

## Introduction

The Individual Savings Account (ISA) replaced both PEPs (Personal Equity Plans) and TESSAs (Tax Exempt Special Savings Account) from April 1999 and has been an extremely successful tax efficient savings vehicle.

The Government's stated aim in introducing all of these products was to encourage people, through tax reliefs, to raise the level of their long term savings.

ISAs were initially made available until 2010, but the Government has now made them permanent and arranged for a welcome simplification of the rules. This provides stability for savers and investors and certainty for the industry which will be benefitting from a huge saving in administration costs.

Statistics provided by HM Revenue & Customs show that for the year ending 5 April 2011, over £53 billion was saved or invested in over 15 million ISA accounts.

The figures in the table below refer to new monies going into those accounts only and do not include the vast amounts in ISAs that have already been built up by savers and investors over the years.

Annual ISA subscriptions as reported to HMRC by providers for the year 2010-2011		
	No of people saving/investing in ISAs (thousands)	Amount invested in ISAs (£m)
Cash ISAs	11,926	38,045
Investment ISAs	3,433	15,837
<b>Total</b>	<b>15,359</b>	<b>53,882</b>

## The Tax Benefits of an ISA

HMRC states that 'saving in an ISA means you do not have to pay any further tax on the income received within the ISA'. This is a political way of stating the facts because it is at once true but could also give a somewhat false impression that all ISAs are totally free of tax.

Cash ISAs are totally free of tax in that no tax is deducted on the interest that is accrued and there is no need to include the interest in a tax return, no matter what level of tax payer you are. As such, Cash ISAs make an excellent place to hold an emergency fund for all types of tax payer. The higher your marginal rate of tax (ie 20%, 40% or 50%) the more benefit you will gain from using a Cash ISA for an emergency fund.

"Cash ISAs make an excellent place to hold an emergency fund for all types of tax payer. However, far too many people use Cash ISAs for long term savings. It ought to be self-evident that if inflation is higher than the interest added to an ISA account, the money thus saved is going to lose its real value over time even allowing for their tax efficient nature."

Arthur Childs  
Arch Financial Planning Limited

Investment ISAs are also referred to as Stocks and Shares ISAs but I tend not to use the latter name as it can put people off using these extremely useful investment vehicles. People often think of 'stocks and shares' as being a small number of direct shareholdings, whereas Investment ISAs can be invested entirely in bonds (ie fixed interest investments) or property (ie commercial property). We encourage our clients to invest their Investment ISAs in a range of risk-rated model portfolios which provides a quality of investment which is a far cry from holding a small number of direct shareholdings.

A Stocks and Shares ISA for our purposes can be considered as a unit trust or OEIC (Open Ended Investment Company) with a tax efficient wrapper. We prefer to refer to these as Investment ISAs.

To return to the fact that ISAs are 'tax efficient' rather than 'tax free' it is important to note that dividend income received by ISAs will usually have a 'tax credit' attached reflecting the fact that 10% tax has been deducted at source. This tax cannot be reclaimed by the ISA manager.

Purely from a dividend income point of view, therefore, Investment ISAs are great news for higher rate tax payers (both 40% and 50%) as no further tax is required on such income. Basic rate tax payers are not disadvantaged by holding an Investment ISA but there is no advantage over holding 'unwrapped' unit trusts for example in terms of the dividend income, except that you avoid the need to include it if you complete a Self Assessment form. Non tax payers are disadvantaged by holding an Investment ISA if dividends are paid as they cannot claim back the tax deducted at source.

If gilts or bonds are held in an Investment ISA then the ISA manager is able to reclaim any tax deducted at source on those gilts or bonds to the benefit of the ISA holder.

Non tax payers who wish to hold Investment ISAs should tend to use gilts or bonds (or more usually gilt or bond funds) as the underlying investment rather than equities (ie stocks and shares).

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There are, however, other benefits of holding Investment ISAs. The gains on an Investment ISA are free of capital gains tax. This is not a major advantage for many investors who are not likely to have to pay capital gains tax on an 'unwrapped' unit trust portfolio anyway if they make sensible use of the annual exempt amount. However, it is convenient not to have to even think about capital gains tax on your investment.

For investors who are 65 or over, the income from an Investment ISA does not count towards the income limit which, once breached, reduces or removes your additional personal 'age' allowance.

## ISA Limits

Individuals who are both resident and ordinarily resident in the UK for tax purposes are eligible to apply for an ISA.

Joint ISAs are not available so married couples must have separate accounts.

Each adult has an annual ISA allowance which, if not used, is permanently lost. The minimum age to use an Investment ISA is 18 and the minimum age to use a Cash ISA is 16.

The highest number of investors in Investment ISAs were to be found in the age range 35 to 44, whilst the highest number of savers in Cash ISAs were to be found in the age range 65 and over.

Office for National Statistics  
Figures for tax year 2008/2009

In the tax year 2011-12 you can invest up to £10,680 in an Investment ISA with one provider, or up to £5,340 can be saved in a cash ISA with one provider, with the remaining being invested in an Investment ISA with either the same, or another provider.

The subscription limits will increase on 6 April 2012. From that date you will be able to invest up to £11,280 in an Investment ISA, or up to £5,640 can be saved in a Cash ISA.

