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Your handy guide to understanding tax

ISAs £1.3 billion tax wasted

An Individual Savings Account (ISA) is one of the most tax-efficient forms of saving, and comes in two types: cash or stocks and shares. The 2014 Budget introduced the New ISA or NISA, which is simply a more flexible way of using the different types of ISA. The annual investment limit for a NISA is currently £15,000, and may consist of any combination of cash or stocks and shares (held respectively in a cash ISA or a stocks and shares ISA). You can open only one ISA of each type per year, but you can also transfer cash or investments between ISAs without using up your annual limit.

Cash ISA

This is a cash savings account that pays interest free of income tax.

Stocks and shares ISA

No tax is paid on any income or capital gains made on stocks and shares held in an ISA.

Junior cash ISA

Junior Individual Savings Accounts (JISAs) are long term, tax-free savings accounts for individuals under 18 who live in the UK.

In the 2014-2015 tax year the savings limit is £4,000. However you can't open a Junior ISA if you already have a Child Trust Fund (CTF).

The money in the account belongs to the child, but they can't withdraw it until they turn 18, (apart from in exceptional circumstances). They can, however, start managing their account on their own from age 16.

Pensions £2.9 billion tax wasted

No tax is paid on any income or capital gains you've made on your investments. Additionally, tax relief is normally available when you contribute to a pension, which reduces the outlay required. For example, a basic rate taxpayer with sufficient earnings who wants to have £10,000 in a pension needs only to pay in £8,000.

The higher the level of tax you pay, the lower the ultimate cost of the pension – for example a higher rate taxpayer needs to contribute only £6,000 to buy a £10,000 pension, taking into account higher rate relief through self-assessment.

Workplace pensions

A workplace pension is one arranged by your employer. It's one of the best ways of saving for your retirement.

A percentage of your pay is put into the pension scheme automatically every payday. In most cases, your employer also adds money into the pension scheme for you, and you get tax relief from the government.

You can usually take some (normally 25% of your total pension) of your workplace pension as a tax-free lump sum when you retire.

Usually you can't access the money until you're 55 at the earliest, unless you're seriously ill.

Auto enrolment

Larger UK employers now have to automatically enrol their staff into a workplace pension if they are aged between 22 and state pensioner age, earn more than £10,000 a year and work in the UK. Smaller employers will soon have to do this too.

Personal pensions

Personal and stakeholder pensions are private pensions that you arrange yourself. You pay money into a pension fund which you use to provide a regular income, a series of lump sums or a single lump sum when you retire.

In most cases you can't access your pension before age 55. The exact age depends on your arrangements with the pension provider or pension trust.

Tax planning with pensions

As the government introduces new measures to reduce the benefits high earners receive from the state, the tax system has become more complex and given rise to a number of 'tax traps'. These can apply where total income for tax purposes exceeds:

- £100,000 or
- £50,000 and a member of the household receives child benefit.

N.B. Total income for tax purposes is known as Adjusted Net Income, and includes items such as the income from cashed bonds.

In these cases, a financial adviser may be able to use a pension contribution to control your tax position. As tax rules can be complex and subject to change, it's important to seek professional advice before taking any action.

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Approaching or over age 55?

Remember that pensions can normally be accessed once you reach 55. Check to see if you have savings in other products that could be working harder in your pension. It's important that you regularly review your savings goals and the products being used, as changes in tax law or products may mean you need a substitution.

Use it or lose it

There is a limit to how much you can contribute to a personal pension and still receive tax relief in each year. This limit (which applies to all types of pensions) is £40,000 per year. If you have not used this allowance in each of the past three years, then this can be used as well. However, after three years any unused allowance is lost.

But if you have used this year's allowance and the previous three years too, then it's still possible to get ahead…

Get ahead!

If you're in a position to do so, you may also be able to use next year's annual allowance, if your pension provider allows this.

Capital Gains Tax (CGT) £158 million wasted

CGT is a tax you must pay when you sell (or dispose of) an asset that has increased in value. This could be anything from a painting to a property (but not your main home, which is exempt).

You pay CGT on 'chargeable assets', e.g. most personal possessions worth £6,000 or more, property that isn't your main home, shares that aren't NISA, ISA or PEP or business assets, to give just a few examples.

Remember that it is the gain you make that's taxed, not the amount of money you receive.

An individual's CGT tax bill can be reduced by using the HMRC's tax free allowance and additional reliefs, namely by using a stocks and shares ISA.

Inheritance Tax (IHT) £550 million wasted

If you are single, IHT is paid if a person's estate (property, money and possessions) is worth more than £325,000 when they die. This is known as the Inheritance Tax threshold.

For people who are married, in a civil partnership or widowed, the threshold for IHT is currently £650,000 between them.

Married couples are able to reduce their tax bill through estate planning, but due to the complexities of the process, it is difficult to achieve the best IHT scheme without the help of a professional adviser.

The rate of IHT is 40% on anything above the threshold. The rate may be reduced to 36% if more than 10% of the estate is left to charity.

Usually the executor of the will or the administrator of the estate pays IHT using funds from the estate.

Estate planning is a highly complex area, especially where it involves the death of a spouse or civil partner. This makes it very hard to achieve the best outcome without the help of a professional adviser.

You can reduce the impact of IHT by careful planning. For instance, making lifetime gifts (e.g. to your intended beneficiaries) can lower the value of your estate upon your death.

You can make gifts totalling £3000 each year free of IHT*. If you don't use your full exemption, you can carry the remainder forward for one year only. A lump sum gift larger than this is known as a Potentially Exempt Transfer (PET). This will only become exempt from IHT if you survive for at least seven years after making it. You could also consider using a trust – your adviser can help you with this.

Gifts to spouses, civil partners or charities are all exempt. Remember, the IHT rules are very complex and may be dependent on your circumstances, so you should always seek professional advice before taking any action.

* *Several other kinds of gifts are exempt anyway – talk to your adviser to find out if you can also use these to help reduce IHT.*