# AF1 Taxation of Investments 2022/2023
# Part 2: Individual Savings Accounts

ISAs are now a significant part of most investors' portfolios. The range of Individual Savings Accounts and their flexibility has evolved since its introduction in the late 90's which means that there is more to learn!

The milestones for this part are to understand:

- The main tax breaks of an ISA
- The main features of a "general" ISA
- The main features of a Lifetime ISA.
- What happens when an ISA investor dies including the use the APS
- The main features of a Junior ISA

ISAs are tax shelters that can be placed around certain assets resulting in income and gains being tax free.

There are three types of ISA.

- The "general" ISA which may also be called a New Individual Savings Account (NISA)
- The Lifetime ISA (LISA)
- A Junior ISA (JISA)

Since they are tax privileged investments both ISA providers and investors must comply with HMRC rules so questions in the exam will tend to focus on these.

## The general ISA

### Eligibility and Investment limits

An ISA can only be taken out in a single name. To be able to take out and contribute to a general ISA, an individual must be:

- UK tax resident, crown servant (or spouse or CP of one)
- Over 18 (or 16 if just investing cash)

- The maximum investment (also termed subscription) is £20,000 per tax year. This is on a use it or lose it basis.
- The £20,000 limit may be split in any proportion between three components:
    - Cash
    - Stocks & Shares
    - Innovative Finance

Investors can only have one ISA provider of each type in a tax year. Most banks and building societies only offer the cash component whereas investment companies only offer the stocks and shares component so investors can select different providers for each one.

Alice split her allowance for the current tax year £5,000 in a cash ISA with ABC bank and £15,000 in an equity ISA with PDQ investments. This is allowed but she cannot split her cash or equity ISA between two different providers. She can select different providers next tax year

On the other hand, using a platform enables an investor to hold different funds and managers in one single ISA.

Jeremy invested £20,000 in Gigantic platform's ISA. Within that he split his holding into five different funds each with a different manager that were offered on the platform.

Subscriptions can either be made by investing new money or by transferring non-ISA holdings. These would first have to be sold and the proceeds invested in an ISA.

Tom has about £50,000 in various unit trusts. He sells some of these raising £20,000 investing the proceeds into an ISA which uses his maximum subscription for that year. He can repeat this in subsequent tax years.

## The components in more detail

### Cash Component

The cash component gives interest free income and can be taken out by UK tax residents who are over 16 years old.

A subset of the cash component is the Help to Buy 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.

**Stocks and Shares component**

These can include directly held shares, including AIM shares, and bonds together with unit trusts, OEIC and ETF investing in these. Property funds including REITs can also be placed in an ISA. All interest and dividends are tax free and there is no CGT liability.

**Innovative Finance component (IFISA)**

This allows "Peer to Peer" lending platforms to offer their product within an ISA wrapper. Investors can only get the benefits of an ISA by investing into a new IFISA. Existing P2P products cannot be placed into an ISA. The investor would have to close the existing account, which may result in a closure penalty, and reinvest into a new IFISA.

## 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 per tax year which forms part of the overall £20,000 allowance. Apart from using the investor's own money an existing ISA, including an HTB one can be transferred but only up to £4,000 annual limit.

**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 if certain requirements are met.

The Government will add 25% to the money invested whether it is new money or a transfer.

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

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

Tara pays £300 a month into her LISA. The government adds £75 to each payment

**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 it to buy a house. She continues to fund the LISA to provide income in later life.

Whilst withdrawals can be made at any time a 25% charge is made unless:

- The investor is terminally ill (expected life expectancy of less than 12 months)
- It meets the criteria for first time purchase.
- The withdrawal is made after the investor's 60th birthday.

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|---|
| Gwyneth’s LISA fund has a value of £24,000. She wants to withdraw £8,400 but as there is a 25% penalty she must withdraw £11,200. (£11,200 @ 25% = £2,800 charge)<br><br>She would then have £12,800 remaining in her LISA |

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.

The LISA 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.

**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 but for a basic rate tax payer the bonus is equivalent to 20% tax relief | Yes. At highest individual rate. |
| Eligibility | 18 to 50 (40 for new plans) | Birth to 75 |

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|---|---|---|
| Minimum age to take benefits | 60 | 55 (57 from 2027) |
| Tax on benefits | All tax free | 25% PCLS, income taxed as recipient's income |

## ISA Post initial subscription

There are relatively few issues that investors need to worry about once the ISA has been set up. For example, the requirement to be UK resident only applies to new and additional investments but does not affect the status of an existing one.

Kumar had built up £30,000 in ISA investments. He then moved to the USA and became non-resident. Whilst he would be prohibited from making further investments, the ISA will retain its UK tax benefits and he will have no UK liability to tax any income or gains.

