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GUIDE TO ISAS 2013/14

THIS IS OUR GUIDE TO INDIVIDUAL SAVINGS ACCOUNTS AND HOW TO MAKE THE MOST OF YOUR ANNUAL TAX YEAR ALLOWANCE. IF YOU WOULD LIKE TO DISCUSS ANY OF THE INFORMATION PROVIDED IN MORE DETAIL, PLEASE CONTACT US.

"AN ISA SITS OVER YOUR CHOICE OF INVESTMENTS TO SHELTER THEM FROM FURTHER TAX."

WHAT IS AN ISA?

'ISA' stands for Individual Savings Account, a tax-efficient wrapper offered under Government legislation as a way of encouraging you to save. An ISA sits over your choice of a number of different investments to shelter them from further tax on income or gains earned.

There are two types of ISA – the Cash ISA and the Stocks and Shares ISA – and the combined allowance for both in the 2013/14 tax year is £11,520. Within this, the limit for Cash ISAs – or for the cash element within a Stocks and Shares ISA – is £5,760.

However, there is flexibility over how these limits can be used – you can, for example, put a maximum £5,760 in a cash account and £5,760 in a stocks and shares account. Alternatively, if you place just £2,000 in cash, you can use the entire remaining balance – £9,520 in this instance – to invest in stocks and shares. If you prefer, you may put your full £11,520 allowance into a Stocks and Shares ISA.

In addition, you can transfer existing Cash ISA holdings to a Stocks and Shares ISA without affecting your current tax year allowance. So, if you have £10,000 already sitting in existing Cash ISA plans, then this amount can be moved to a Stocks and Shares ISA, yet leave your entire current tax year allowance still available for new investment.

WHAT SHOULD I LOOK FOR IN A CASH ISA?

Cash ISAs are simply cash accounts that sit within an ISA wrapper and therefore have certain tax advantages. As with a normal bank account, the underlying account will pay a certain level of interest. Therefore, when shopping around for the best Cash ISAs, investors should check to ensure the rates on offer are competitive.

However, a high rate is not the only reason for selecting a Cash ISA as the highest rate today might not prove to be the best rate over the longer term.

There may be Cash ISA providers offering rates that are slightly lower but consistently competitive over the long term and these might suit those who do not want to keep shifting between providers. Furthermore, some providers tie money up for a period of time so that, although these accounts may pay higher rates, savers will pay for those rates by waiting for as long as 90 days to make a withdrawal.

In essence, even these seemingly simple products need some research. Make sure you make the right choice before you commit yourself.

A RANGE OF INVESTMENTS TO CHOOSE FROM

OF YOUR £11,520 ALLOWANCE FOR THE 2013/14 TAX YEAR, YOU CAN CHOOSE TO INVEST UP TO £5,760 IN CASH AND THE REST OF THE BALANCE IN STOCKS AND SHARES. HOWEVER, IF YOU DO NOT NEED A CASH ISA OR YOU BELIEVE YOUR TAX BENEFITS ARE BETTER USED ELSEWHERE, YOU CAN AVOID THE CASH ISA COMPLETELY AND INVEST THE FULL AMOUNT INTO STOCKS AND SHARES.

SELF-SELECT ISAS

Self-select ISAs allow you to choose your own investments and will generally offer a choice of individual shares, individual bonds or collective investment schemes such as open-ended investment companies (Oeics), unit trusts, investment trusts or exchange-traded funds (ETFs). The choice will ultimately depend on your reasons for investing and your tolerance for risk.

If you are seeking capital growth and are comfortable with the possibility of losing some or all of your capital, investing in single shares is a high-risk approach that can pay off. However, collective investments are often a more appropriate choice, particularly if your ISA investment constitutes a significant proportion of your overall savings.

"YOUR INVESTMENT CHOICE WILL ULTIMATELY DEPEND ON YOUR REASONS FOR INVESTING AND YOUR TOLERANCE FOR RISK."

COLLECTIVE INVESTMENTS

By investing in a collective investment, you are accessing not one or two but many different companies or holdings. Known as diversification, this approach is designed so that poor performance from one holding should not have a significant effect on the overall performance of your entire portfolio.

