February 2023

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Create and Secure Your Future

The **essential** guide to ISAs

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The government first introduced ISAs, or Individual Savings Accounts, just before the turn of the millennium in 1999. Launched by Gordon Brown to encourage more people to save for the future, ISAs have grown to become one of the UK's most popular savings products.

Despite this, they were initially labelled a "colossal failure" by Labour MP Quentin Davies just months after they launched due to the slow rate of uptake. However, they've since become an essential part of saving for the British public.

A primary goal of the ISA was to simplify the process of using savings products.

ISAs replaced the Personal Equity Plan (PEP) and Tax-Exempt Special Savings Account (TESSA). Throughout the development of ISAs, successive governments have tweaked and redesigned different aspects of them, including the addition of new products and amended limits.

The changes mean that choosing the right ISA product for you while understanding how to make the most of your allowance isn't as straightforward as it was previously. Read on to find out what you need to know about ISAs.

What is an ISA, and what makes them valuable?

To put it simply: an ISA acts as a tax wrapper that enables you to save and invest tax-efficiently.

You don't pay tax on the interest you earn on money in a Cash ISA. Similarly, returns from investments that are held in an ISA are free from Income Tax and Capital Gains Tax (CGT). This means ISAs could be a useful way to minimise your tax liability while also putting your money to work.

To make the most of your money, introducing an ISA into your financial plan should be something you consider. The annual ISA subscription limit for the 2023/24 tax year is £20,000.

You can spread your annual allowance across different ISAs, but you are limited to contributing to one Cash ISA and/or one Stocks and Shares ISA each tax year.

ISAs are certainly among the most popular and widely used savings and investment products in the country. As they offer a range of options that may benefit different demographics and circumstances, there is likely to be an account that can fit into your financial plan.

The latest government figures reveal that in 2020/21:

- Roughly 12 million adult ISAs were subscribed to
- A total of £72 billion was added to ISAs
- The share of accounts subscribed to in cash fell to 66%, compared to 75% in the previous tax year

The Personal Savings Allowance

The introduction of the Personal Savings Allowance in 2016 means that ISAs have lost part of their appeal. Many adults now benefit from tax-free savings, even if they aren't held in an ISA.

Basic-rate taxpayers can earn up to £1,000 interest per year tax-free. However, this allowance falls to £500 per year for higher-rate taxpayers, while additional-rate taxpayers do not benefit from the allowance at all.

As a result, ISAs may still be an important part of reducing tax liability.

You can make use of both your PSA and ISA allowance. The PSA applies only to interest on cash savings.

How has the ISA changed over the years?

1999

The ISA is introduced with an overall annual subscription limit of £7,000 and a Cash ISA limit of £3,000

2008

It takes almost a decade for the first subscription limit increase, and the overall amount rises by just £200

2009

The overall ISA allowance increases to £10,200, but only for investors aged over 50

2010

The 2009 additional allowance for over 50s lasts just a year before being rolled out to all investors

2011

Junior ISAs are introduced following the scrapping of Child Trust Funds

2014

The Cash ISA limit is increased to match the overall subscription limit of £15,240, allowing savers to use their full allowance for cash savings for the first time

2015

The Help to Buy ISA launches to support first-time buyers – The Additional Payment Subscription (APS) is introduced allowing a surviving spouse or civil partner to 'inherit' the tax benefits of an ISA

2016

Launch of the Innovative Finance ISA, which allows investors to hold peer-to-peer lending investments

2017

The Lifetime ISA launches to offer an incentive for those saving for a first home and retirement – The ISA limit is increased to £20,000, where it currently remains

2019

The Help to Buy ISA is closed to new accounts

2020

The Junior ISA annual allowance increased to £9,000, allowing families to save more on behalf of their children

Finding an ISA product that makes sense for you

ISAs aren't quite the same products as they were when they were originally introduced back in 1999. They have evolved to become more intricate in the way they help you save and invest.

Some of the ease of understanding has perhaps been lost in the process, so it's useful to understand what products are available, and how they work.

1. Cash ISA

Cash ISAs are a popular choice of savings accounts and, according to the government, represent around 66% of all ISAs. Anyone over the age of 16 can open a Cash ISA.

Cash ISAs are similar to a traditional savings account, yet they also have the merit of paying tax-free interest.

While the tax-efficient interest you earn in a Cash ISA can help your money grow, it's useful to consider how inflation may affect the growth of your savings in real terms. This is especially relevant during periods of high inflation – such as that in the latter half of 2022 – as it becomes more likely that interest rates fall behind the pace of inflation.

This would mean that your money gradually loses value relative to the price you pay for goods and services.

It's also worth remembering that not all Cash ISAs are the same. Some accounts may have restrictions on deposits or withdrawals.

While less flexible types of Cash ISAs could offer more attractive interest rates, they may not support your goals.

Reasons to consider a Cash ISA:

- Tax-efficient interest on your savings
- Capital is usually secure
- Useful for short-term goals
- You can normally access your money straight away

The Financial Services Compensation Scheme protects your savings

Cash ISAs have protection from the Financial Services Compensation Scheme (FSCS), which means up to £85,000 of your money is protected for each provider you save with if the firm failed.

