ML FINANCIAL ASSOCIATES

A guide to ISAs

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ISAs – a simple explanation

An ISA is an Individual Savings Account. As the name suggests, these are accounts that can be accessed by individuals (you cannot have an ISA in joint names). ISAs were introduced in April 1999 as a replacement to Personal Equity Plans (PEPs) and Tax-Exempt Special Savings Accounts (TESSAs).

The political thinking was that ISAs could bring together these two different tax efficient products into one type of account and would help to encourage and widen their usage.

Over the following years, the type of ISA available has been changed as has the amount that can be invested into each type. Making them NISAs (New ISAs), became effective as of 1 July 2014 and existing ISAs became NISAs automatically from that date. However, the new name, NISA, has not really caught on; the description and title 'ISA' remains how, today, these accounts are commonly known.

The rules around ISAs are structured to make them easily accessible and simple to understand whilst still providing valuable tax benefits, especially over the longer term. They now offer greater flexibility than ever before and higher allowances.

Who can invest into an ISA?

To open an adult ISA you have to be aged 16 or over if the ISA is a Cash ISA or 18 or over if the ISA is a Stocks and Shares ISA. Between the ages of 16 and 18 you can invest the full allowance (£20,000) but only in a Cash ISA.

You have to be resident in the UK for tax purposes (ask your tax office if you are in any doubt about this), or a Crown employee, such as a diplomat or a member of the armed forces who is working overseas and paid by the Government. The spouse, or civil partner, of one of these people can also open an ISA.

For the rules around Junior ISAs, please see the separate section within this document.

The different types of ISAs available

There are now five different types of ISA: **Cash ISAs**, **Stocks and Shares ISAs**, **Innovative Finance ISAs**, **Help to Buy ISAs** and **Lifetime ISAs**.

With Cash ISAs, Stocks and Shares ISAs and Innovative Finance ISAs, you can put up to £20,000 (the current allowance) into these - you can invest as much as you like of your allowance in any of the three types (but only up to the total of £20,000). Help to Buy ISAs and Lifetime ISAs are governed by slightly different rules, covered below. The Help to Buy ISA was withdrawn from the marketplace in 2019 so it's no longer possible to open a new one. It's still possible to add new investments to existing Help to Buy ISAs, however.

Cash ISAs

Cash ISAs are like an ordinary savings account except they have no tax applied. Although quite a simple account, the range of savings accounts that can be held under a cash ISA is actually quite diverse.

For example, they can include bank and building society accounts; National Savings and Investments products that are specially designed for ISAs; Sharia compliant products; and life insurance policies that fail to meet the qualifying conditions for the Stocks and Shares ISAs.

Stocks and Shares ISAs

Stocks and Shares ISAs allow for investment into a wide range of higher risk assets, for example, shares, government bonds and corporate bonds. These investments do NOT have to be in the UK. The investment can be direct (for example, you can hold Marks and Spencer shares through a Stocks and Shares ISA) or through a fund.

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The different types of ISAs available

Here is a list of the investments that can be included within a Stocks and Shares ISA:

- shares and corporate bonds issued by companies officially listed on a recognised stock exchange anywhere in the world
- gilt edged securities ('gilts'), issued by the UK government, similar securities issued by governments of other countries in the European Economic Area and 'strips' of all these securities
- units or shares in funds authorised by the Financial Conduct Authority (unit trusts or Open Ended Investment Companies (OEICs))
- units or shares in non-UCITS (Undertakings of Collective Investment in Transferable Securities) retail schemes authorised by the FCA for sale to retail investors in the UK
- shares and securities in investment trusts
- units or shares in UCITS funds based elsewhere in the European Union (these are similar to unit trusts and OEICs authorised by the FCA)
- Any shares which have been transferred from an HMRC approved SAYE share option scheme or Share Incentive Plan
- life insurance policies
- stakeholder medium-term products

Newer investment options have also become available:

- Certain Core Capital Deferred Shares issued by a building society
- Certain securities, such as retail bonds, which have fewer than 5 years to run to maturity at the time they are first held in your account
- Certain investments that do not currently satisfy the current 'cash-like test' for Stocks and Shares ISAs - such as some company shares, units or shares in a collective scheme and some types of insurance policy

You will see this is a long list with many different possible underlying investment options. Most investors use some form of managed ISA, with funds under the ISA account arranged according to the wider investment strategy being employed by the investor.

However, the range of possible options allows for many different investment strategies to be pursued under the Stocks and Shares ISA and these are constantly being updated.

