R02: Individual Savings Accounts 2020/2021

An ISA is not a product but is a tax shelter that can be placed around different assets tha results in the income and gains being tax free.

To confuse the issue there is more than one type of ISA. There is what can be called a **General ISA**. This term isn't used by HMRC and in the exam if the question just refers to an ISA, it is referring to a general ISA. There are three other types of ISA which are:

- Help to Buy (HTB) ISA
- Lifetime ISA (LISA)
- Junior ISA (JISA)

These will be considered later and for the moment we'll focus on the standard ISA.

Another piece of HMRC jargon is that they refer to money being placed into an ISA as a **subscription**.

As with any tax privileged regime the Government imposes restrictions and rules and questions in the exam will focus on these. The main rules cover:

- The assets or products can be placed in an ISA.
- Who can take one out
- The amount that can be invested in a tax year

Eligible assets

An ISA can have three elements.

- **Cash** (deposit accounts)
- **Stocks and Shares or Investment element** which includes irectly held Gilts and shares, including investment trust shares together with unit trusts, OEICS, ETF and a REIT
- **Innovative Finance**. These are Peer to Peer loans can also be held within an ISA. The FCA has restricted the sale of these to High Net Worth and sophisticated investors.

A life insurance policy, including an Investment Bond within an ISA cannot be placed in an ISA. Nor can NS&I Products although they do offer their own cash ISA

Who can take one out?

Individuals must be:

- Over 16 to have a cash based ISA
- Over 18 to have a non-cash ISA.
- Be a UK tax resident in the tax year the subscription is made

Hans was UK tax resident in 2019/20 and subscribed the maximum into an ISA. He became non-resident in 2020/21 so cannot take one out but the one made in 19/20 retains its tax privileges.

An ISA can only be in a single name. There is no such thing as a joint ISA.

An ISA cannot be put into a trust so it will always be included in the owner's estate.

The amount that can be invested in a tax year

- The maximum subscription for 2020/2021 is £20,000.
- This is on a "use it or lose it" basis.
- This can be split between the three main elements.
- Each element can have a different provider.

Jack invests the maximum £20,000 in 2020/2021 with £8,000 in cash through Megabank and £12,000 in a unit trust through Neverfail Investments.

What Jack cannot do is split his cash element between Megabank and Challenger Bank.

The stocks and share element can split into a number of funds as long as they are with the same ISA provider

Kamil subscribes £20,000 to Pluto Investment's ISA that uses a platform structure. He splits this into five different funds with £4,000 each. Each fund could be with a different manager but it is still with one provider.

Subscriptions can either be made by investing new money or, in the case of the stocks and shares component, by transferring non-ISA holdings.

Tom has about £50,000 in various unit trusts. In August 2020, he transfers £20,000 of these into an ISA which uses his maximum subscription for that year. He can repeat this in subsequent tax years.

Note that Tom would have made a disposal for CGT when the unit trusts are transferred.

Post subscription rules

Withdrawals

Withdrawals can be made from any of the three elements although the provider of the cash element may impose a penalty in to form of loss of interest. Once a withdrawal has been made its tax privileged status is lost.

If a withdrawal is made in the tax year of subscription, the investor is allowed to replace it.

Keith invested the full £20,000 in a cash ISA in May 2020. In August 2020 he withdraws £3,000. He can contribute a further £3,000 by April 5 2021.

Rani has £10,000 in an ISA and withdraws £1,000. She can contribute another £11,000 in the current tax year to take her up to the maximum subscription.

Providers aren't obliged to allow investors to do this so their conditions should be checked.

Transfers

Assets in one ISA can be transferred to another provider without losing its tax free status. It is also possible to transfer a cash ISA to an Equity ISA and vice versa. All providers must allow investors to transfer out but they are not obliged to allow transfers in.

Care must be taken that it is a transfer. If the ISA is closed all the tax benefits are lost and only that year's unused subscription can be made.

Lu has £50,000 in an ISA. He decides to move all of it to a new provider. He instructs the provider to close the account rather than transfer it. As a result, the maximum that he can place into an ISA is £20,000 in the current tax year

The rules on how much can be transferred are different depending on whether the transfer relates to the current or previous year's contribution.

Ben invested the maximum £20,000 in August 2020. He also has an ISA with a value of £40,000 from contributions made in previous tax years.

If he wants to transfer the contribution made in August 2020 in tax year 20/21 he must transfer all of it. (any growth in the original subscription must also be transferred)

With the ISA from the previous year he can transfer just part of it.

After April 6 2021 he can transfer part of the subscription made on 20/21

Death

An ISA loses its status on the death of the investor but the underlying assets remain and distributed to beneficiaries by will or intestacy.

