Atkins Bland

Investments • Pensions • Financial Planning

Guide to: Individual Savings Accounts

Introduction

A bit of history

Individual Savings Accounts (ISAs) are a popular component of personal savings and investment portfolios for millions of British residents.

First introduced in 1999, the ISA was launched as a new, tax efficient account that replaced both Personal Equity Plans (PEPs) and Tax-Exempt Special Savings Accounts (TESSAs). The ISA was designed to make saving and investment more accessible to the majority of the British public.

At first, two versions were made available - a cash ISA for savings and a stocks and shares ISA for investments. The yearly allowances were £3,000 and £7,000 for cash and stocks and shares ISAs respectively. All nice and simple.

However, since then a number of changes and the introduction of new versions have made selecting the right ISA, or even a combination of ISAs, much more complex.

What is an ISA?

What is an Individual Savings Account and how do they work?

Broadly speaking, ISAs are tax favoured vehicles for an individual's savings, allowing investors to save money without paying tax on either income or capital gains. There is no tax payable on money withdrawn from an ISA, and also no limit on how much cash can be withdrawn from the account.

There are currently six types of ISA available:

- Cash ISA
- Stocks and Shares ISA (S&S ISA)
- Innovative Finance ISA (IFISA)
- Help to Buy ISA (HTBISA) - now closed to new applicants
- Lifetime ISA (LISA)
- Junior ISA (JISA)

ISAs are available to residents of the UK (and Crown Servants and their spouses).

The annual allowance

This tax year all British residents and crown employees have an annual ISA allowance of £20,000. The contribution period is aligned to the tax year, which is from 6th April up to and including the 5th April. Savers have this period to use their allowance. At the beginning of a new tax year the annual allowance is replenished. There is no accumulation of unused allowances, so if not used in any particular year, it is lost.

Any money placed into an ISA will receive full tax benefits until it is withdrawn.
The £20,000 annual ISA allowance can be split between a Cash ISA, a Stocks and Shares ISA or an Innovative Finance ISA in any combination a saver chooses.

For example, a lump sum of £20,000 could be placed entirely into a Cash ISA, a Stocks and Shares ISA or an Innovative Finance ISA.

Alternatively, the £20,000 could be spread across each of these three ISA types, perhaps by placing £3,000 into a Cash ISA, £10,000 into a Stocks and Shares ISA, and, £7,000 into an Innovative Finance ISA.

With regard to the other three ISA types, Junior ISAs are the property of the child they are registered to and have an annual contribution allowance of £9,000 in the 2020/21 tax year.
Help to Buy and Lifetime ISAs have more complex rules, looked at later in this guide.

What is an ISA?

What is an Individual Savings Account and how do they work?

“Flexible” ISAs

Changes beginning in the 2016/17 tax introduced the notion of “flexible” ISAs. Essentially, this ruling allows ISA holders to withdraw cash from an ISA and replace it in the same tax year, without decreasing the current year’s allowance.

Cash ISAs, Stocks and Shares ISAs and Innovative Finance ISAs can all be flexible. The other ISAs cannot (Junior ISA, Help to Buy ISA and Lifetime ISA).

Please note, the flexibility rules are optional and at the account provider’s discretion. If you have an ISA or are considering opening one, it is important to ask the provider whether or not the account is “flexible”. Alternatively, you may prefer to check with an adviser.

Interest and the Personal Savings Allowance (PSA):

Introduced in 2016, the PSA gives UK taxpayers up to £1,000 of savings interest tax free. The allowance permitted depends on the individual’s tax band.

Income Tax band	Personal Savings Allowance
Basic rate	£1000
Higher rate	£500
Additional rate	£0

In addition to deposit savings accounts, this includes interest income distributions from collective investment funds such as unit trusts, investment trusts and open-ended investment companies (OEICs) as well as interest received from peer-to-peer lending agreements.

Interest received on money held in an ISA does not count towards an individual’s PSA.

Since the introduction of the PSA, account providers now tend to pay interest “gross”, i.e. without tax deducted, rather than “net” which is after the deduction of tax at source.