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The different types of ISAs available

Innovative Finance ISA

The Innovative Finance ISA was a new introduction for the 2016/2017 tax year. The ISA operates in the same way as a cash ISA, but funds invested are used within the peer-to-peer (P2P) lending market. In return, investors receive the normal benefits of an ISA through tax-free interest and capital gains. Some providers are predicting returns of 6-8% on the products, but investors should appreciate that the risks are typically higher.

This is because of the nature of P2P lending, which cuts out the 'middle man' and allows individuals to satisfy the finance requirements of other individuals or businesses. Through the Innovative Finance ISA, investors can use FCA-regulated and approved P2P websites to lend money through personal loans, small business loans and property loans.

As with the other main forms of ISA, the total amount you can invest across ISA types is £20,000.

Help to Buy ISA

The Help To Buy ISA allows you to save up to £200 each month to save for a deposit on your first home. The government then boosts your savings further to the tune of 25%, up to a total limit of £3,000, as long as you're a first time buyer purchasing a property priced up to £450,000 in London and up to £250,000 everywhere else in the UK.

There is no minimum deposit each month, and you're also able to pay in £1,000 when the account is opened that doesn't count towards your monthly savings. However, you need to save at least £1,600 in total to qualify for the government bonus.

It's no longer possible to open a new Help To Buy ISA, but existing accounts can continue to be topped up until November 2029. The accounts are limited to one per person, which means both people in a couple can have an account and benefit from the bonus.

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The different types of ISAs available

Lifetime ISA

The Lifetime ISA essentially replaces the Help to Buy ISA for new investors, as well as extending the appeal beyond those who want to purchase their first home.

This is because there are two possible uses for the money saved in a Lifetime ISA: as a deposit on a first home, or to save money for the purposes of withdrawing when you are over 60 years of age. Money can be withdrawn from Lifetime ISAs outside of these two circumstances, but in those cases, a 25% charge is normally applied.This has been reduced to 20% until April 2021, so essentially means only the bonus will be claimed back.

You can open a Lifetime ISA at any point between the ages of 18 and 40 and continue to contribute to the account until you are 50.

In a similar way to the Help to Buy ISA, the Lifetime ISA accumulates money for investors via government top ups. You can put in up to £4,000 each year and the government will add a 25% bonus to your savings, up to a maximum of £1,000 per year. The £4,000 limit contributes to your overall £20,000 annual limit. Assuming you were to start saving at 18 and carry on contributing the maximum until you were 50 years old, your Lifetime ISA would have grown to £160,000, excluding investment returns, with £32,000 of that coming from government top-ups.

How much can be invested?

£20,000 for the tax year 2020/21.

Subject to this overall limit and eligibility, you can invest whichever amounts you wish to split between the various ISA types. This is a new rule since changes made in 2014, different to the rule that applied before 1 July 2014 which limited the amount of money you could place into a Cash ISA.

You can have one provider running both Cash and Stocks and Shares under the one account. It is important to remember these are individual allowances - both a husband and a wife can invest these amounts each year. Assuming current contribution limits, an individual would be able to save over £200,000 tax free (£400,000 for a couple) within ten years. However, it is also important to remember that if you do not use your allowance in a particular year, that allowance is lost. You cannot backdate your contribution and you cannot bring forward any unused allowance.

Warning: ISA limits do not 'roll on': you cannot use an unused portion of last year's ISA allowance to top up this year's limit.

How long do I need to invest for?

As far as Cash, Stocks and Shares and Innovative Finance ISAs go, there is no time period involved or minimum period. With a Stocks and Shares ISA, where the money is invested, there should be a consideration that this will be held for some time.

But this is just for the purposes of risk management and not because of any rule. The rules impose no time limits or restrictions. The only aspect you need to think about is how these ISAs fit in with your general financial planning and other savings and investments.

Help to Buy and Lifetime ISAs are different in that they are products designed to help you to save for specific eventualities. As such, there are penalties for these ISAs if you then decide you want to use the funds saved for another purpose.

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Is my money tied up? Can I get it out?

As stated above, there is no restriction and your money is not tied up when it comes to Cash, Stocks and Shares and Innovative Finance ISAs, unless you choose to use some form of underlying investment or cash account within an ISA, which in its own right has a contractual arrangement to a certain period. Subject to this and in all other cases, you can withdraw your money, in full, without any tax consideration, at any time.

Help to Buy and Lifetime ISAs have their own rules and purposes for use, as noted in the previous sections. It was previously the case that if you subscribed to an ISA in a tax year and then withdrew money from that ISA in that year, you would lose the allowance equal to the withdrawal. You may also have been unable to make further deposits into your ISA depending on how much money you had already committed to it.

