



**HARTSFIELD**

FINANCIAL SERVICES LIMITED

**Capital Management**

# Making the most of ISA's

The art of investing

KEY GUIDE

## An introduction to ISAs

When Individual Savings Accounts (ISAs) first appeared in 1999 as a replacement for PEPs and TESSAs, they were a relatively straightforward offering. There was one plan with a choice of three investment variants: stocks and shares, cash or life assurance (merged into the stocks and shares component in 2005). In the 18 years since, what was once simple has become more complicated. On some counts, there are now seven different categories of ISA, although the government's website says there are only four (cash ISAs; stocks and shares ISAs; innovative finance ISAs; and Lifetime ISAs). For clarification, we outline five below in chronological order of availability.

Despite their proliferation, all ISAs have a number of features in common. For example, they all enjoy tax privileges, a consequence of which is that the amount that you can invest in each type and in all ISAs are generally subject to annual limits. ISAs may only be run by HM Revenue & Customs (HMRC) approved ISA managers.

## The main categories of ISA

The ISA family can be divided up in several ways – hence the differing headcount. One way of looking at it is to consider them in terms of when they first became available:

- **Basic ISA** The original 1999 ISA lives on as a plan with two investment components: stocks and shares or cash. The two are now interchangeable, so you can transfer from a stocks and shares ISA to a cash ISA or vice versa. However, many ISA providers do not offer both variants.
- **Junior ISA (JISA)** The JISA is available to children under 18 who do not already have a Child Trust Fund (CTF) account. Again, both cash and stocks and shares variants are available.
- **Help to Buy ISA** In practice this is a variant of a cash component Basic ISA. As the name suggests, this ISA is aimed at first time buyers and its main benefits revolve around home purchase. The Help to Buy ISA was launched in December 2015, but it has since been overshadowed by the Lifetime ISA (see below). Until 5 April 2018 there are special terms for transfers from a Help to Buy ISA to a Lifetime ISA. Help to Buy ISAs will be withdrawn in December 2019, although existing investors will be able to continue making contributions.
- **Innovative Finance ISA** These relatively new ISAs are limited to investments in cash and two specialist, higher risk lending areas.
- **Lifetime ISAs (LISA)** The LISA is aimed at encouraging saving for first home purchase or retirement by adults under the age of 40. It provides investors with a government bonus, but comes with penalties if funds are withdrawn before age 60, other than for a first home purchase.



### Action point

*Make the most of ISAs – they are all free of UK income tax and capital gains tax.*

## ISA eligibility

ISA investors must be resident in the UK, or a non-resident Crown employee working overseas and subject to UK tax on their earnings. Spouses and civil partners of eligible non-resident Crown employees can also contribute if they are themselves non-resident.

An ISA can only be arranged on an individual basis (so cannot be held jointly) and it cannot be held in a trust. However, ISAs can effectively be inherited by a surviving spouse or civil partner.

Age eligibility for starting an ISA depends upon the type of plan, as show in the table below.

**ISA eligibility**

Type of ISA	Opening age range	Notes
<b>Basic ISA</b>	18 upwards	16 and 17 year olds may start a basic ISA, but can only choose the cash component.
<b>Junior ISA</b>	Under age 18	Investors cannot also have a Child Trust Fund (CTF). Broadly speaking, this means JISAs are available to any child who was born before 1 September 2002, after 2 January 2011 or who was born between those dates and whose CTF monies have been transferred into a JISA.
<b>Help to Buy ISA</b>	16 upwards	Help to Buy bonus must be claimed by 1 December 2030.
<b>Innovative Finance ISA</b>	18 upwards	
<b>Lifetime ISA</b>	18-39	Contributions cannot be made from age 50 onwards.

 **Focus point**

*There is nothing to report about ISAs on your tax return.*

**ISA investment and account structures**

ISAs, JISAs and LISAs currently have two possible investment components:

**1. The stocks and shares component**

Shares listed on any recognised stock exchange and certain other exchanges, such as AIM, can be held in the stocks and shares component of an ISA. Some, but not all AIM shares are eligible for inheritance tax business property relief after two years of ownership.

- All Financial Conduct Authority (FCA) authorised retail funds (i.e. virtually any unit trust, OEIC or UCITS) are eligible for ISA investment.
- Corporate bonds and EEA government securities are also eligible investments, regardless of the term to maturity.
- Cash can be held in the stocks and shares component without restriction.
- The stocks and shares component can also include life assurance, although this is now extremely rare.

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

**2. The cash component**

This may be invested in bank or building society deposits as well as money market unit trusts that hold deposits rather than securities. National Savings & Investments offers a single ISA product, the Direct ISA, to all investors.

The Help to Buy ISA is only available with a cash component.

