June 2020

TEMPLEGATE

Your essential guide to **ISAs**

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ISAs, or Individual Savings Accounts, have been around for over 20 years. Back in 1999, then Chancellor Gordon Brown introduced the product in the hope of encouraging more people to save for the future. Since then, they've become an essential part of many financial plans.

Despite the overall success ISAs have enjoyed over the last two decades, they weren't an instant hit. In fact, Labour MP Quentin Davies branded them a "colossal failure" a few months after they launched, due to their limited uptake. But ISAs gradually became a saving staple among the British public.

One of the key aims of the ISA was to make saving simple, replacing the now-defunct Personal Equity Plans (PEPs) and Tax-Exempt Special Savings Accounts (TESSAs). However, as with many things finance-related, successive governments have changed parts of ISAs, added new products, and altered limits. As a result, picking an ISA product and understanding how to make the most of your allowance isn't as simple as it once was.

What is an ISA and why should you choose one?

An ISA is essentially a tax wrapper that allows you to save and invest tax-efficiently. You don't pay tax on the interest earned on Cash ISA accounts and the returns generated from investments held in an ISA are also free from tax. Making an ISA part of your financial plan can help you make the most of your money and minimise tax liability.

The annual subscription limit for this tax year (2020/21) is £20,000. You can split your allowance between multiple accounts, including cash and investment options. However, you can only open one of each type of ISA per tax year.

If you use an ISA, you're certainly not alone. They're one of the most popular savings and investment products. The latest official statistics for 2017/18 show:

The introduction of the Personal Savings Allowance (PSA):

In 2016, the PSA was introduced and means that ISAs have lost part of their appeal as it means some 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, whilst 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. It's also worth noting you can make use of both your PSA and ISA allowance.

What's more, the PSA applies only to interest on cash savings. So, when investing an ISA still offers a tax-efficient solution.

- Around 10.8 million Adult ISAs were subscribed to
- Roughly 72% of ISA subscriptions are in Cash ISAs
- In total, around £69 billion was added to ISAs over the year
- The average subscription was £6,409

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

Choosing the right ISA product for you

As the ISA has evolved, it's become more complicated to choose the right product for you. If you're hoping to open a new ISA, there are now four different types to choose from and, if you have an existing Help to Buy ISA, you can continue to make contributions.

1) Cash ISA

Cash ISAs account for over 70% of ISA subscriptions, making them the most popular way to save.

A Cash ISA is similar to a traditional savings account, with the added benefit of all interest earned being tax-free. Your money is held in cash and is secure. Your savings are also protected under the Financial Services Compensation Scheme (FSCS). This means up to £85,000 is protected per bank, building society or credit union if they fail. One key thing to note with the FSCS is that some firms use multiple trading names under the same banking licences, for example, HSBC and First Direct. As a result, the FSCS would only cover £85,000 across accounts with two firms. The easiest way to check which banks share a licence is to search the Financial Conduct Authority's register here.

Interest earned when saving with a Cash ISA helps your money to grow. However, it's important to look at the growth in real terms. For the last decade, interest rates have been incredibly low and haven't kept up with inflation. In real terms, that means savings likely have less spending power. Over the long term, this can have a significant impact on the value of savings.

Within Cash ISAs, there are also several different options. For example, ISAs with restrictions, such as when you can access money or those where you must deposit a certain amount each month. These may offer more competitive interest rates but the limits must fit with your plans.

Anyone over the age of 18 can open a Cash ISA.

When should you choose a Cash ISA?

This type of ISA can be useful if you have short-term saving goals or need ready access to saving - for example, an emergency fund.

2) Stocks and Shares ISA

If you're looking to invest with a long-term goal in mind, a Stocks and Shares ISA can help you do so tax-efficiently. Capital gains and income earned from investments held in an ISA are protected from tax.

The benefit of investing, rather than holding assets in cash, is that you have an opportunity to increase the value in real terms. Historically, investment values have increased over the long term, helping you to beat the impact inflation has on your savings. However, in the short term, investment volatility does occur, so it's not advisable if your goal is less than five years away.