**Withdrawals and Transfers**

An ISA does not need to be held for a set period to retain its tax privileges. All withdrawals, including interest and dividend distributions paid directly to the holder are tax free (apart from the penalty charge on a LISA withdrawal) and can be made at any time although providers may impose an early withdrawal penalty.

If the provider has designated their product as a **Flexible ISA** it's possible to make a withdrawal and then replace it in the same tax year.

Keith invested the full £20,000 in a flexible cash ISA in May 2020. In August 2021 he withdraws £3,000. He can invest a further £3,000 by April 5 2022 bringing his total subscription back to £20,000.

If the ISA wasn't a flexible one he would have to wait until April 6 2022 to replace this.
Here's another example using a flexible ISA:

Rani has £12,000 in an ISA and withdraws £1,000. She can contribute another £9,000 this tax year to take her up to the maximum subscription.

**Transfers**

Providers must allow investors to transfer their ISA to another provider without losing its tax-free status (this is a transfer out) They are not obliged to accept transfers in. It is also possible to transfer a cash ISA to an Equity ISA and vice versa.

Josh has £40,000 in a cash ISA but is unhappy with the interest being paid so he transfers £30,000 into an equity ISA.

Lucy has £50,000 in an equity ISA and is concerned about current volatility. She transfers £20,000 into a cash ISA.

A transfer will not use up any of that year's allowance of £20,000 as it isn't a new contribution.

Care must be taken that it is a transfer and not a withdrawal. If the ISA is closed the ISA wrapper is removed 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 in the current tax year is £20,000

The rules on the amount that 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 the current tax year. 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 the current tax year he must transfer all of it. (any growth in the original subscription must also be transferred)

With the ISA from the previous years he can decide to transfer just part of it.

## Death of the investor

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 before 6 April 2018, the ISA wrapper was removed. The executors became liable for tax on any income received and CGT on any disposal whilst these were in the estate.

Kevin died in January 2018. He had substantial ISA investments in both Gilts and Equities. In April 2018 the executors receive a £1,500 interest payment from one of his Gilt unit trusts. They were liable for tax on this.

(More detailed information on the taxation of an estate can be found in Wills and Intestacy part of the Trust module)

If the investor dies 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 surviving spouse will notify the ISA provider of the death who will then designate it as a continuing ISA.

## Additional Permitted Subscription

If the investor died on or after 3 December 2014 a surviving spouse or civil partner gets an **Additional Permitted Subscription (APS)**. They inherit the deceased's ISA wrapper even if they don't inherit the underlying assets. This can be used alongside their own £20,000 annual allowance.

- To qualify as a surviving spouse or CP the couple must have been living together at the date of death. If the couple were separated under a court order, a deed of separation or the marriage/CP has broken down the survivor will not get an APS.
- The surviving spouse does not need to be UK resident to use the APS.

Dominique and Jim are non-resident. Whilst Jim was UK resident he had built up ISA holdings of £15,000. On his death Dominique gets an APS of £15,000. Even though she is non-resident she can open up an ISA and contribute up to the APS. She cannot use the annual exemption.

The amount of the APS depends on the date of death.

- **Death occurs before April 6 2018** the APS is the value of the deceased's assets at date of death.
- **Where death occurs on or after April 6 2018** the APS is the greater of:
  - The value of the assets at date of death
  - The value of the assets when they cease to be a continuing ISA.

Frank died in **January 2018**, Margaret would get an APS of £60,000. She could invest £60,000 plus the normal annual limit of £20,000. If the value increases to £65,000 before they are passed to her, the APS remains at £60,000

Frank died in **May 2018**. When the continuing ISA is closed in 2019 its value had increased to £66.000 so her APS would be £66,000. If the value had fallen to £58,000, her APS would be £60,000

The APS must be used within three years of death or if the estate is still in administration after three years, the APS entitlement will expire 180 days after the estate is wound up.

If there is more than one continuing ISA, a separate choice can be made for each.

Tom’s estate has two continuing ISAs. A had a value of £25,000 and B £20,000 at Tom’s death. When these are closed, A has a value of £27,000 and B £18,000. The APS is £47,000

## The practicalities of the APS.

An entitlement to an APS arises immediately on the spouse’s death, there is no need to wait until probate is granted or the estate to be wound up. The surviving spouse will also get the APS even if the ISA assets aren’t passed to him or her.

Judith died and left an ISA with £30,000 of various unit trusts to her daughter. She will inherit these as non-ISA assets, but Judith’s husband still gets an APS of £30,000.