	Investment Limits 2011/2012	Investment Limits 2012/2013
Cash ISA	Up to £5,340	Up to £5,640
Investment ISA	£10,680 less any amount deposited in Cash ISA in same year	£11,280 less any amount deposited in Cash ISA in same year
<b>Total Allowance pa</b>	<b>£10,680</b>	<b>£11,280</b>

Using collective investments has enabled Investment ISAs to be invested in *equities* (ie funds of company shares both in the UK and internationally), *gilts* (ie loans to the UK Government), *corporate bonds* (ie loans to companies), *property* (mainly commercial property) and *commodities* (oil, gas, steel, gold, wheat etc).

## Transferring ISAs

An ISA can be transferred to another manager and does not count towards the ISA allowance for the year of transfer. Non UK residents who already have ISAs can also transfer them.

Since 6 April 2008 money has been able to be transferred from Cash ISA accounts into Investment ISAs without affecting the annual allowance.

This is particularly useful for clients who have accumulated more in Cash ISAs than is needed for an emergency fund and they would like to make use of the greater long-term growth potential of Investment ISAs.

We particularly recommend transferring your existing Investment ISAs to the Nucleus Wrap (if you have total investments of at least £20,000) or the Cofunds Fund Supermarket (for smaller investments). By doing so you will no longer have to hold your ISA with one fund manager, or a small selection of fund managers, but can choose to diversify your investment between a wide range of fund managers with thousands of funds from which to choose.

"The advent of online fund platforms such as fund supermarkets and wraps has meant that the 'one provider' rule is effectively meaningless as any number of investment houses and investment funds can be used".

Arthur Childs  
Arch Financial Planning Limited

As mentioned, we prefer our clients to invest via one or more risk-rated model portfolios to gain the advantage of professional fund management. Where clients are able to use the Nucleus Wrap they also benefit from quarterly reporting and quarterly rebalancing of their portfolios.

## Access To Your Investment

There is no 'lock-in' period for ISAs so you can withdraw money at any time without losing the tax advantages of your investment.

However you need to be aware that once you have invested up to the limit in a tax year and you make a withdrawal you cannot re-invest the amount withdrawn at a later date without using up your ISA allowance in a future tax year.

## The Situation on Death

If you die while holding an ISA, income and capital gains accrued from the date of your death cease to be tax exempt.

The benefits are passed to your beneficiaries either as cash, or as a transfer of the underlying investment fund which will no longer be in an ISA wrapper. In this respect an ISA will always form part of your estate for Inheritance Tax purposes as it cannot be assigned or held in trust.

“For an elderly person who is likely to have an Inheritance Tax problem it may be totally inappropriate to describe an ISA as being ‘tax free’ or ‘tax efficient’, as it is likely to be subject to a 40% tax charge on their death”.

Arthur Childs  
Arch Financial Planning Limited

## Additional Retirement Income

An ISA is a useful investment vehicle for providing additional retirement income. Although tax is deducted on the dividend income received by the fund this is no different to the treatment of dividend income in a pension fund. There is no further tax to be paid on the dividend income in your hands and this is particularly beneficial if you are a higher rate tax payer. Under current legislation income produced from fixed interest funds held in an ISA is tax free.

Furthermore, the income that you receive from your ISAs does not have to be declared to HMRC and even more importantly does not count towards the maximum income level before the Age Allowance is reduced. In this respect the income from an ISA can be doubly beneficial.

The ability for savers to convert their Cash ISAs into Investment ISAs should not be overlooked. People retiring today need to realise that equity investments can produce a dividend income stream that is as good as any return they might receive from deposit accounts. More importantly, a proportion of assets held in equity investments is necessary if you want to stop your savings and investment income losing its value over the long term as a result of inflation.

Please note, however, that neither an ISA, nor any other investment vehicle, can replace a proper pension plan as the foundation of your pension funding.

## Junior ISAs

Junior ISAs (JISAs) have been available from 1 November 2011 with a limit of £3,600 for each eligible child per year as part of the Government’s commitment to encourage saving for children. For further information please refer to our Guide: *Junior ISAs*.

## Risk Factors

- An investment into an ISA, unit trust, OEIC or other collective investment scheme is intended as a long-term investment.
- It is important that you are aware that the value of units in a unit-linked investment such as an ISA, unit trust, OEIC or other collective investment scheme, as well as any income which they generate, can fall as well as rise.
- If you surrender the contract, especially during the early years, you may get back less than you have invested.
- Where past performance is mentioned please note that the past is not necessarily a guide to future performance.

Please note that this information does not constitute personal advice and should not be treated as a substitute for specific advice based on your circumstances.

Any information given in this Guide relating to income tax legislation is based on our understanding of legislation and practice in force at the date of this Guide. Whilst we believe our interpretation of current law and practice to be correct in these areas, we cannot be responsible for the effects of any future legislation or any change in interpretation or treatment.

In particular you are warned that levels of tax and tax reliefs and also State Benefits that may have been referred to, are subject to alteration and, in any case, the value of such reliefs and benefits may depend on an individual's circumstances.

### For personal advice

If you would like to receive advice on investing in an investment ISA or transferring existing ISAs to an online platform please ask your usual Arch adviser or contact us via one of the following:

Tel: **0845 3700 661**  
or **01483 204600** (if local)  
Email: **enquiries@arch-fp.co.uk**  
Online: **www.arch-fp.co.uk**



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