With a Stocks and Shares ISA, you can invest in a range of qualifying investments, this includes stock markets listed shares on a registered stock market, government bonds and investment trusts that meet certain conditions. You can also choose to invest through a fund or select your own investments.

With these options, it's possible to build an investment portfolio that reflects your risk profile. As a result, it's important to understand what an appropriate level of risk, with your circumstances and goals in mind, is. You should also keep in mind that all investments come with some risk and it is possible that you won't get back the full amount invested.

Anyone over the age of 18 can open a Stocks and Shares ISA.

When should you choose a Stocks and Shares ISA?

An ISA that invests your savings should only be used if you have a long-term goal (minimum five years) and understand your risk profile.

3) Innovative Finance ISA

Innovative Finance ISAs have been around since 2016 and offer an additional way to invest. Rather than holding traditional investments, like a Stocks and Shares ISA, an Innovative Finance ISA is designed for peer-to-peer lending investments.

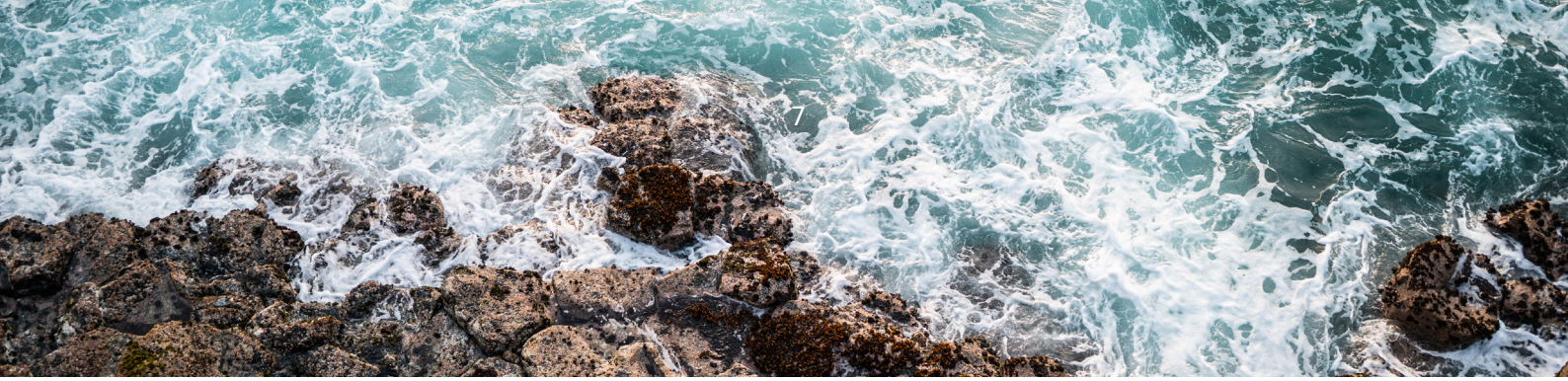
Peer-to-peer lending is used by a range of businesses and individuals that do not want or can't obtain lending through a traditional bank loan. Instead, peer-to-peer allows you to act as a lender to those seeking financial support. Rather than returns, you'll receive a rate of interest as the loan is paid back. Numerous platforms allow you to find peer-to-peer lending opportunities but it's important you do your research to understand the associated risks and borrower profile. If a borrower defaults on payments, you could lose money.

Typically, the higher the rate of interest being offered, the higher the level of risk. Compared to traditional investments, peer-to-peer lending is considered high-risk and you should consider if it's the right option for you before proceeding.

Anyone over the age of 18 can open an Innovative Finance ISA.

When should you choose an Innovative Finance ISA?

Investors with a high-risk profile that are looking to diversify existing investments may find an Innovative Finance ISA is an option for them.



4) Lifetime ISA

The Lifetime ISA (LISA) is the latest ISA product to be launched, debuting in 2017. It's designed to provide support for those looking to purchase their first home or save for retirement.

The first thing to note with a LISA is that there are additional restrictions. You must be aged between 18 and 40 to open a LISA, although you can continue to add to your account until you're 50. The maximum you can pay into a LISA each tax year is capped at £4,000. Should you decide to make a withdrawal before the age of 60 for a reason other than buying your first home, you'll face a penalty.

