Investing for income and gains:

How investment trusts can make the most of ISA's and pensions

How would YOU like to turn £80 into £100 before costs, simply by moving your money from one 'pocket' to another? Or, if income is your priority, How would YOU like to boost returns by a fifth or more simply by moving your money from one financial wrapper to another?

- You don't need to be a magician to achieve these feats, you just need to use tax shelters the government provides to encourage everyone to save and invest. Tax shelters, such as individual savings accounts (ISAs) and pensions are not just for rich people but can help anyone; including people whose earnings are so low that they pay no tax, such as stay-at-home parents and even children.

- Investment trusts can help you make the most of these opportunities to pay less tax and keep more of what you earn. They offer individual investors of all sizes a professionally-managed route into stock market assets which – over the last century or so – have tended to deliver higher returns than bank or building society deposits during most periods of five years or more[1]. Please note, that your capital is more secure in deposit accounts.
  1 Barclays Capital Equity Gilt Study 2013, Equity Performance table (page 101, figure 8)

- However, the past is not a guide to the future and share prices can fall without warning. Investment trusts, like unit trusts, are a form of 'pooled fund' which aim to diminish the risk inherent in stock markets by diversification. They spread investors' money over dozens of underlying assets, to minimise exposure to setbacks or failure at any one company or – in the case of international funds – any one country. It's important to note that diversification does not guarantee investment returns and doesn't eliminate the risk of loss.

- Investment trusts and unit trusts also offer a tried-and-tested way for individuals to share the cost of professional fund management. However, many investment trusts have a long track record of delivering high returns with low costs. Independent research found that over the last one, five and 10 year periods, the average investment trust delivered higher returns than the average unit trust over most investment sectors – partly because many unit trusts charge annual fees around 1.5% while many investment trusts charge a third of that[2]. In other words, more of your money works for you and less sticks to the middleman's shovel.
  [2] Canaccord Genuity Wealth Management Research, Price total returns to 30 September 2013, commissioned by the Association of Investment Companies and published in December 2013.

- The sooner you start to invest the more you stand to gain because the earliest pounds invested may have longest to grow for your benefit. Whatever your investment objective is, beware of unnecessary delay. Think of it like passing an exam; those who start early and revise regularly have a better chance of achieving good results than those who leave it too late. Although please remember that the value of your investments and the income from them may go down as well as up.

- Here and now, contributions paid into pensions attract initial – or upfront – basic rate tax relief at 20%. So, if you pay in £80, the taxman will top this up to £100 in the pension before costs. That's equivalent to a guaranteed day one gain of 25% before costs. Everyone, including non-taxpayers, is entitled to invest up to £2,880 a year into pensions and have it topped up by the taxman to £3,600 in the fund before costs.

- High earners can obtain even more tax relief. So, for example, if you pay 40% tax, you can boost the value of your fund by £100 for a net cost of only £60, after you have reclaimed the extra relief by completing a self-assessment tax return. People who pay 45% tax, need only give up £55 to achieve the same uplift to their pension fund.

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- Tax shelters, such as individual savings accounts (ISAs) and pensions are not just for rich people but can help anyone; including people whose earnings are so low that they pay no tax, such as stay-at-home parents and even children.

- However, beware that the annual allowance on SIPP changes for 2016/17 – https://www.youinvest.co.uk/pensions/sipp-changes

  Annual allowance tapering – 2016/17 onwards

- The annual allowance for your SIPP is set by the Government and is usually £40,000 for most people. From 6 April 2016, this annual allowance is tapered for high-income individuals . For every £2 of "adjusted income" above £150,000, the annual allowance is reduced by £1. The maximum reduction is £30,000, meaning that someone with adjusted income of over £210,000 has an annual allowance of £10,000. Adjusted income is all income plus any employer pension contributions paid in the relevant tax year.

- A net income threshold of £110,000 also applies. If someone has net income (earnings less all pension contributions) of less than £110,000 they will not normally be subject to the tapered annual allowance, although any new salary sacrifice arrangements set up on or after 9 July 2015 will be included in the net income threshold. So exchanging salary or bonus payments for employer contributions here would not be effective.

- The lifetime cap or maximum pension fund allowed before tax charges will be £1m for 2016/17 although people who affected should seek financial advice about how to protect their fund

- The main disadvantage of pensions for most people is that, once you have paid money in, you cannot take it out until you are 55 years of age. Even then, no more than 25% of the fund can be taken as tax-free cash. The rest can only be drawn as income that is subject to tax at each individual's marginal or top rate of income tax.

- No such restrictions apply to ISAs, which makes them suitable for a wider range of objectives than retirement – although it should not be forgotten that ISAs can also provide a way of beating the lifetime cap and annual limits on pensions by diversifying your investments over different tax shelters. You do not need to choose between ISAs and pensions; many people have both.

- Every adult can invest up to £15,240 in a stock market-based ISA during the 2016/17 tax year which ends on April 5, 2017. Alternatively, every adult can put up to £15,240 into a cash ISA, which is similar to a tax-free bank or building society account. Or they can hold one of each type of ISA this year, subject to the £15,240 annual allowance. Junior ISAs or JISAs enable up to £4,080 to be sheltered from tax this year for the benefit of anyone aged less than 18.

- There is no initial tax relief, nor any minimum age or holding period before you can encash an ISA. However, JISAs cannot be encashed until the child reaches 18 years of age. Any return achieved by investments held in an ISA or JISA is entirely free from Capital Gains Tax and there is no need to declare ISAs or JISAs in your tax return or pay any further income tax on cash withdrawn from them.

- Savers and investors are allowed to keep £100 of every £100 income generated by ISAs, instead of just £80 after basic rate tax on income from other taxable sources. Tax-free gains and tax-efficient income from ISAs are even more valuable to high earners, who might otherwise suffer 40% or 45% tax on both.

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- The important point about all these annual allowances is that they expire at the end of the tax year; that's midnight on April 5. You cannot go back to make use of ISA allowances that were not taken up in earlier years and there are restrictions on utilising earlier years' pension allowances.

- So, if you want the taxman to help you save for retirement and to place more of your wealth beyond the grasp of HMRC, it makes sense to use each year's ISA and pension allowances as they arise. It really is a case of use them or lose them.

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