HOW TO MAXIMISE YOUR TAX-FREE INTEREST

TAX-FREE CASH

TAX Cafe®

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Introduction

Between 2009 and 2022 the UK enjoyed well over a decade of rock-bottom interest rates.

Rates were first cut aggressively in the aftermath of the 2008 global financial crisis and reached their lowest level in March 2020, during the coronavirus pandemic, when the Bank of England cut its base rate to just 0.1%.

A similar picture could be seen all around the world. Some commentators pointed out that interest rates hadn't been this low in 5,000 years.

Throughout this period mortgages were dirt cheap, providing a huge boon to homeowners and landlords. At one point it was possible to fix your mortgage at less than 1% for five years.

Savers were not so lucky. Most easy-access accounts paid minuscule amounts of interest, often no more than 0.1% per year. Many people simply left all their cash in a current account earning no interest at all – there was very little incentive to do anything else.

This has all changed. The era of ultra-low interest rates is now over and savers and borrowers have to change their behaviour to make the most of the new state of affairs.

That's what this brand new guide is all about. In the pages that follow you will discover how to earn more interest on your cash and how to make sure your interest is always ***tax free***.

Part 1 Interest Rate Basics

Chapter 1 looks at the importance of *real* (inflation-adjusted) interest rates. If you can earn a real return on your savings, your wealth will increase over time.

But to earn that precious real return you may have to shop around for the best deals AND your interest income will probably have to be tax free.

To enjoy the highest interest rates you may have to place your savings in some of the smaller, lesser-known banks. Fortunately the Financial Services Compensation Scheme (FSCS) shoulders all the risk – up to £85,000 per person per banking group.

Chapter 2 tells you everything you need to know about this compensation scheme: how company owners and other business owners are protected, how cash held in your SIPP or stocks and shares ISA is protected, how to avoid banks that share the same banking licence and the special protection for "temporary high balances" of up to £1 million.

Chapter 3 explains how the "annual equivalent rates" (AERs) you see advertised with various savings products are calculated and how to use them to maximise your interest income.

Part 2 How Interest Income Is Taxed

Chapter 4 covers the personal savings allowance and starting-rate band. These allow you to earn anything from £500 to £6,000 of tax-free interest when your savings are not sheltered in an ISA.

Chapter 5 shows how much income tax is payable by those who have used up their various tax-free allowances and what can be done to reduce the amount of tax payable on interest income.

Chapter 6 explains ***when*** your interest income will be taxed. With some savings accounts interest is only taxable when the product matures – possibly after five years. In one example we show how, by postponing tax, the taxpayer ends up £1,469 better off; in another example the taxpayer ends up £737 worse off.

If you are a company owner you may be able to enjoy an additional £5,000 of tax-free interest. However, your interest income may also increase the tax payable on your dividend income. Chapter 7 has several examples showing how much tax different company owners pay on their interest income.

Part 3 Making the Most of Tax-Free ISAs

We all know about ISAs but this part of the guide contains lots of unique information that will help you make the most of this wonderful tax shelter.

Chapter 8 looks at cash ISAs: how to find the highest interest rates, a recent change that has made cash ISAs much more attractive, the tremendous benefits of Flexible ISAs (not all banks offer them) and how to transfer your existing ISA savings to take advantage of the best deals.

Chapter 9 covers money market funds. These have attracted billions of pounds of investors' cash in recent times. Money market funds pay more interest than most banks (around 5.3% at present), all tax free if held in a stocks and shares ISA. However, they're also a bit more risky than conventional savings products.

In Chapter 10 we discuss whether it's better to use your £20,000 ISA allowance to earn tax-free interest in a cash ISA or tax-free capital gains and dividends in a stocks and share ISA.

Chapter 11 examines the pros and cons of Innovative Finance ISAs. These offer the opportunity to earn much more tax-free interest (maybe 10% or more) but the risks are far greater.

Part 4 More Tax Planning Ideas

If you have to pay income tax on some of your interest income you can reduce the damage by making bigger pension contributions. Chapter 12 contains a number of examples showing how you can completely wipe out all the income tax payable on your interest income.

Chapter 13 explains how you can use your children to save tax. If you have to pay income tax on some of your interest income, one thing you can do is give money to your adult children so that they can earn tax-free interest. In one example this produces an overall saving of £2,340 after a few years.

Part 5 Savings Platforms & Premium Bonds

Chapter 14 shows how, by using an online savings platform like Hargreaves Lansdown's Active Savings, you can effortlessly transfer your savings from bank to bank, thereby maximising your interest income.

Chapter 15 is all about premium bonds, which allow you to earn tax-free prizes of up to £1 million. An investment in premium bonds can be an attractive alternative to a taxed savings account if you're a higher-rate taxpayer or additional-rate taxpayer.

Part 6 Sole Traders & Company Owners

In Chapter 16 we turn our focus to savings accounts available to sole traders and company owners. Why keep all your business cash in a current account when you can earn a decent amount of interest by opening an easy-access savings account? We also explain how company owners can get some of the company's cash into their own hands, so that they can earn tax-free interest.

Chapter 17 covers directors who *borrow* money from their companies and directors who *lend* money to their companies. A couple who run a company together can borrow up to £20,000 tax free for up to 21 months. Bigger loans can be made extremely cheaply.

And if you lend money to your company any interest the company pays to you could be both tax deductible for the company and tax free in your hands: the best case scenario when it comes to extracting cash from your company. Some company owners may be able to save over £1,000 by getting their companies to pay them interest.

Part 7 Earn Tax-Free Interest by Paying Off Debt

Paying off your personal debt is a great way to earn tax-free interest. This is because paying less interest is just as good as earning it – and often better from a tax standpoint.

Chapter 18 looks at the benefits and drawbacks of paying down the mortgage on your home. Apart from earning tax-free interest, this may help you qualify for a better mortgage deal (by reducing the loan-to-value ratio on the property).

In Chapter 19 we compare paying down your mortgage with keeping money in a savings account. At present you may be able to enjoy a better tax-free return by keeping your money in a cash ISA… but paying off your mortgage may be more attractive than a taxed savings account.

Chapter 20 explains why paying off personal loans, credit cards and other short-term borrowings will often produce the highest returns of all. The average borrower will enjoy tax-free returns ranging from 9.05% to 22.45% per year.

In Chapters 21 and 22 we look at paying off buy-to-let mortgages and other business borrowings. As a general rule it's better to reduce your *personal* debt before you reduce your *business* debt – business debt enjoys tax relief and is therefore cheaper.

Landlords enjoy 20% tax relief on their interest payments and self-employed business owners who are higher-rate taxpayers enjoy 42% tax relief, sometimes as much as 62%.

However, sometimes these borrowers also face very high interest rates and loan arrangement fees. So these chapters show you how to quickly calculate the *after-tax* cost of your buy-to-let mortgages or other business borrowings.

Armed with this information you can decide whether it's worth using any spare cash you have to reduce these loans.

Company Owners with Business Premises

Many company owners own their business premises *personally* and the company pays them rent. There may also be a mortgage on the property and the interest payments will enjoy full tax relief, making this one of the best types of debt to have. Many company owners who are higher-rate taxpayers will be enjoying 45% tax relief on their interest payments.

Chapter 23 shows you how to quickly calculate the after-tax cost of such a mortgage, so you can decide whether it's worth paying off early.