Recent years have seen two key changes in the treatment of an ISA following the investor's death. These are:

- The introduction of the **continuing ISA**.
- The introduction of the **Additional Permitted Subscription**

The Continuing ISA

If the investor died on or after 6 April 2018 the ISA becomes a **continuing account of a deceased investor** or **continuing ISA** for short. No further money can be invested but it continues to enjoy its tax-free status. This status will last until the sooner of:

- The administration of the estate is complete
- The ISA is closed
- Three years after death of the investor

The executors or the survivor's spouse will notify the ISA provider of the death who will then designate it as a continuing ISA.

Additional Permitted Subscription

A spouse or civil partner can claim an additional allowance equivalent to the deceased's ISA holding at the date of their death. This is known as the **Additional Personal Subscription (APS)**

The amount the surviving spouse gets is the greater of the value of the deceased spouse's ISA holding at date of death or the date when the assets were transferred to the survivor.

When Don died his ISA holdings had a value of £80,000. His will passed everything to his wife Ivanka

By the time the executors distributed his estate the value of the ISA was £82,000. Ivanka has an APS of £82,000

If the ISA had fallen in value to £77,000, the APS would be £80,000

In practice she will normally receive the assets without its ISA wrapper so must sell the underlying assets and invest the money into an ISA provider of her choice. This is a **cash subscription** and must be used within three years of death or if the estate takes longer to wind up, within six months of this happening

If Don died on August 4 2020 she can use her APS at any time between August 5 2020 and up August 4 2023.

- The APS is in addition to her normal annual allowance.
- If she has sufficient cash, she could use the APS before she receives payment from the estate
- She can spread the subscriptions can be over the three years
- The recipient must use a single provider to receive the APS. This is to enable HMRC to monitor that the maximum isn't exceeded.

Surviving spouses who don't receive the underlying assets will still get an APS.

Helen died and left all her ISA investments to her son James. The APS is £110,000

James cannot use the APS but Helen's husband Fred can. He would have to have sufficient assets to make use of this.

Occasionally a provider will allow the surviving spouse to transfer the funds to an ISA in their name. This is termed an **in specie transfer**.

- This must take place within 6 months of the spouse becoming the owner of the assets.
- The survivor must use the same provider and funds as the deceased spouse

We will now look at the remaining types of ISA:

- Help to buy ISA
- Lifetime ISA
- Junior ISA

Help to buy ISA

This is a type of cash ISA designed to assist first time buyers. It was withdrawn for new accounts on October 31 2019 but contributions can be continue to be made to existing accounts.

Apart from interest being tax free, there is a 25% government bonus on the whole fund when it is used to fund a first time purchase.

To qualify the investor must have been:

- 16 or over and be a UK tax resident
- Have a valid NI number.
- a first-time buyer and not have another house anywhere in the world
- Not had another active cash ISA in the same tax year

To get the bonus the purchased property must:

- Be in the UK
- Cost up to £250,000 or up to £450,000 if buying in London
- Not rented out after it is purchased
- Be purchased with a mortgage

The way it works is as follows:

- The account was opened with a bank or building society
- An initial deposit of up to £1,200 could be made.
- Monthly payments of up to £200 can then be made
- Once £1,600 has been saved it qualifies for the minimum government bonus of £400
- The bonus is £50 for every £200 that is saved with a maximum bonus of £3,000
- When the property is purchased the solicitor will apply for the bonus once the bank or building society is told that the account is being closed. The bonus can only be released once the property is purchased so cannot be used to fund a deposit.

As with a standard ISA it can only be taken out on an individual basis. A couple can have two Help to Buy ISA and potentially qualify for a government bonus of £6,000

The Help to Buy ISA was available until 30 November 2019. Existing ones that are open at that date can continue but the bonus must be claimed by 1 December 2030.

Lifetime ISA (LISA)

The Lifetime ISA or LISA was introduced in April 2017. Many of the features are the same as general ISA but there are significant differences regarding:

- Maximum subscription.
- Eligibility
- Tax benefits.
- Taking withdrawals.

Maximum subscription

This is £4,000 which forms part of the overall £20,000 allowance. This can be made either by new money or by transferring funds from an existing ISA. Transfers can be also be made from a HTB ISA but only up to 5 April 2018.

Eligibility

Apart from being a UK tax resident there is an age restriction. You must be at least 18 and be under 40 to open one but contributions can continue until age 50. If you are contributing to a help to buy ISA you cannot contribute to a LISA.

Individuals can only take out and contribute to one LISA per tax year but can have a different provider each year.

Tax breaks of a LISA

As with a standard ISA income and gains within the funds' investments are tax free. The proceeds are also tax free to the investor.

In addition, the Government will add 25% to the money invested whether it is new money or by transfer but not on the growth or interest.

Frank contributes £1,000 to a LISA and gets a £250 bonus.