It's useful to note that some firms may have multiple trading names under the same banking licence. One example of this is Lloyds Bank and Halifax, both existing under the Lloyds Banking Group company licence.

The FSCS would only cover a total of £85,000 between the accounts held with the two firms if they share a banking licence. To combat this issue, the FSCS makes it easy to check which banks share a licence with other firms through its register, which is completely free to use.

2. Stocks and Shares ISA

Another ISA option that could be suitable for long-term investing is a Stocks and Shares ISA. Anyone over the age of 18 can open a Stocks and Shares ISA.

Investing in the stock market could help you grow your money in real terms once the effect of inflation has been considered.

Also, if the timeline fits your goals, investing in a Stocks and Shares ISA could be better for generating a return over a longer time frame than a Cash ISA.

Any returns made through a Stocks and Shares ISA are exempt from Capital Gains Tax and Income Tax – so you won't be sacrificing tax benefits if you choose this over a Cash ISA.

You can choose from a variety of qualifying investments when investing through a Stocks and Shares ISA. As a result, you can tailor the investments according to your goals, time frame, and level of risk.

You don't necessarily have to choose the investments yourself – funds are available to invest in through Stocks and Shares ISAs or we can help you create a portfolio suitable for your needs.

Remember, investments often come with short-term volatility and that the value of a Stocks and Shares ISA could fall as well as rise. The value of your investment can go down and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

Overall, it's useful to keep your investment goals in mind when making decisions regarding your Stocks and Shares ISA, including which investments to make, while also considering your personal and financial circumstances.

There is a wide range of assets and equities that you can invest in using a Stocks and Shares ISA which includes:

- Corporate or government bonds
- Unit trusts
- Investment trusts
- Exchange-traded funds (ETFs)
- Individual stocks and shares on a registered stock market

You may want to consider opening a Stocks and Shares ISA if you:

- Are investing for the long term – typically five years or more
- Are prepared to take some investment risk
- Want to benefit from tax-efficient growth on your investments
- Do not need immediate access to your savings

3. Lifetime ISA (LISA)

LISAs are normally used to help you buy a first home or build retirement funds.

One of the main attractions of a LISA is that you benefit from a government bonus. To help and encourage people to save to buy their first home or for retirement, the government gives a 25% bonus on their deposits.

However, there are additional limitations if you use a LISA:

- You can only open a LISA if you are aged between 18 and 39 – you are free to add to your account until the age of 50
- Contributions to a LISA are limited to £4,000 each tax year
- Withdrawals before you are 60 – unless you use the money to buy your first home – incur a 25% withdrawal penalty

The potential 25% withdrawal charge for accessing your money before the age of 60 means you should fully understand your goals before committing to a LISA. If you suddenly need to access the money for reasons other than buying your first home, the 25% charge will essentially mean you lose the bonus and a part of your own deposits.

If you're looking to save a deposit to purchase your first home, a LISA could be a great option. Meanwhile, for those building retirement funds, a LISA isn't likely to be as tax-efficient as regular pension schemes, however, it can provide a useful boost to your retirement savings.

You can also choose between holding cash or stocks and shares in your LISA. So, taking the time frame of your goals into account is important when opening a LISA.

You may consider opening a LISA if you:

- Are aged 18 to 39
- Want to build funds for purchasing your first home
- Want to benefit from a government bonus
- Want to save or invest for retirement to support your pension contributions
- Want to secure tax-efficient interest or returns on your savings

4. Innovative Finance ISA

First created in 2016, Innovative Finance ISAs provide a potential way to invest if you have a higher risk profile. Anyone over the age of 18 can open an Innovative Finance ISA.

As opposed to holding traditional investments, as a Stocks and Shares ISA would do, Innovative Finance ISAs use a peer-to-peer lending system. This means you'd act as a lender to individuals or businesses. Such borrowers may not be able or wish to secure a regular bank loan.

If you lend money through an Innovative Finance ISA, you could earn "interest" on the money you lend for the duration of the loan.

Many providers offer peer-to-peer lending; however, it's essential that you understand the risks that could come from this type of investment. Some opportunities may be higher risk than others, and if a borrower defaults on payments, you could lose money.

Usually, the interest rate of a peer-to-peer loan will reflect the level of risk it carries; interest rates will usually be higher for borrowers who have a greater risk of defaulting on payments.

Peer-to-peer loans are usually considered high-risk when compared to other types of investments. So, before committing, it's important to make sure this option is right for you and your circumstances. You should thoroughly research each peer-to-peer lending opportunity.

You may consider opening an Innovative Finance ISA if you:

- Have an appetite for higher risk
- Want to benefit from the potential of tax-efficient returns
- Wish to diversify your investment portfolio

5. Help to Buy ISA

Help to Buy ISAs are a type of Cash ISA that were introduced in December 2015 but closed to new accounts in 2019. If you were quick enough to open an account in the four years they were available, you can continue contributing to your Help to Buy ISA until November 2029.