The Budget in March 2015 reformed these general rules somewhat: instead of being able to put up to £20,000 in the 2020/21 tax year into an ISA in total, people can take out their money and put it back in within the same year, without losing their ISA tax benefits - ***as long as the repayment is made in the same financial year*** as the withdrawal. Not all providers can facilitate this feature however (known as 'flexi-ISA).

The original limit for ISAs, when they were introduced in 1999, was a total contribution of £7,000, with only £3,000 able to be saved in cash.

What's the tax treatment?

There is no tax on any income you receive from an ISA. This includes dividends, interest and bonuses. On 1 July 2014, the rules changed so that interest on cash held in a Stocks & Shares ISA was completely tax-free, whereas previously, the interest was effectively paid net of basic rate tax.

There is no tax on capital gains arising on an ISA (losses on ISA investments cannot be offset for Capital Gains Tax purposes against capital gains outside your ISA).

The insurer does not have to pay tax on income and capital gains on investments used to back your ISA life insurance policies. You do not have to pay any tax when the policy pays out.
You can take your money out at any time without losing tax relief.

You do not have to declare income and capital gains from ISA savings and investments or even tell your tax office that you have an ISA.

How do I know which ISA to choose?

There are two questions you need to answer to decide which ISA to choose:

What **type** of ISA account should you use?

Which ISA **provider** should you use?

Setting aside the Help to Buy ISA which exists for one specific purpose, the first thing you need to decide is whether you want to invest in a Cash ISA or a Stocks and Shares ISA, a combination of the two or to branch out into the newer forms of ISA with the Innovative Finance ISA and Lifetime ISA. This will probably be determined by your wider financial planning needs and approach. We can help you and advise you with this decision.

Once you have decided which type you will be using, or the balance you will be putting across the four types, you will then need to decide which company or provider to invest with.

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How do I know which ISA to choose?

If you are seeking a Cash ISA account or an Innovative Finance ISA, you will want to compare the different interest rates and terms offered by the various companies. The objective will be to get the highest interest return. Cash ISAs will state their return while Innovative Finance ISAs will state a target return. These may vary from year to year; it is worth checking regularly to ensure that your ISA is paying a competitive rate.
If you are going to use a Stocks and Shares ISA, you need to determine what your investment approach will be and the level of risk you will want to take. This will help determine the underlying holdings that will be suitable.

If you have other investments then you will probably look to align your ISAs and the investments you choose with your overall investment strategy.

Once you have decided the nature of the underlying investments and whether to invest direct or via funds, you will want to find the best company (ISA provider). This decision will be made based on a combination of factors; for example, what are the charges? What range of funds do they offer? Can you access the ISA through the internet? What is the administration and service record?

These decisions are ones we can help with either as a stand-alone decision or as part of a wider financial planning view. We can advise you on suitable accounts and ISA providers and appropriate funds or investments to hold underneath the ISA.

Can I ‘switch’ an existing ISA?

Since July 2014, you have been able to transfer amounts you held in a Stocks and Shares ISA to a Cash ISA. This applies to amounts that you paid in since 6 April 2014, as well as amounts that you have paid in during previous tax years. Equally, you are also permitted to transfer any funds from a Cash ISA to a Stocks and Shares ISA if you wish. Different rules will apply depending upon when you paid the relevant amounts into your Stocks and Shares ISA.

If you wish to transfer savings relating to any current year's payments to your account, you must transfer these as a whole. However, any savings relating to payments to your account in earlier years can be transferred to a Cash ISA in whole or in part. Not all ISA providers will allow part transfers, so you should check this with the provider of your Stocks and Shares ISA when deciding whether to transfer.

You can now transfer between Cash and Stocks and Shares ISAs as many times as you wish.

These are the terms under the overall ISA rules, but it is worth looking at the rules of the **individual managers offering ISAs as they may have their own terms and conditions which may be more restrictive**.

There are also different rules for Lifetime ISAs, where transfers to another type of ISA will incur the withdrawal penalty and Help to Buy ISAs. In the case of the latter, transfers can be made into Lifetime ISAs, or cash can be withdrawn.

Transferring shares from an employee share scheme

You can transfer any shares you get from a SAYE share option scheme run by your employer, or a Share Incentive Plan, into a Stocks and Shares component of an ISA without having to pay Capital Gains Tax.

The value of the shares at the date of transfer counts towards your annual limit.This means you can transfer up to £20,000 worth of shares in the tax year 2020/21 (assuming that you make no other subscription).

You must transfer the shares within 90 days from the day they cease to be subject to the Plan, or (for approved SAYE share option schemes) 90 days of the exercise of option date. Your employer should be able to tell you more.

