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Leading on Investments and Savings

Guide to ISAs

What is an ISA?

An ISA is somewhere you can save money without having to pay tax on it - your Individual Savings Account. You can build up savings as cash, like in a bank account, or if you are open to a little more risk, you can invest your money on the stock market or in peer to peer loans.

When you put your money in an ISA you don't have to tell the taxman, and you won't pay any income tax on it, or any capital gains tax either. So, for example you won't pay tax on any interest that you earn, or on any shares that are sold. There are limits on how much you can save though. They change from year to year, but in 2018/19 you can put in up to £20,000.

There are different types of ISA - a cash ISA, a stocks and shares ISA, a Help to Buy: ISA, a Lifetime ISA, and an innovative finance ISA. More on these options later, but you can't put money into more than one ISA of the same type in a single year.

The Different Types of ISA

Cash ISA → This is usually a savings account at a bank or building society, so as you might expect, you can choose whether or not to have a fixed interest rate, or one that can go up or down, and how much access you need to your savings. The most important thing to note though, is that the interest is paid free of any tax.

There is also a special kind of cash ISA called a Help to Buy: ISA, which is for people saving for the deposit to buy their first home. You can put in up to £1,000 to start with, then up to £200 per month, and the Government will boost that by 25% when you buy your first home (only available for new applications until November 2019).

Stocks & Shares ISAs → These ISAs allow you to put your money into a wide variety of investments on the stock market. You can get one through various firms such as a bank, or a wealth manager, stockbroker, fund manager, or fund platform. The key point about stock market investments is that their value can go down as well as up, so they are for people who don't mind taking some risks. But if you are prepared to invest for five years or more, and don't mind a degree of risk, the returns have tended to be significantly higher than cash savings.

Innovative Finance ISAs → This sort of ISA is for investing in what are called 'peer to peer' (P2P) loans, something that is relatively new in the UK. What a P2P loan does is to use a firm to match together full or partial loan amounts for people who want to borrow money and people who want to make a gain by lending it to them. People using an ISA to do this can choose different levels of risk and returns, and usually these are higher than for cash savings.

Lifetime ISAs → This latest type of ISA helps you to start saving/investing towards your first home or for your later life (age 60+). The benefit is that you get a 25% bonus from the Government each time you pay into your Lifetime ISA. But if you take money out for anything other than buying your first home, your retirement, or in the event of terminal illness or death, the government will charge you 25%, (which works out at 33% on the money withdrawn) so these ISAs are not for people looking to make withdrawals. There are two additional restrictions which apply to Lifetime ISAs - you can only open one up to the age of 40 yrs and the annual subscription limit is £4,000.

Transferring an ISA

You can transfer any type of ISA to any other type, even if it is with a different ISA provider. However transfers to and from Lifetime ISAs can be more complicated because of the annual Lifetime ISA limit of £4000 and a 25% withdrawal charge that you would have to pay should you transfer your Lifetime ISA to either a cash, stocks & shares or innovative finance ISA. If you want to transfer to another ISA provider, you need to ask your new provider to do that - it isn't something you can do yourself just by cancelling one ISA and starting another.

ISA withdrawals and flexible ISAs

All types of ISA, apart from innovative finance ISAs, must allow you to withdraw your money when you want to. Some ISA providers (particularly cash ISAs with fixed interest rates) may make a charge on early withdrawal and, as already mentioned, there will be a charge for taking money out of a Lifetime ISA if it isn't for an allowable purpose.

From 6 April 2016, ISA managers had the option of making their ISAs flexible by adding flexibility to the ISA terms & conditions. Where an ISA is flexible you can withdraw money and put it back again in the same tax year without it counting towards that years maximum allowed saving/investment.

It is worth noting that not all ISAs include such flexibility in their terms & conditions meaning that any payments you make into your non-flexible ISA following a withdrawal would still be treated as a new payment.

ISAs at death

Since April 2018, the benefits of an ISA don't stop if you die. Now they will continue for 3 years or until your estate has been finalised.

If you were to die, leaving a surviving spouse or civil partner, they will be allowed to contribute an additional amount into their own ISA on top of their normal allowance, depending on the value of the estate.