As its name may imply, this account was created to help people save to buy their first home. The account could be opened with a deposit of up to £1,200. You can contribute a maximum of £200 a month.

Savers then receive a 25% government bonus up to a maximum of £3,000. You could use this money to help with moving fees, legal costs, and other expenses you face as a first-time buyer.

Through the Help to Buy ISA, first-time buyers can purchase a home worth up to £250,000 (£450,000 in London).

Passing on an ISA when you die

For a lot of people, ISAs are their central method of saving or investing. As such, this makes it important to have a comprehensive understanding of how you can pass an ISA to a loved one when you die.

When planning to leave an ISA to your loved ones, there are different implications depending on who will receive it. For example, leaving an ISA to your spouse or civil partner will enable them to use the additional permitted subscription (APS).

Understanding the additional permitted subscription

The APS gives the surviving partner the unique chance to combine the size of the deceased partner's ISA with their own annual ISA allowance.

Imagine you have £50,000 in your ISA when you pass away that you plan to leave to your spouse or civil partner. Your partner could use their usual £20,000 ISA allowance, as well as an APS of £50,000 after inheriting your ISA. This allows your loved one to inherit your ISA without losing the tax benefits of their annual ISA allowance.

It's possible the value of your ISA changes between your time of death and the date your ISA is transferred. In the event of this, the APS is calculated as either the value of the money passed on, or the value at death, whichever is highest. In doing so, loved ones shouldn't lose out on any of the ISA's growth during the probate process.

It's helpful to know that, even if you leave your ISA to your child, your partner would still receive the same APS, even though the funds are in your child's name. This could allow your partner to add more to their ISA.

The surviving partner must use the APS within three years after the date of death. If the probate process is complex and exceeds this time frame, the APS must be used within 180 days after the estate has been administered.

When leaving assets to your spouse or civil partner, including your ISA, the assets will not be liable for Inheritance Tax (IHT).

What happens if you leave your ISA to someone who isn't your spouse or civil partner?

If you leave an ISA to someone who is not your spouse or civil partner, they will not receive the APS. In addition to this, the assets may be subject to Inheritance Tax (IHT) if the total value of your estate exceeds the nil-rate band, which is £325,000 for the 2023/24 tax year.

If you suspect your estate may surpass the IHT threshold, there are usually ways to mitigate how much IHT your estate will be liable for. Please get in touch to discuss what options are available to preserve your family's inheritance.

Junior ISAs: Creating financial security for your children

Assessing your savings and investments may lead you to consider how best to start building a nest egg for your children or grandchildren. Luckily, Junior ISAs (JISA) could help with this goal.

There is no minimum age for opening a JISA. A child's parent or legal guardian can create an account in the child's name as soon as they are born. Starting your child's saving journey early is a practical way to create future financial stability.

The money placed in a JISA cannot be accessed until the child is an adult. They can manage the account from the age of 16. However, withdrawals are only possible once they turn 18, when the account automatically converts to an adult ISA.

The JISA allowance for the 2023/24 tax year is £9,000 for each child.

When opening the account, you can choose either a Cash JISA or a Stocks and Shares JISA. Just as you would do with your own ISA, you should consider what your goals are when selecting an account.

Cash JISAs often offer higher interest rates than adult Cash ISAs. However, you should consider how inflation may cause the money to lose value in real terms, especially over the long term.

On the other hand, a Stocks and Shares JISA carries investment risk, which means the value of your investment will rise and fall. So, it's important to weigh up your goals and priorities when choosing a JISA.

JISAs carry the same tax privileges as their adult counterparts. This means any interest earned in a Cash JISA will not be subject to tax, and returns from a Stocks and Shares JISA are exempt from Income Tax and CGT.

Although it's the child's future you're saving for, you'll likely have already thought of what the money should go towards. Worthy contenders could be to fund higher education, driving lessons, or their first home.

Once your child turns 18 and gains full control of their ISA, they may have different ideas about how to use the money. So, it can be useful to talk to them about how the nest egg you've built for them can be put to use.

Official figures from the 2020/21 tax year reveal:

- Around £1 billion was subscribed to Junior ISAs
- Roughly 57% of funds were held in Junior Cash ISAs
- The average Junior ISA subscription increased 19% from the previous year, totalling £1,133

Child Trust Funds

Child Trust Funds were the predecessor of the JISA.

A Child Trust Fund was set up on behalf of all children born between 1 September 2002 and 2 January 2011 by the government, and included an initial contribution.

Although they are now obsolete, you can still make contributions to existing accounts.

If your child has a Child Trust Fund, you could transfer the funds to a JISA. Depending on the provider, the interest rates may be more competitive, and you'll have the option to invest.

You must transfer money in a Child Trust Fund and close the account if you want to open a JISA.

For lost Child Trust Funds, HMRC has a useful service that can help you find the provider here: gov.uk/child-trust-funds/find-a-child-trust-fund

ISAs are a vital part of many financial plans. If you'd like to discuss how they fit into your wider plan and which type of ISA would best suit your goals, please get in touch:

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