Joe transfers £4,000 from a standard ISA into a LISA and gets £1,000 bonus.

Based on the current annual maximum of £4,000 the government will add £1,000.

Taking withdrawals

Unlike the general ISA a LISA has two specific uses:

- To help fund a first-time house purchase.
- To fund retirement.

Investors do not need to designate its purpose at the outset and can change their plans.

Helen took out a LISA with the intention of using it to fund a first-time purchase. She then receives an inheritance and uses this to buy a house. She continues to fund the LISA to provide income in later life.

The fund can be accessed at any time but there will be a penalty of 25% of the amount withdrawn unless:

- The investor is terminally ill (expected life expectancy of less than 12 months)
- It meets the criteria for first time purchase.
- It is encashed after 60.

As a temporary measure the withdrawal penalty has been reduced to 20% for 20/21

Gwyneth has contributed the maximum of £4,000 a year and in 20/21 the fund has a value of £24,000. She then withdraws £10,000 and a penalty of £2,000 is applied. Her fund now has a value of £14,000

Cancellation under the 30 day cooling off notice will not attract a penalty but no bonus will be added. Withdrawals by the LISA manager to pay fees and charges can also be made without attracting a penalty charge.

First time house purchase

The criteria are similar to a Help to Buy ISA. The purchaser must be

- 18 or over and be a UK tax resident
- Have a valid NI number.
- Be a first time buyer and not have another house anywhere in the world

To get the bonus the property that is being purchased must:

- Be in the UK
- Cost up to £450,000.
- Not rented out after it is purchased
- Be purchased with a mortgage

The LISA must have also been open for at least 12 months.

A criticism of the Help to Buy ISA was that the funds were only released after the purchase was completed. The LISA fund plus deposit can be used to provide an exchange deposit provided the purchase is completed within 90 days of the conveyancer receiving the funds from the LISA manager. If completion takes longer the conveyancer can ask for an extension.

The following table shows the main differences between the HTB ISA and the LISA

	HTB ISA	LISA
Eligibility	Minimum age 16, no maximum	18 to 40
Availability	Scheme ends 30 November 2019	No cut off date
Purpose	House purchase only	House purchase and/or retirement
Investment	Cash only	Cash/stocks and shares
Contribution	£200 a month plus £1,200 initial deposit	Maximum £4,000 a year
Bonus	25% of fund with a max of £3,000	25% of annual contribution from date started until age 50
Bonus paid	On completion	Monthly
Maximum fund	£12,000 before addition of bonus	None. Only limited by years of contributions
Maximum property value	£450,000 London/£250,00 elsewhere	£450,000
Transfers from ISA	No	Yes

Penalties	None but if not used for house purchase, no bonus paid.	20% of amount withdrawn in 20/21 unless used for first time house purchase

Taking benefits after 60

The fund can be taken in whole or in part after age 60 without a penalty. In comparison to a Personal Pension these are the main differences

	LISA	PP
Maximum individual contribution	£4,000 out of overall ISA limit of £20,000	Greater of £3,600 and 100% of NRE. Penalties if Total Pension Input of £40,000
Employer contribution	Not allowed	Allowed
Carry forward	No	Yes
Tax relief on contributions	No	Yes
Eligibility	Birth to 75	18 to 40 but can continue until 50
Minimum age to take benefits	55 (57 from 2027)	60
Tax on benefits	All tax free	25% PCLS, income taxed as recipient's income

Junior ISA (JISA) and Child Trust Fund (CTF)

- This is open to children aged under 18
- Before April 2016 if children qualified for a **Child Trust Fund (CTF)** they were ineligible for a JISA. However a CTF can be transferred into a JISA
- A CTF was available to children born between 1 September 2002 and 2 January 2011
- A Junior ISA can only be opened by a parent or legal guardian but other people may then contribute to it
- The maximum contribution to a JISA (and a CTF) is £9,000 for tax year 2020/21. Note that the JISA allowance is per tax year whereas the CTF is per plan year as the start date is the date of birth of the child.
- Unlike an adult ISA you can only have one provider (two if separate cash and equity) for the whole life of the plan
- Both have the same tax breaks as a standard ISA.
- Both can be in Investments or cash with no restrictions on the proportion held within each class
- In both cases there is no access to the fund until the child reaches 18. At that point it switches automatically into an adult ISA and becomes the child's property. The only exception to this is if the child dies or becomes terminally ill.
- One oddity of the ISA regime is that someone who is 16 or 17 can take out a cash ISA in their own name with a limit of £20,000 whilst their parents could also open up a

JISA for them. This would give them a total ISA contribution limit of £29,000. If the money for the cash ISA (not the Junior ISA) comes from the parents any income above £100 will be treated as the parents and be taxable