**Innovative Finance ISA**

The Innovative Finance ISA was launched in April 2016, although regulatory approval meant a slow start. These ISAs permit investment in cash and two specialist financial products:

- Peer-to-peer loans - loans arranged to other people or businesses without an intermediary bank being involved.
- ‘Crowdfunding debentures’ – investing in a business by buying its debt.

In both instances, the businesses involved are usually unlisted and small. Whereas the Financial Services Compensation Scheme protects up to £85,000 of deposits held in the cash component of Basic ISAs, there is no such protection for peer-to-peer loans or crowdfunding debentures.

**ISA account investment limits**

The general rule is that in any one tax year, you may only subscribe to one of each type of ISA. This means that in 2017/18, subject to eligibility, you can subscribe to:

1. A Basic ISA with a stocks and shares component.
2. A Basic ISA with a cash component or a Help to Buy ISA (a small number of providers incorporate both types within the one ISA wrapper).
3. An Innovative Finance ISA.
4. A LISA.

If an ISA is transferred in full, the one-ISA-per-type-per-year rule still applies. Any subscription made at any time in the tax year during which the transfer is made is treated as a subscription to the recipient ISA.

 **Action point**

*The total contributions limit across all ISAs for adults is £20,000 per tax year for 2017/18.*

**Example – using the ISAs limits 2017/18**

Lindsay is 37 and in May 2017 started a LISA with a subscription of £4,000. If she wants to maximise her ISA investment in 2017/18 to use the full £20,000 limit, her options include:

Type of ISA	Option 1 Amount £	Option 2 Amount £	Option 3 Amount £	Option 4 Amount £
Basic – Cash	16,000	Nil	5,000	10,000
Basic – Stocks & Shares	Nil	10,000	4,000	3,000
Innovative Finance	Nil	6,000	7,000	3,000
<b>Total</b>	<b>16,000</b>	<b>16,000</b>	<b>16,000</b>	<b>16,000</b>

Lindsay could only arrange one of each type of ISA, but if she has existing ISAs in any category, she could use the full transfer route to make contributions to a new ISA.

The maximum overall investment across all ISAs in 2017/18 is £20,000. However, there are sub-limits for Help to Buy and LISAs:

- The maximum **Help to Buy** subscription is an initial £1,000, plus £200 a month. For instance, a plan started at the beginning of the tax year on 6 April has a maximum

first year input of £2,400 (£1,000 + 12 x £200), whereas for one started on, say, 8 March, the maximum first year input is £1,200 (£1,000 + £200).

- For **LISAs** the maximum subscription is £4,000 per tax year.
- For **JISAs**, the maximum contribution in 2017/18 is £4,128. In addition, a 16 or 17 year-old can subscribe £20,000 to a cash component Basic ISA (including a Help to Buy ISA).

## Transfers

The ISA transfer rules are complex and leave discretion for providers on whether to accept transfers in, although they are obliged to allow full transfers out. Funds transferred between ISAs or between the cash and stocks and shares components generally do not count as fresh subscriptions, but can complicate the calculation of subscription limits.

Until 5 April 2018 it is possible to transfer funds built up in a Help to Buy ISA into a LISA and receive the 25% LISA bonus on the transferred amount with neither the transfer nor the bonus counting as a 2017/18 LISA subscription.

Transfers will usually involve costs and/or penalties and may result in lost bonuses. Any transfer should only be undertaken after seeking expert advice.

## Flexibility

Some, but not all, ISA providers take full advantage of the legislation and allow you to withdraw and replace cash sums during the same tax year without the replacement counting as a fresh subscription. This flexibility is not available for LISAs or JISAs and is severely restricted in the case of Help to Buy ISAs.

### Example – Using ISA flexibility

Graeme has a cash ISA worth £60,000, having invested the maximum £20,000 subscription in early April 2017. Six months later he is in the process of moving home and needs £40,000 cash to complete his purchase. He has this amount in a fixed term deposit which matures in February 2018, but he does not want to pay an interest penalty to gain early access. Instead he could use the flexibility his ISA offers to withdraw the sum he needs now and then replenish his ISA with the monies from his maturing deposit before 6 April 2018.



### Action point

*ISAs are effectively inheritable by a surviving spouse or civil partner.*

## Inheritance

On death, the value of any ISA may effectively be inherited and used as an “additional permitted subscription” by a surviving spouse or civil partner. The ISA’s tax advantages are thus able to outlive the original ISA owner, which can have important estate planning benefits. The mechanism involved is somewhat tortuous and changes to simplify the process are currently under review by the government.

