

Smart investments

Should I invest into a pension or an ISA?

Investors looking for tax-efficient ways to build a nest egg for retirement often look to both Individual Savings Accounts (ISAs) and pensions. Tax-efficiency is a key consideration when investing because it can make a considerable difference to your wealth and quality of life.

However, the type of investment and tax-efficiency is a common dilemma faced by many people. Which is better – an ISA or a pension? In truth, there's a place for both, and it's easy to argue the case for each of them.

ISAs allow you to invest in the current 2019/20 tax year up to £20,000 each year, providing tax-efficient growth and income. Withdrawals are tax-free because the money paid in was from after-tax income.

Pensions are also very tax-efficient. All contributions within allowance limits receive tax relief from the Government payable at up to your highest rate of tax. For example, it would only cost a basic-rate taxpayer £80 to contribute £100 into their pension because they would receive tax relief at 20%. This is added to the £80, representing the 20% tax they would have paid if they had earned that £100.

For higher earners, it is even better, with higher-rate taxpayers able to claim back up to a further £20 and additional-rate taxpayers being able to claim back up to a further £25 via self-assessment.

Tax relief is given on personal contributions up to 100% of your earnings (or £3,600 if greater). If total contributions from all sources, including your employer if applicable, exceed the annual allowance (£40,000 for most people but can be less for higher earners or those who have flexibly accessed a pension), you will suffer a tax charge on the excess funding if it can't be covered by unused allowances from the previous three years.

So, pensions give you tax relief on money going in, but when it comes to drawing on your pension, tax will be payable at your marginal rate apart from the tax-free lump sum (normally 25% of your benefits).

ISA investments don't allow for tax relief on the money being invested, but they do give you total tax exemption on any gains made within the ISA. So with an ISA, when you come to withdraw funds, you will not pay a penny of Income Tax or Capital Gains Tax.

Put simply, the right option will be different for different people. There will be some for whom the right answer is a pension, others for whom the

right answer is an ISA. If it was clearly one or the other, it would be far simpler.

An important point to remember is that you cannot normally access your pension until age 55, whereas your ISA is accessible any time. ■

INCREASE YOUR WEALTH BY MAKING YOUR MONEY WORK HARDER

If your goal is to live an idyllic retirement lifestyle, we can help you build wealth with a clearly focused strategy. To find out more, please contact us – we look forward to hearing from you.

Information is based on our current understanding of taxation legislation and regulations. Any levels and bases of, and reliefs from, taxation are subject to change. Tax treatment is based on individual circumstances and may be subject to change in the future. Although endeavours have been made to provide accurate and timely information, we cannot guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No individual or company should act upon such information without receiving appropriate professional advice after a thorough review of their particular situation. We cannot accept responsibility for any loss as a result of acts or omissions.

TAX COMPARISON

	Pension	ISA
Funds in	Income tax relief on contributions at up to the highest marginal rate	No tax relief on contributions
Investment returns	No tax paid on income and gains	No tax paid on income and gains
Funds out	25% of fund paid as tax-free cash. Remaining fund subject to Income Tax at highest marginal rate	Not subject to Income Tax or Capital Gains Tax
Death Benefits pre-75	Paid as a lump sum or drawdown to nominated beneficiary free of all tax	Forms part of estate and subject to IHT if estate exceeds nil-rate band and not left to exempt beneficiary.
	Does not normally form part of estate	Spouse/civil partner can inherit additional ISA allowance based on value of deceased's ISA funds
Death benefits post-75	Taxed at beneficiary's marginal rate	Forms part of estate and subject to IHT if estate exceeds nil-rate band and not left to exempt beneficiary
	Does not normally form part of estate	Spouse/civil partner can inherit additional ISA allowance based on value of deceased's ISA funds