are on offer, together with smaller rewards ranging from £100,000 to £25, all of which are paid tax-free. Although Premium Bonds can be cashed in at any time penalty-free, it should be remembered that the prizewinning element means there is no guarantee of a positive return.

While not currently on sale, there will be people already holding NS&I Savings Certificates, which could soon mature. The certificates come in two guises – fixed interest and index-linked – with the former paying a fixed rate of interest throughout the term, and the latter a fixed rate of interest above Retail Prices Index inflation.

The promise to pay an inflation-beating rate tax-free meant the index-linked certificates, in particular, proved hugely popular when they were on sale. However, under rules designed to prevent NS&I dominating the savings market, the provider is only permitted to take in a certain amount of money each year. As a result, the last issue of certificates was withdrawn in September 2011, with no indication as to whether or when a new issue can be expected.

For those who already hold a certificate that is about to mature, however, there is the option to roll over into a new certificate. Even though inflation is currently low, at the minute the certificates are the only way to guarantee that savings will stay ahead of inflation tax-free.

Further alternatives

A less well known tax-free alternative available from Friendly Societies is the Tax Exempt Savings Plan (TESP). TESPs are stock market based investments that must be held for a period of at least 10 years. Up to £25 a month can be put into a plan to eventually provide a tax-free lump sum, though it should be remembered that stock market exposure means there is no guarantee that money will not be lost.

Looking longer-term, contributing to a pension is one of the most tax-efficient ways to save. Tax relief is paid on contributions at the highest rate of income tax that you pay, which means that for every £80 a basic rate taxpayer pays in, a further £20 is added to the pension fund by the Government. Pension funds also generally grow free of income tax and capital gains tax.

See latest Cash ISA rates

Easy Access	Notice Variable
◄1 Year Fixed	1 Year Fixed
2 Year Fixed	3 Year Fixed
4 Year Fixed	5 Year Fixed