In many instances the survivor won’t have available funds to use the APS until they become the owner of the assets when there are two alternatives: a **cash subscription** or an **in specie contribution.**

Henry has an APS of £90,000. He also inherited the underlying assets which were mainly in Gilt and Corporate Bond funds. He decides to sell them all using the proceeds to invest in a new ISA. This would be classed as a **cash subscription** and must be done within three years from his wife’s date of death.

He can select a different manager from his late wife. He can also decide to invest in different funds or place it in a cash, or innovative finance ISA as he wishes. He could also invest in a Lifetime ISA provided he has or qualifies for one. The maximum contribution will still be £4,000 for each tax year.

Alternatively, he could transfer the assets directly to a new ISA but this must be with the same manager used by the deceased spouse. The manager must also agree to this. This is an **in-specie contribution** and Henry has 180 days from becoming owner of the assets to do this. Once the assets are transferred he could transfer them to different funds.

Once the survivor has made an investment using the cash subscription method any further investments must be with the same manager. This is because the responsibility of checking the survivor doesn’t go above the APS falls on the receiving manager. There is no need to use all the APS in one go but remember that the entitlement ends three years after the deceased’s date of death.

Henry decides to use the cash contribution method. On July 1 2019 he invests £25,000 into a new ISA with Planet fund managers. On June 1 2020 he decides to invest the remaining £65,000 of his APS. This must be with Planet.

Both cash and in-specie contributions using the APS are treated as being paid in the previous tax year. This avoids breaching the “only one ISA provider of each type in a tax year” for new subscriptions. It also means it’s permissible to transfer **part** of the ISA to a different provider in the current year.

Susan put £20,000 into an equity ISA with Growfast investments on April 10 2019. She also has an APS of £42,000 and arranged an in specie contribution to her late husband's ISA manager, Neverfall managers on September 1 2019. Making two subscriptions to different managers in the same tax year is not normally allowed but an APS is treated as being paid in 2018/2019 so it is allowed.

She decides to transfer £10,000 of the Neverfall holding on January 4 2020 it to another provider and this is permitted.

The previous example illustrated that it's possible to Individuals with an APS to make a contribution using the standard annual allowance and the APS in the same tax year. There is no requirement to use the annual subscription ahead of the APS but in practice it is better to do this as it lapses at the end of the tax year whereas there are normally three years to use the APS. It is important that the investor makes it clear whether the annual allowance or the APS is being used.

Whilst the APS can be used before the estate is distributed this can lead to complications.

Maisie's husband's ISA had a value of £40,000 on his death. His executors designate this as a continuing ISA.

Two months later the estate hasn't been distributed and Masie invests £25,000 using her own savings electing to use her APS.

Five months after her husband's death the estate is wound up and the value of the ISA has increased to £42,000. As a result of the £25,000 contribution the APS is £40,000 rather than £42,000

On the other hand if money is withdrawn from a continuing ISA **before the survivor uses the APS**, the original amount of APS remains intact.

Tova's husband died with a cash ISA of £30,000 in May 2019. The executors decided to keep this open as a continuing ISA. The executors withdrew £5,000 to pay for the funeral expenses three weeks after his death. On September 1 2019 the ISA is closed with a value of £25,050. Her APS is £30,000

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

A Junior ISA is available to children under 18 who have not got a **Child Trust Fund (CTF)**. This was given automatically to children born between 1 September 2002 and 2 January 2011. Whilst CTFs are no longer available, they can continue but they can be transferred into a JISA. The tax rules, with one minor exception, are the same for both.

A JISA 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 child's date of birth.

Unlike an adult ISA you can only have one provider (two if separate cash and equity) for the whole life of the plan although it can be transferred to another provider.

They have the same tax breaks as a standard ISA and if the capital came from a parent they are exempt from the £100 parental income rule. Investments can be in cash or equities with no restrictions on the proportion held within each class

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 a JISA for them. This would give them a total ISA contribution limit of £29,000.

HMRC take the view that to get the tax breaks the money must come from a 16/17 year old's income or savings. If the money for the cash ISA (not the Junior ISA) comes from the parents it will fall under the parental income rule and any income above £100 will be taxed and treated as the parent's income.

If is not clear whether HMRC will allow it's tax privileges if it comes from anyone else such as grandparents. At current interest rates it's unlikely that the interest will be above the child's personal allowance

That concludes this part so you should now understand:

- The main tax breaks of an ISA
- The main features of a "general" ISA
- The main features of a Lifetime ISA.
- What happens when an ISA investor dies including the use the APS
- The main features of a Junior ISA

Further reading

https://www.gov.uk/individual-savings-accounts
https://www.helptobuy.gov.uk/help-to-buy-isa/how-does-it-work/

https://www.gov.uk/lifetime-isa