PENSIONS vs ISAs
Which is best?

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Introduction

With the start of the new tax year, investors need to consider how funding ISAs and Pensions fit into their longer-term financial objectives. It can be complicated, there are many pros and cons of both investment types, so we have provided a simple guide to the significant differences and how they may affect you.

Tax.

One of the main benefits of a pension is that you get income tax relief on any money you contribute. For example, if you are a basic rate taxpayer and you want to add £1,000 into your pension, you would pay £800 and HMRC would add £200.

There is no tax relief available when saving money into an ISA. So, although your ISA isn't taxed, if you wanted to save £1,000 into your ISA you would have to pay £1,000.

For both investment products, the growth on investments are free of Capital Gains Tax (CGT) however, only the ISA will be free of Income Tax. Only 25% of any pension pot can be withdrawn tax free. This is called Pension Commencement Lump Sum (PCLS). After which all further payments are taxed as income.

Investment Limits.

Pensions have different limits regarding how much you can invest and still receive tax relief. Each year you can contribute up to the "annual allowance" (which is currently £40,000). If you have no UK earnings you can still contribute up to £3,600 each year. There is also a "lifetime allowance", which caps the maximum value of your pension over your working life.

With ISAs there is an annual contribution limit, which for the 2018/19 tax year is £20,000.

Accessibility.

With a pension, you normally must wait until age 55 to access it. You can then take up the PCLS and the remainder is normally used to provide income. The options available include purchasing an annuity, which provides a guaranteed income for the remainder of life, or flexible drawdown, which gives more choice.

You can draw on your ISA at any age. All withdrawals are completely tax-free, and you can choose to make a big one-off withdrawal or a series of smaller withdrawals.

What happens when I die?

Pensions normally fall outside of your estate and therefore are free of Inheritance Tax (IHT). If you die before drawing pension benefits your pension may pay out a lump sum. For a company pension this could be based on a multiple of your salary. For personal pensions this could simply be the fund value on the day you die.

Pensions can now be regarded as truly intergenerational investments because you can pass down the pension to spouses and successors by nominating them to receive the funds on death. This places pensions as an excellent tool for tax planning across the generations.

ISAs are relatively simple: if you die, the ISA value is part of your estate. You can pass it to a spouse or civil partner as an additional ISA payment, on top of the normal limits. While this does help to maintain the relief from income and CGT, it does not resolve the fact that those funds are generally part of an estate and may be subject to IHT.

Which is best?

In practice, a combination of ISAs and pensions will be suitable for most people. It is important to understand the ins-and-outs of any investment you choose so you know what to expect when you retire.

Any Questions? - If you have questions or are not sure how the options will impact you, speak to the team here at Raymond James, Hitchin, to work out the right combination for your lifestyle and income.

RISK WARNING
With investing your capital is at risk

Tel: 01462 422507
www.rjwealthmanager.co.uk
2nd Floor, 99 Bancroft, Hitchin, Hertfordshire SG5 1NQ