LITRG response to FCA draft guidance on the Lifetime ISA

Employment Tax Personal tax

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The Financial Conduct Authority (FCA) have consulted on handbook changes relating to the Lifetime ISA. LITRG's response points out that tax complexities need to be considered by advisers.

LITRG welcomed the opportunity to respond to some of the questions asked in the Financial Conduct Authority's consultation document CP16/32 on Handbook changes to reflect the introduction of a Lifetime ISA. Naturally, the response was restricted to those questions relevant to LITRG's remit of tax and how tax relates to the welfare benefits system, especially affecting those on low incomes.

LITRG's response centred around the tax differences between saving in ISAs and saving in pensions, presenting the average saver with an almost impossible decision. (These complexities were previously illustrated in our article 'The Savings Conundrum' published in Tax Adviser July 2016.) Complex calculations will be needed involving the relative advantages of the two routes as well as the inevitable uncertainty of an investment designed for both the long and the short term. The former tax-exempt input into pensions and taxed outcome has, since pensions freedom, become less clear-cut with the new possibilities of drawing serial tax-free lump sums or widely variable income drawdowns, giving the pensioner more control over their tax rates. It therefore becomes far from straightforward to compare the tax-free outcomes of an ISA with those of conventional pension schemes.

Furthermore, the taxed input into the proposed Lifetime ISA can vary to the disadvantage of the saver whose salary increases so that he becomes a higher rate taxpayer. While for a basic rate taxpayer the tax relief on pension contributions was, at 20%, equal to the Government bonus of £1,000 for each year's £4,000 in a Lifetime ISA, at 40% he is missing out on the extra 20% relief he would get on his pension contributions.

LITRG’s response also highlighted the differences in taxation of pensions compared to ISAs on death. While ISAs fall into the estate on the death of the saver and be subject to Inheritance Tax (IHT), either immediately or perhaps later, having passed intact to a surviving spouse or civil partner; pensions written in trust will fall outside IHT and can be passed on to nominated successors either tax-free before age 75 or at the legatee’s marginal rate thereafter.

There is a major area of risk for the Lifetime ISA saver if he finds himself having to claim benefits. Most benefits, including universal credit, are means-tested against income and/or savings. Uncrystallised pensions are usually ignored for such calculations, whereas the Lifetime ISA saver may well find himself excluded from a claim by virtue of his Lifetime ISA savings.

The value of employees’ contributions plus tax relief plus employers’ contributions into an auto-enrolment pension will generally exceed the value of solely employees’ contributions into a Lifetime ISA. An exception to this would be if an employee is not earning enough to pay income tax, but can opt in to an employer’s scheme with an employer contribution, and that scheme operates on a net pay arrangement – in which case, the employee will (quite unfairly, but that is another matter) miss out on tax relief.

Using part or all of a Lifetime ISA for first-time house purchase means that the saver inevitably starts saving into a pure pension much later in life and therefore misses out on the enormous effect of compound interest and tax-free investment growth over a long period.

While advising on saving into a pension or a Lifetime ISA is clearly a regulated area, it is likely that many people might also need the services of a suitably qualified tax adviser to help steer them through many of the above issues.

LITRG’s full response to the draft legislation can be found on the LITRG website.