So, why would you choose a LISA? In a bid to encourage people to save a deposit and for retirement, the government will provide a 25% bonus on the deposit made each year. Put in the maximum annual amount and you effectively receive £1,000 as 'free' money.

The important thing if you're considering opening a LISA is to consider your goals. If you decide to make a withdrawal before the age of 60 and aren't purchasing your first home, the withdrawal charge is 25%[1]. This means you'll lose the government bonus and a portion of your own contributions. As a result, you should think carefully about how a LISA aligns with your goals.

For the most part, a LISA is an excellent way to increase a deposit on a first home if you're certain that you want to buy a property. If you're planning to save for retirement, a LISA is unlikely to be more efficient than a traditional pension, but it can be a good tool for supplementing existing pensions.

Finally, a LISA can be either a Cash or Stocks and Shares ISA. Therefore, you need to consider the time frame of your goals and risk profile when opening a LISA.

When should you choose a Lifetime ISA?

A LISA can be a useful product if you're certain you want to purchase a property for the first time or if you're looking to supplement pension savings.

5) Help to Buy ISA

The Help to Buy ISA closed to new accounts in November 2019. As a result, this isn't an option if you're looking for a new place to save or invest. However, if you already have a Help to Buy ISA, you can continue saving into the account until November 2029.

The Help to Buy ISA was designed to help individuals aspiring to purchase their first home. An account could be opened with a deposit of up to £1,200, and up to £200 could be deposited each month. The government will then provide a 25% bonus, up to a maximum of £3,000, during the process of buying property. This money can be used for the deposit, to pay legal fees or any other indirect cost associated with buying a home.

The Help to Buy ISA was open to first-time buyers aged over 16. It can be used to buy any home worth up to £250,000 (£450,000 in London). If you have an existing Help to Buy ISA, you can choose to transfer the savings to another ISA product.

[1] **Please note:** Between 6 March 2020 and 5 April 2021, the LISA withdrawal penalty is temporarily reduced to 20%.

Leaving an ISA behind for loved ones

As a key saving and investment vehicle, ISAs may form part of your legacy plan. If you intend to leave your ISA to a loved one, it's important to understand the regulations and potential tax liability.

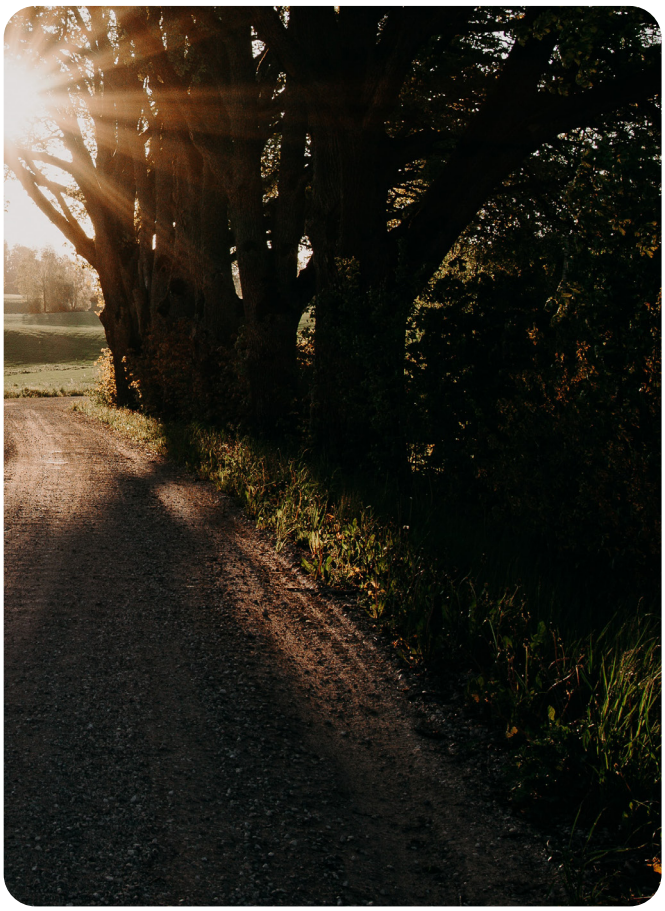
If you plan to leave behind ISA savings and investments to a surviving spouse or civil partner, the additional permitted subscription (APS) applies.