## Tax treatment of ISA investments

All ISAs enjoy the same tax treatment on invested funds:

### Stocks and shares component

All capital gains and dividends are free of UK tax. Foreign withholding taxes may apply, however. Dividends received within an ISA are ignored when considering your available dividend allowance (currently £5,000, but likely to reduce to £2,000 from

2018/19). Outside of an ISA the tax on dividends exceeding the dividend allowance now ranges from 7.5% for basic rate taxpayers to 38.1% for additional rate taxpayers.

### Focus point

*Preferential terms for transfer from a Help to Buy ISA to a LISA expire on 5 April 2018.*

Interest received on bond and cash investments is tax free and does not count towards your personal savings allowance.

If AIM and similar shares are held in an ISA, the normal inheritance tax (IHT) business property relief rules apply. Broadly speaking, these mean that many AIM shares are IHT-free after they have been held for two years.

## Cash component and Innovative Finance ISA investments

All interest is tax free.

Additional tax benefits apply to Help to Buy ISAs and LISAs.

### Help to Buy ISA

The extra tax benefits for the Help to Buy ISA only apply if the funds are used to finance a first-time buyer's home purchase. The maximum value of the property to be bought is £250,000 (£450,000 in London). Purchases may be made on a joint basis, meaning that a couple could each use a Help to Buy ISA to buy the same property.

For eligible first-time buyers, the government provides a tax-free bonus equal to 25% of the ISA's value. The bonus is subject to a minimum of £400 (implying a minimum ISA value of £1,600) and a maximum of £3,000 (for ISAs valued at £12,000 or more). No bonus payments will be made after 1 December 2030 or on transfer to a LISA (see above). At current interest rates building up a fund of £12,000 will take over four years if you make the maximum subscriptions throughout.

If the Help to Buy ISA funds are not used for first time property purchase, there is no bonus payable, but the normal cash component tax-freedom for interest still applies.

### LISA

LISAs offer eligible investors a 25% tax-free government bonus on their subscriptions until they reach age 50. So, for example, if you subscribe the maximum of £4,000 in a tax year, the government will add an extra £1,000 to your LISA.

This generosity comes with strings attached. If you withdraw funds from a LISA before you reach age 60, a 25% penalty will apply to the amount withdrawn unless:

- Your LISA is at least 12 months old and you are using the funds towards a first-time purchase of a home valued at up to £450,000 (anywhere in the UK), or
- You have become terminally ill.

### Example – the LISA penalty

Steve made a contribution of £3,000 to a LISA, to which the 25% government bonus of £750 was added. Over the following year the LISA grew in value to £4,000. If at that point Steve decided to withdraw £1,000 to spend on a new computer, he would receive only £750 after the 25% penalty is deducted.

## How we can help

Investment is a specialist area and can only be conducted by authorised advisers. We can:

- Advise you whether ISAs make sense for you in terms of your particular needs and objectives.
- Advise which ISA variants are most suited to your circumstances.
- Review your existing ISA holdings to see if they still meet your aims and circumstances.
- Recommend the most appropriate ISA(s) for you in terms of asset allocation. The decision whether to invest in cash, fixed interest, property, equities, innovative finance arrangement or a mix should be taken in the context of your overall risk profile, the asset allocation of your other investment holdings and, to some extent, your tax position.
- Advise you on whether to bring Child Trust Fund investments under the JISA umbrella and the opportunities this offers.
- Advise you on whether to transfer a Help to Buy ISA to a LISA before 6 April 2018.
- Explain the relative advantages and disadvantages of LISAs and pensions.
- Set out the way in which ISAs can form part of your estate planning arrangements.
- Advise you on strategies to minimise the tax on your investments outside ISAs.
- Ensure that our planning assumptions are factually correct, and that our recommendations fit in with your overall tax and financial planning.
- Provide you with ongoing information about the progress of your investments on the basis agreed with you.
- Revise your investments from time to time and as agreed, to ensure that they continue to match your needs and circumstances.



### Focus point

*Making a choice between ISAs and your pension needs requires expert advice.*

Investing in shares should be regarded as a long-term investment and should fit in with your overall attitude to risk and financial circumstances.

Your capital is at risk if you make peer-to-peer loans or invest in crowdfunding debentures. Any such lending is likely to be highly illiquid, meaning that you may not be able to access your monies until the loan is repaid, assuming there is no default.

Past performance is not a guide to future performance. The value of investments and income from them can go down as well as up, and you may not get back the original amount invested.

Levels and bases of, and reliefs from, taxation are subject to change and depend on your individual circumstances.

*This publication is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking any action on the basis of the contents of this publication. The Financial Conduct Authority (FCA) does not regulate tax advice, so it is outside the investment protection rules of the Financial Services and Markets Act and the Financial Services Compensation Scheme. This publication represents our understanding of law and HM Revenue & Customs practice as at 21 June 2017.*



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