Collective schemes offer access to a whole range of different investments. Some will offer a 'one-stop shop' investment into a number of different asset classes, such as equities, bonds and property. Others will focus on just one area, which could be anything from large UK companies right through to Japanese bonds. To make the choice easier for you, most unit trust and Oeic funds are sorted into sectors by the Investment Management Association (www.investmentfunds.org.uk) so you can compare funds with similar goals.

If you want a lower-volatility fund or if you have a relatively short timeframe, it may be best to pick a collective fund that offers a lower exposure to equities. A fund in the 'Mixed Investment 0-35% Shares' sector, for example, might be appropriate.

Alternatively, if you are looking to maximise long-term growth, and are prepared for a 100% exposure to equities, the UK All Companies sector is a good place to start. If you wish to be even more adventurous, there are equity fund sectors for every region in the world and, if you are seeking to generate an income, it is worth considering an investment in the bond or equity income sectors.

LEADING IMA SECTORS

UK funds	Overseas funds
UK All Companies	Global
UK Equity Income	Global Bond
UK Smaller Companies	Asia Pacific ex Japan
£ Corporate Bond	Asia Pacific inc Japan
£ Strategic Bond	Global Emerging Markets
£ High Yield	Europe excluding UK
UK Gilt	Europe including UK
UK Index Linked Gilts	European Smaller Cos
	North American
	North American Sm Cos
	Japan

Mixed investment	Other
Mixed Inv. 0-35% Shares	Money Market
Mixed Inv. 20-60% Shares	Protected
Mixed Inv. 40-85% Shares	Specialist
Flexible Invesment	Technology & Telecoms
UK Equity & Bond Income	

Source: IMA, April 2013

CHARGES

When making your choice, you should also be aware of the associated charges. There may be a charge for the ISA wrapper (though this is increasingly rare), but there will be upfront and ongoing charges for the underlying investment. This fee will vary according to the complexity of the product and the company that manages it.

As such, a straightforward ETF or other index-tracking fund that mirrors the performance of an index such as the FTSE 100 will be cheaper than, say, a Japanese Smaller Companies fund, where a fund manager selects the stocks, often using their and their company's own in-depth research, and may have a team of investment professionals to support them.

Your tax position could also affect your investment choice but such a consideration is likely to require specific professional guidance. If you are interested in discussing your tax position further, please contact us. In the meantime, here is a summary of some of the broader issues to bear in mind.

SOME TAX CONSIDERATIONS

While ISAs are well known for being 'tax-efficient', your choice of investments can make a big difference to the level of benefit that is generated. All the income and growth you receive from your ISA is tax-free in your hand, but the treatment of each asset class is different while it remains invested – and this can be confusing.

Cash ISAs, for instance, are entirely free of income tax. Therefore, if you earn £1 in interest, you receive the whole lot. On a normal bank account, basic rate taxpayers currently pay tax of 20p on that £1 and higher-rate taxpayers would be liable for a further 20p. As such, you receive more on your money from this type of account than you would receive outside an ISA.

Similar to cash, the interest on corporate bonds is also tax-free. However, unlike Cash ISAs, the capital value can fluctuate, and there is therefore the possibility of a tax-free capital gain as well as tax-free income. Of course, on the flipside, this also means there is the chance of a capital loss if markets move against the investment – and there is also a risk to your income if a company defaults. As a result, corporate bonds generally pay a higher level of income than cash deposits as a way of compensating investors for taking on this additional risk.

The tax benefits on shares are a little different. Under normal circumstances, basic rate taxpayers currently face a 10% tax on dividend income. This 10% tax payment is not refundable within an ISA, regardless of the tax position of the investor. You could argue, therefore, that a Stocks and Shares ISA offers little additional benefit to a normal basic rate taxpayer – although there are still considerable advantages for a higher-rate taxpayer, who does not have to pay any additional income tax on dividend receipts.

However, based on their historical performance, equities have offered greater long-term growth potential than any other asset class and this is particularly true for areas such as emerging markets, which carry a corresponding level of additional risk. For this type of investment, the benefit of the ISA wrapper is primarily derived from the fact investors will pay no capital gains tax.