Please note – not all ISA managers / providers will accommodate such transfers.

Your ISA contribution limits reset at the end of the tax year (April 5th) each year. You cannot carry over any unused portion of your limit to next year's allowance.

The position on death

Although ISAs are personal, they can now retain their tax advantaged status after death until they're passed on to the ultimate beneficiary (or if sold in the meantime or not distributed within three years of the original policyholder's death). If left to a spouse or civil partner, they will retain their tax advantages until sold or until the survivor's death. An ISA life insurance policy will pay out on death. A personal representative will have to claim the death benefit. There will be no tax to pay on income or capital gains that arise before the insurer accepts the claim. However, personal representatives will be taxed on any interest that is paid if there is then a delay in paying out the claim. The insurer will deduct tax at the lower rate before paying over the interest.

ISA investments form part of an estate for Inheritance Tax purposes.

The position on moving abroad

You can only open an ISA if you are resident in the UK for tax purposes (ask your Tax Office if you are in any doubt about this).

Crown employees, such as diplomats or members of the armed forces who are working overseas and paid by the government, are eligible to open an ISA. Their spouses or civil partners can also open an ISA.

If you start an ISA in the UK and then go abroad, you cannot continue putting money into the ISA (unless you are a Crown employee working overseas or the spouse or civil partner of a Crown employee working overseas). However, you can keep your ISA and you will still get tax relief on investments held in the ISA. When you return, you can start putting money in again (subject to the normal annual limits).

Should I use an ISA or a pension?

This is an age-old question, often asked. There is no clear answer, as it is so dependent on personal circumstances. In many cases, the ideal position is, if at all possible, you should use ISAs and Pensions. Both are tax efficient investments, with some notable differences. Pensions grant tax relief on contributions, boosting the sums on the amounts put in. £100 into an ISA costs £100, whereas in a pension, £100 contributed costs £80 and for higher taxpayers even less. Both offer tax efficiency within the plans as there is no tax charged on the underlying assets.

Pensions, however, are restricted and cannot be released prior to age 55 (under current rules), whereas ISAs are free to take at any time.

From April 2015, radical changes to UK Pensions mean they can now be accessed freely (whereas prior to this they were restricted), however monies withdrawn from a pension, over and above a 25% tax free lump sum, will be taxable at the pension investor's marginal rate. Any decision about whether to put available money into a pension or an ISA (or the balance between them) should be based on your wider financial planning requirements.

What is a Junior ISA?

Junior ISAs have separate rules and conditions to adult ISAs.

They are long term, tax free savings accounts for children.

They are available for children aged under 18, who live in the UK and who were not entitled to a Child Trust Fund (CTF) Account. If they were eligible, they cannot have a Junior ISA.

There are two types of Junior ISA: a Cash Junior ISA and a Stocks and Shares Junior ISA (i.e. mirroring the general ISA approach).

Up to the age of 16, only a parent or an individual with parental responsibility can open a Junior ISA for the child. 16 or 17 year olds can open their own Junior ISA.

The money belongs to the child and cannot be withdrawn before age 18.

Parents have responsibility for 'managing' the ISA (e.g. opening it, choosing the company to open it with, making any changes etc) up to age 16. At 16, the child can take over this responsibility.

At age 18, the Junior ISA automatically converts to an adult ISA.

The Junior ISA limit is £9,000 for the tax year 2020/21. This can be any mix between a Cash version and a Stocks and Shares version.

Getting help and advice

There is a clear, long term benefit to using ISAs to shelter sums from tax (both current and future tax) and the contribution allowances are sufficiently generous to make this a significant financial planning opportunity.

ISAs are ideal for those aiming to build long term savings, with regular contributions, building up funds for a later date; they are ideal for individuals (for example, retired people) who want an income generating investment; they are ideal for any taxpayer aiming to shelter money from tax in a simple but highly effective tax wrapper.

In the case of Stocks and Shares ISAs, where the future return on invested money could be variable and subject to fluctuations, the difference in selecting the right company and funds (or other underlying investments) could be a difference measured in tens of thousands of pounds in the longer term.

ISAs can form a substantial part of your financial planning and it is important to ensure that your ISA plans are aligned to your wider life planning goals.

Contact us

The information contained in this guide was updated in May 2020 and was based on the rules and regulations, limits and allowances in existence at that time. Readers should always ensure that they receive appropriate financial advice from a regulated adviser prior to making any investment into ISAs.

Past performance is no guarantee of future returns, the price of units and the income from them can fall as well as rise, the value of any investment is not guaranteed and on encashment, you may not get back the full amount invested.

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