Lifetime ISA vs Pension

If you are finding that you have excess cash within your monthly budget, there is value in saving this money for your longer term future. In this article I have considered two tax efficient "wrappers" that, depending on your circumstances, could significantly enhance any savings you able to make by virtue of tax relief. Before deciding on the tax "wrapper" it would be worth considering a few other steps first.

You should initially consider:

- Paying down debts, especially expensive debt like credit cards.
- Ensure that you have a suitable emergency fund and cash reserve (please see other blogs in this area).
- What level of access you will need to the money you are saving? Can it be left untouched for 5 years or maybe longer?
- Are you comfortable with risking any of the money you are saving?

After you have considered the above, you can then start to formulate your long term plan and essential element of which will be which tax "wrapper" to use?

If you have a medium to long term time frame an asset back investment in something like a stocks and shares ISA, a Lifetime ISA or Pension could certainly have an advantage. In this piece I have concentrated on just the LISA and Pension options. With a wide range of options available to you, the most suitable solution will be informed by your individual circumstances and not simply by the tax efficiency of the wrapper.

Here are some highlights of the two tax wrappers:

Lifetime ISA (LISA)

You are only able to open a LISA if you are aged between 18 and 40 and once you open a LISA, you can contribute each year until age 50. You are only able contribute £4,000 per tax year to a LISA. The government will add a 25% bonus on top of the money you have saved (£4,000 x 25% = £1,000). So, for every £4,000 you save you end up with £5,000 invested. Any growth or income within the LISA will be free from income tax and capital gains tax.

You can access your LISA at any point, however if you do this before the age of 60 or you do not use the investment to purchase your first property, you will be penalised and lose 25% of your investment (you are not penalised if the withdrawal is made because you are terminally ill, with less than 12 months to live). The £4,000 contribution counts towards your overall annual ISA allowance of £20,000.

Pension

Most UK residents can open and contribute to a pension. You will start with an annual

allowance of £40,000 per year (although this will be reduced if you are a high earner, see tapering within other Wingate articles) and you can potentially carry forward unused allowances from the previous three years, if you have qualifying earnings. Any growth or income related to your pension will grow free of income tax and capital gains tax. Importantly for most pensions, the money within the pension will sit in trust outside of your estate for inheritance tax purposes.

If you are employed, there is the added advantage that your employer may match your contributions into a pension, to a certain limit. This can have a marked impact on the benefit of each contribution.

You cannot access your pension until the age of 55, under current legislation. When you access your pension, you will be able to draw 25% as tax free cash however the remaining capital will normally be taxed at your highest marginal rate, even if you are retired.

Comparison Table

Below I have made a simple comparison for a £4,000 contribution into each “wrapper”.

I have ignored growth and assumed that a higher rate taxpayer whilst working, will be a basic rate taxpayer in retirement. This can be the case, but care should be taken not to take this summery and apply it to your own situation.

	LISA	Pension (basic rate taxpayer)