

ISAs vs pensions

Outline	Tax-efficient investments are an essential financial planning tool. The two main tax-efficient wrappers in the UK are pensions and ISAs, which both provide a valuable shelter against income tax and	capital gains tax, allowing your investments to grow tax-free. This factsheet explores the benefits of ISAs and pensions and compares the two different tax wrappers.
What is an ISA?	An ISA is a tax-free savings account. There are four main types of products available on the market: cash ISAs, stocks and shares ISAs, innovative finance ISAs, and lifetime ISAs. Any UK resident can open an ISA, and all income and gains are	tax-free, meaning that your money will grow tax-free for as long as it is in the account. This favourable tax process is combined with easy access to your money whenever you need it, although this is not the case for lifetime or fixed-term ISAs.
Use or lose your annual ISA allowance	Every UK adult can pay up to £20,000 into an ISA each tax year. This allowance is the maximum amount that can be invested per year. Under-16s are able to contribute £9,000 a year into ISAs, while those who are 16 or 17 can additionally contribute up to £20,000 into an adult cash ISA equivalent. It's possible to split your allowance	across different ISA types. For example, you could put some of your allowance in a stocks and shares ISA, and the rest in a cash ISA. A couple can invest up to £40,000 each year, allowing significant savings to be moved into a tax wrapper over time. The allowance is only available for a given tax year, so it is lost forever if it's not used by 5 April.
What is a private pension?	Defined contribution (DC) workplace schemes and self-invested personal pensions, or SIPPs, are the most common form of private pensions. Pensions grow through regular contributions by you and your employer, as well as through the investments that you choose. Most of these plans have a wide range of investment choices that can be	tailored to match your risk profile and long-term goals. Switching DC pensions is simple, which makes it easy to consolidate several old schemes into one new plan, which can often lead to lower costs and charges and improved administration. You gain flexible access to your DC pension from the age off 55 (this will rise to 57 in 2028).
What are the tax benefits of pensions?	<p>DC pensions have four important tax benefits:</p> <p>Tax relief: Personal pension contributions are deductible against income tax for employees, subject to limits and restrictions. Basic rate taxpayers save 20% tax, while higher and additional rate taxpayers can save 40% and 45% respectively on their pension contributions.</p> <p>Higher earners losing the tax-free amount (personal allowance) pay 60% tax on part of their income. By making a pension contribution you can regain some, or all, of your personal allowance. Your employer makes contributions on top, and these are tax deductible for your employer.</p> <p>Tax-free growth: Investments in your pension are not subject to income tax or capital gains tax.</p>	<p>Tax-free cash: When drawing from your pension, 25% of the total can be taken tax-free. This can be done as a lump sum, or taken flexibly at any time during retirement. The balance of your pension is subject to income tax (but not National Insurance).</p> <p>Careful planning can keep the tax bill to a minimum. For example, you can use the tax-free personal allowance of £12,570 each year, and keep pension income within the basic rate tax band.</p> <p>No inheritance tax (IHT) – for now: Pensions currently feature outside of the estate for IHT purposes. However from April 2027 unused pension assets will form part of the estate, unless left to a spouse or civil partner. Details around the proposed rule change are yet to be finalised.</p>
Comparing tax wrappers	Like general investment accounts (GIAs), cash and investment ISAs offer flexibility and easy ac-	cess, but they compare more favourably due to their tax-sheltered status. You should therefore

maximise your ISA contributions every tax year, before any contributions to a GIA.

The comparison between ISAs and pensions is more complex. Pensions are locked away until age 55 (57 from 2028), and tax rules can reduce returns/contribution potential. Pension assets are currently outside of the estate for IHT purposes, but this will change from April 2027. ISAs may be subject to IHT, unless left to a spouse/civil partner. It is possible for spouses or civil partners to inherit their partner's ISA allowance if their partner passes away. This 'additional permitted subscription' is equal to the value of the ISA at death, or

when the account is closed by the executors of the deceased's estate. This additional permitted subscription comes on top of the standard £20,000 annual ISA allowance.

It is possible for spouses or civil partners to inherit their partner's ISA allowance if their partner passes away. This 'additional permitted subscription' is equal to the value of the ISA at death, or when the account is closed by the executors of the deceased's estate. This additional permitted subscription comes on top of the standard £20,000 annual ISA allowance.

	Investment account	Investment ISA	Pension
Access	Any time	Any time	From age 55/57
Income tax saving on contribution	None	None	Yes, up to 60% tax relief
Max. contribution/investment per tax year	No maximum	£20,000	Up to £200,000 ¹
Outside IHT estate	No	No	Yes, until April 2027
Pot size limit	None	None	None ²

1 Annual allowance of up to £60,000, plus carry forward of up to £140,000 (unused allowance from previous 3 tax years)
 2 The 25% or 55% tax liability on amounts above the lifetime allowance (LTA) of £1,073,100 has been abolished. The tax-free cash lump sum entitlement will remain at £268,275 (25% of the original LTA), unless you benefit from fixed protection

Don't forget to claim pension tax relief

It is thought that many people miss out on thousands of pounds of pension tax relief. This is because most higher and additional rate taxpayers need to claim tax relief from HMRC via their annual tax return, unless their employer processes pension contributions before tax has

been taken. You can also write to your local tax office if you don't complete a self-assessment form. If you have forgotten to claim tax relief you can make a claim for up to the four previous tax years.