Overview of the rules linked to different types of ISA

The different kinds of ISA and how they work

Cash ISA

Annual allowance - *£20,000*
Minimum age requirement - *16*
Can be flexible? - *Yes*

A Cash ISA is much like a deposit account except the interest is tax free and does not count towards the PSA. Other than this, there is not much else to set the two apart, except for the general rules applying to ISAs, such as the yearly subscription limit (or ISA allowance).

If the PSA is not being used elsewhere, there may, of course, be no current tax benefit from using a cash ISA, although tax rules can change so having money in a tax-exempt environment may still prove beneficial, even if it isn't under current rules.

Stock & Shares ISAs

Annual allowance - *£20,000*
Minimum age requirement - *18*
Can be flexible? - *Yes*

These types of ISA provide a wider scope of investment opportunities. Whereas a Cash ISA can be described as a tax-free savings account, a stocks and shares ISA allows the investor access to shares in companies (equities), corporate and government bonds, plus collective investments such as unit trusts, investment trusts and Open Ended Investment Companies (OEICs), Property Authorised Investment Funds (PAIFs) and Real Estate Investment Trusts (REITs).

Investments held within a stocks and shares ISA are free from tax on capital gains, dividend income, property income and interest earned on debt assets such as Bonds.

Investments available within a stocks and shares ISA carry risk of capital loss and we recommend non-sophisticated investors obtain advice before opening a stocks and shares ISA.

Overview of the rules linked to different types of ISA

The different kinds of ISA and how they work

Innovative Finance ISAs (IFISAs)

Annual allowance - *£20,000*
Minimum age requirement - *18*
Can be flexible? - *Yes*

An option available since April 2016, Innovative Finance ISAs are designed for individuals that wish to participate in the Peer-to-Peer lending market.

Peer-to-Peer lending enables individuals to join together to lend money to other people and businesses for a defined rate of interest. A Peer-to-Peer lending platform cuts out the traditional role of Banks, in theory reducing the costs of the loan for the borrower and increasing returns for the saver.

However, as in almost all aspects of life, there is no such thing as a free lunch. The higher returns on offer from Innovative Finance ISAs are accompanied by additional risk of capital loss should the borrowers default.

Savings placed in an Innovative Finance ISA and lent to individuals or companies are inherently riskier than money placed in a savings account. The higher the interest rate, the less credit worthy the borrowers and the more the risk of default.

Having said that, one of the strengths of Peer-to-Peer lending platforms is that they enable an investors risk to be spread across a wide number of borrowers. This creates diversification so can reduce risk, although it cannot eliminate risk entirely.

Peer-to-Peer lending and Innovative Finance ISAs are not covered by the Financial Services Compensation Scheme.

Overview of the rules linked to different types of ISA

The different kinds of ISA and how they work

Lifetime ISAs (LISAs)

Annual allowance - *£4,000*
Minimum age requirement - *18 (Max age 40)*
Can be flexible? - *No*

The Lifetime ISA was introduced in the 2017/2018 tax year and differs in a number of ways to those covered so far.

The LISA provides savers under 40 a tax incentivised method of building a capital sum to help with retirement funding, or, to build a deposit for a first-time home purchase.

To qualify, individuals must be aged 18 to 40, and as long as a Lifetime ISA is opened before age 40, contributions can be made up to age 50.

The maximum that can be invested into a LISA each year is £4,000. This comprises part of an individual's overall annual ISA allowance (£20,000 for tax year 2020/21).

LISA contributions will receive a government bonus of 25%. This bonus is credited directly to the individuals LISA roughly one or two months after the contribution is made. For example, if the maximum amount of £4,000 is contributed, an additional £1,000 will be credited to the LISA in the form of a government bonus.

The investment options available for LISA investors include cash accounts and the various options available with a Stocks and Shares ISA (see earlier).

There are, however, a number of restrictions relating to accessing the money within a LISA. The money can only be withdrawn penalty-free if:

- It is used to purchase a first home valued up to £450,000, at least 12 months after the first deposit is made
- It is taken from the age 60 or over
- If the account holder is terminally ill.