Equities should always be considered a long-term investment as there is a possibility you may not receive back your original investment – particularly in the first few years. Before making any investment decision, you should weigh up the tax advantages against the potential risks and likely returns.

USE IT OR LOSE IT

One thing is not up for debate – you only receive one ISA allowance every tax year.

You cannot carry your allowance over to the next tax year and therefore, if you do not do something about it, you will lose it. While your annual allowance can be used at any time during the tax year, the deadline of 5 April helps to concentrate the mind and there is generally an increase in ISA investments at that time of year.

However, you do not have to wait. You can use your allowance at any time – and many would suggest the earlier the better, particularly with Cash ISAs, as the earlier you open a Cash ISA, the more interest you will earn.

For Stocks and Shares ISAs, some people still attempt to 'time' an investment in and out of the market although few have proved themselves adept at this type of market prediction. An alternative approach is to 'drip-feed' your allowance on a monthly basis, so you invest at different prices as markets fluctuate. Ultimately, this approach can help to smooth the return on your investment.

Nevertheless, regardless of how or where you decide to invest your money, you must do so before 5 April. At the end of the tax year, your ISA allowance is gone. So start your research now and make sure you do not miss out.

YOUR QUESTIONS ANSWERED

When were ISAs introduced?
ISAs were introduced in 1999 and have grown in popularity ever since. According to HM Revenue & Customs, almost £54bn had been subscribed to ISAs by the end of the 2011/12 tax year, while the overall market value of ISA holdings had risen to £391bn.

Who can open an ISA?
You must be a UK resident for tax purposes and over the age of 16 to open a Cash ISA, or over 18 to open a Stocks and Shares ISA. If you open an ISA and then move abroad, you cannot add any new money to that ISA. However, you are able to keep the existing investment open and continue to enjoy the tax benefits on that investment.

Can I change my mind if my investment provider underperforms?
Yes – you are able to transfer your ISA proceeds to a different manager at any time. This is particularly easy if you have a self-select ISA, where you can change investment managers without switching ISA providers. However, you should always bear in mind – particularly with bonds, property or equity investments – that this should be a long-term decision. Moving can add costs and it is therefore best not to be overly swayed by short-term fluctuations in markets.

How would I transfer an ISA to another provider?
In order to transfer the money and retain the tax benefits, you must complete a 'transfer request' with your new provider, who will then contact the existing provider on your behalf and arrange to take charge of the proceeds for you.

You must not close one ISA and then reinvest the proceeds in another, as this is deemed to be a withdrawal. Once you withdraw, you lose all tax benefits on the money and cannot reinvest, except where the amount falls below your current tax year's unused allowance.

How do I monitor performance?
While some ISA providers allow you to view the value of your holdings online, all should at least send you regular statements to let you know how much your investment is worth. You can compare these to previous statements to see how your investment is progressing.

In between statements, if you are invested in a collective investment or direct shares, their prices are available on the internet or in certain newspapers. If you are invested in a cash deposit account, you should monitor mail from the bank telling you of changes to interest rates – and compare this with tables in Sunday newspapers and on internet finance sites to ensure you are receiving the most suitable deal.

When can I withdraw my money?
Some accounts may have notice periods but you can give instructions to withdraw at any time. The provider will then divest your money and return the proceeds to you. You do not need to withdraw all of your money – you can just take a proportion of your investment and leave the rest invested. Do be aware, however, that some providers have minimum investment levels you have to meet.

What happens if I open two ISA accounts in the same tax year by mistake?
If this happens, the assets in the second ISA will become fully taxable. You are not able to nominate the second ISA as the preferred account for the tax year in question – so make sure you are happy with the provider you have chosen before you make your move.

Do note that, if you pay into an ISA via regular savings, the first payment on or after 6 April automatically opens an account for the new tax year. If you wish to stop payments into an existing account and move to a new one, make sure you provide instructions to the provider and your bank well in advance or you will either be stuck with it for another year or have to go through the lengthy 'transfer' process to put things right.

contact

We hope you found the information in this guide useful and informative. If any of the points are of interest, or you would like to discuss your own situation in more detail, please get in touch.

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