This means the surviving partner has a one-off additional ISA allowance that is equivalent to their deceased partner's ISA when they passed away. So, let's say you have £40,000 in your ISA when you die that you'd like to leave to your spouse. That tax year the surviving partner would have their usual £20,000 ISA allowance, as well as an APS of £40,000 for inheriting their spouse's ISA. This means they can add the inherited sum to their own ISA savings or investments.

Between death and an ISA being transferred, the value may change depending on interest payments and investment performance. Where this is the case, the APS is the value of the money passed on or the value at death, whichever is higher. This means a partner can benefit from any growth that occurs during the probate process.

The APS applies whether your spouse or civil partner inherits your ISA. So, if you left £40,000 of ISA assets to your child, your partner would still receive a £40,000 APS, which they could use to add other assets and capital to their own ISA.

The APS is available for three years after the date of death or, if the probate process takes longer, 180 days after the estate has been administered.



If you leave your ISA assets to a spouse or civil partner, no Inheritance Tax will be due, as is the case with other assets.

However, if you want to leave ISA assets to someone who isn't your spouse or civil partner, they will not benefit from the APS and, if your entire estate is worth more than £325,000, Inheritance Tax may be due.

If you think your estate may be liable for Inheritance Tax, there are often things you can do to reduce liability if you're proactive. Please get in touch to discuss your legacy.

Junior ISAs: Building a nest egg for children

As you look at your savings and investments, now is also a good time to consider options if you want to build a nest egg for children. Junior ISAs offer an excellent way to save for the future with children and grandchildren in mind.

You can choose either a Cash Junior ISA or Stocks and Shares Junior ISA. In the same way, you consider the time frame and goals when deciding between cash and investing your own money, these play an important role in deciding which type of Junior ISA to choose.

Usually, you'll find that Junior Cash ISAs have more competitive rates than their adult counterparts. However, inflation eroding value in real terms is still an issue over the long term. Likewise, if you choose to add money to a Junior Stocks and Shares ISA, savings will be exposed to investment risk that should be carefully considered alongside risk profile.

Junior ISAs come with the same tax benefits as adult ISAs, no tax will be due on interest or returns earned. For the 2020/21 tax year, the Junior ISA subscription allowance was increased significantly, to £9,000.

A child's parent or legal guardian can open a Junior ISA on their behalf from the day they are born. It's a step that can ensure they have the foundations of a solid financial future and are used by many families. Official figures for 2017/18 show:

- Around 907,000 Junior ISAs were subscribed to
- £902 million was subscribed to Junior ISAs
- Around 57% of money was held in cash

However, one of the important things to keep in mind is that you won't be able to access the money added to a Junior ISA. The child will be able to manage the account from when they are 16, this may include selecting investments or transferring savings to another ISA product. But they cannot withdraw money until they're 18 when the account will automatically become an adult ISA.

As you're saving for their future, you probably have some idea of what you'd like it to be used for. Perhaps you hope it'll support them through further education, act as a deposit on a first home or pay for driving lessons. However, as children will be able to access the money as they choose once they turn 18, it's worth having a conversation about how the money will be used and what your preferences would be.

Child Trust Funds:

Junior ISAs were introduced to replace the now defunct Child Trust Funds.

All children born between 1 September 2002 and 2 January 2011 had a Child Trust Fund set up by the government on their behalf, including an initial contribution. You can still make deposits to existing Child Trust Funds or transfer them to a Junior ISA, which may offer a better rate of interest and allow you to invest the savings.

If you have 'lost' a Child Trust Fund, you can contact HMRC to find the provider here.

ISAs have become an essential part of financial plans for many individuals and families. If you'd like to discuss how they fit into your wider plan and which type of ISA suits your goal, please contact us.

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Please note:

The value of your investment can go down as well as up and you may not get back the full amount you invested. Past performance is not a reliable indicator of future performance.

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