Pension planning: What to look out for

The maximum you can contribute each year that benefits from tax relief is £60,000 (or up to 100% of your relevant earnings). If you exceed this annual allowance you will face a tax charge on the

excess, which is levied at your marginal rate of income tax. The annual allowance is tapered (reduced) for those earning over £260,000.

	Tax breaks	Potential pitfalls
Pension contributions	<ul style="list-style-type: none"> Tax relief on your pension contributions 	<ul style="list-style-type: none"> Tapering of allowance to £10,000 (due to high earnings or taking pension income)
Inheritance tax considerations	<ul style="list-style-type: none"> Pensions can currently be passed on to family members free from inheritance tax 	<ul style="list-style-type: none"> From 6 April 2027 unused pension assets will be liable for inheritance tax
Other tax aspects	<ul style="list-style-type: none"> Tax-free investment growth Tax-free cash lump sum (25%) available 	<ul style="list-style-type: none"> 75% of pension withdrawals are subject to income tax

You may be able to pay more into your pension in a tax year by ‘carrying forward’ any unused annual allowance from the prior three tax years. The annual allowance can be as little as £10,000 if you have taken pension income in the past (money purchase annual allowance), or if your adjusted income is over £360,000.

The lifetime allowance (LTA) of £1,073,100, the maximum that can be saved into pensions without incurring extra tax, has been abolished. The 25% or 55% tax charge on amounts exceeding the threshold was removed from 6 April 2023. This is great news for savers with large pots, who can continue/resume pension payments and benefit from tax relief on their contributions.

Checklist

- How do ISAs compare with pension investments in your situation?
- Have you maximised your individual/family allowances?
- Have you chosen the right ISA type and asset mix for investment ISAs?
- Are you maximising your pension contributions? How much tax could you save by topping up your pension?
- Are you on track for a comfortable retirement income? When can you afford to retire/can you retire earlier than planned?
- What options are best for your pension(s) after retirement?
- Are you minimising your tax burden? With pensions set to fall into the estate from April 2027, what are your options, and what mitigating actions could you consider?

Lumin financial planning

Financial planning sets you up for the next stages of your life. There are important decisions to get right, and it is always good to plan early. Speak to a Lumin expert for professional and independent

advice around pensions, ISAs and investments, estate and tax planning, and financial protection for yourself and your loved ones.

In expert hands with Lumin

Lumin is a leading independent financial adviser headquartered in St Albans, with particular reach across London and the South East. We offer trusted and professional advice on pensions and retirement, investments, inheritance and tax planning, financial protection for individuals and businesses, and mortgages. Lumin’s financial plans are geared toward growing, or protecting, wealth by optimising our

clients’ income, assets, tax burden and financial security. Whatever your financial ambitions, you can count on our expertise to provide peace of mind. We are backed by VZ Group, the leading independent financial services provider in Switzerland.

 **Financial advice made easy: Scan the QR code to arrange a complimentary meeting over a coffee.**

London | St Albans
info@luminwealth.co.uk
www.luminwealth.co.uk
03300 564 446

5 Sandridge Park
Porters Wood
St Albans
AL3 6PH

Cornwell House
21 Clerkenwell Green
London
EC1R 0DX

Heath House
51 Dane Street
Bishop’s Stortford
CM23 3BT

4 Pauls Hill
Penn
High Wycombe
HP10 8NZ

This document is for general information only. It does not constitute advice or (by itself), a basis for any financial decision. You should only make such decisions based on your individual circumstances and, we recommend, with advice from a suitably qualified and regulated financial adviser. Whilst we endeavour to be accurate, Lumin Wealth does not accept responsibility for any inaccuracies in this document or for any loss that may result from reliance on it, but this disclaimer does not affect our responsibilities or your rights under the Financial Services and Markets Act 2000. Any financial projections in this document are provided for illustrative purposes only and should not be regarded as predictions. Past performance is not a guide to future returns. The value of investments may fall as well as rise and you may get back less than you invested. Tax treatment depends on your individual circumstances and rules may change. Lumin Wealth Limited is authorised and regulated by the Financial Conduct Authority, or FCA, (under registration number 775068). It is a limited company registered in England and Wales under company number 03381115. Copyright: No part of this publication may be reproduced or transmitted in any form without the prior permission of Lumin Wealth. The FCA does not regulate tax and estate planning.