If the money is withdrawn for any other reason than the above, a 25% penalty will apply. This 25% is a larger amount than the bonus added, so reflects a capital loss. This means the LISA is not suitable for those who may need to withdraw the money for any reason other than buying a first home, before they are 60.

We do not cover all of the rules and considerations regarding a Lifetime ISA in this general guide. However, if you would like to receive further details on this complex product please contact your adviser.

Overview of the rules linked to different types of ISA

The different kinds of ISA and how they work

Help to Buy ISAs – closed to new applicants

Help to Buy ISAs closed to new applicants on 30th November 2019. Those who opened a Help to Buy ISA prior to closure could save up to £3,400 in the first year and then £2,400 each year afterwards and were available from age 16.

Launched in 2015 Help to Buy ISAs are a form of Cash ISA designed to help first time buyers save for a house deposit. Savers could make an initial deposit of up £1,200 followed by contributions of up to £200 per month.

If using the money accumulated in a Help to Buy ISA to buy a first house, the government adds 25% to the overall amount up to a maximum of £3,000. However, it is important to be aware that the government bonus is paid at *completion* of the property purchase, therefore cannot be used as part of the deposit.

Anyone who opened and funded a Help to Buy account before the closure to new applicants can continue to pay in up to £200 a month until 30th November 2029. The government bonus must be claimed before 1st December 2030.

Junior ISAs

Annual allowance	-	*£9,000*
Minimum age requirement	-	None, but must be under 18
Can be flexible?	-	*No*

Junior ISAs can be set up by parents or guardians of UK resident children under the age of 18. Although opened and managed by a parent or guardian, the child is the registered owner. Savings can be placed in either a Cash JISA or Stocks and Shares JISA or can be split between each in any proportion.

Once the registered owner, i.e. the child, turns 16 they are eligible to take control of the money in the account and the investment decisions. On turning 18 the account converts to a standard Cash or Stocks and Shares ISA and full control passes to the child.

On turning 18 the child may withdraw the money in the account in full, if they choose.
While the Junior ISA provides a tax-efficient savings and investment vehicle for children, the inflexible ownership rules mean they may not always be suitable for those wishing to save for a child's future and retain some control over access.

Again, it's best to receive advice before making any decisions as this could help to avoid any problems further along.

Further considerations

Other factors to note when discussing ISAs

Transfers

At times, savers may wish to move the money in their ISA to another more attractive provider, for example a different Cash ISA with a better interest rate, or from a cash ISA to a Stocks and shares ISA.

It is important that a transfer is requested rather than arranging the transaction independently by withdrawing the money from the original account and sending to the new account yourself. This is because as soon as money is removed from an ISA it loses ISA status, so can only be put into the new account if current year allowances are available. Even if the allowances are available, this may be a waste if there is other capital which could have taken advantage of the allowance.

Again, we urge you to seek advice before taking action.

Inheritance

In the event of death, your ISA will make up part of your estate for Inheritance Tax purposes. However, since 3 December 2014, a spouse inheriting money which was in an ISA can retain the ISA status.

Important notes

Any opinions expressed on the merits or disadvantages of any options are intended as a general comment only and not as specific advice to the reader.

This document is intended as a supplement to full independent advice and not as a replacement for it and should be read in conjunction with any personalised recommendations provided by Atkins Bland Ltd and with any product brochures supplied.

The value of investments will fall as well as rise, as can any income produced.

Inflation can reduce the real value of capital and the income it generates

Past investment performance is not a reliable guide to the future

Any reference to taxation, regulation or legislation is based on our current understanding and details should be checked before any reliance is placed upon its accuracy.

The impact of taxation and tax planning depends on individual circumstances and may be subject to change, which can be retrospective.

Errors and omission excepted

Prepared by Atkins Bland Ltd. April 2020

Atkins Bland

The value of investments and any income generated will fall as well as rise.
An investor may, therefore, get back less than the amount invested.