tisa

Leading on Investments and Savings

Individual Savings Accounts (ISAs)
A Technical Introduction

October 2018

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1 ISA Legislation

The primary legislation is contained in the Income Tax (Trading & Other Income) Act 2005, the Taxation of Chargeable Gains Act 2992 and the Finance Act 1998 which, between them, give HM Treasury certain powers to make regulations concerning the running of ISAs.

The detail is set out in secondary legislation in the form of Statutory Instruments (SIs) which are laid before the House of Commons by HM Treasury, as required. These consist of the principal regulations issued in 1998, as amended from time to time.

	Parliament	Passes the Acts
	↓	
Primary legislation	ITTOIA 2005, TCGA 1992 & Finance Act 1998	Establishes the powers
	↓	
	HM Treasury	Recipient of the powers from the Act
	↓	
Secondary legislation	Statutory Instruments	Detailed ISA regulations
	↓	
	HM Revenue & Customs	Recipient of powers from the Regulations
	↓	
	ISA Managers	Manage accounts under the ISA Regulations
	↓	
	Investor	Has beneficial ownership (or receive the benefits) of the held investments held in his/her account

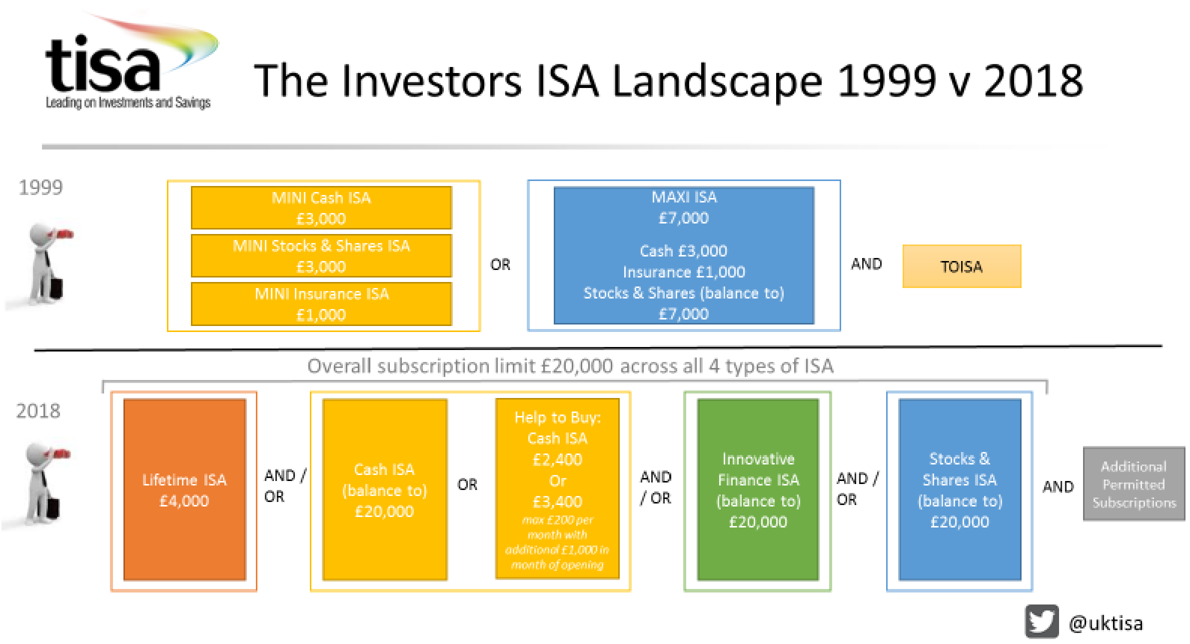
2 History of ISAs

ISAs were originally launched on 6 April 1999 to replace the previous tax incentivised schemes, Personal Equity Plans (PEPs) and Tax Exempt Special Savings Accounts (TESSAs) although PEPs remained in force and subscriptions could continue to be made to previously opened TESSAs for a further five years. The capital investment into TESSAs could, within six months of maturity, be rolled over into a cash ISA (often referred to as TESSA only ISAs or TOISAs).

ISAs were initially available to individuals who were over 18 years of age and the annual subscription limit was £7,000 which could be invested in up to three ISA components. The three components consisted of stocks & shares, cash and insurance. The rules were complicated further by the creation of two ISA types being the MAXI and MINI ISA. Investors were permitted to subscribe to one MAXI ISA or up to three different MINI ISAs in any given tax year. The MAXI ISA could include any combination of a stocks & shares, cash, or insurance element, although in practice nearly all MAXI ISAs included only a stocks & shares element, whilst MINI ISAs were set up as either MINI stocks & shares, MINI cash or MINI insurance ISAs.

After further changes to the ISA regulations in 2005, when the MINI insurance ISA was dropped, the ISA scheme was simplified further in 2008 when the MINI and MAXI labels were dropped, PEPs were automatically converted into stocks & shares ISAs which resulted in two ISA types going forward, a stocks & shares and a cash ISA.
Since 2008, there have been further changes to the ISA regulations introducing in April 2015 a new ISA allowance for individuals whose deceased spouse/civil partner held an ISA at death (referred to as additional permitted subscriptions), in December 2015 a Help to Buy: ISA (a special kind of cash ISA), in April 2016 an innovative finance ISA and in April 2017 a lifetime ISA.

The overall annual ISA limit has also increased steadily over the years from £7,000 to £20,000. The various ISA types are explained in more detail below. The below chart compares the ISA types and subscription limits in 1999, when the ISA scheme was launched and today (in the 2018/19 tax year).



3 Types of ISAs and ISA subscription limits

There are now four separate ISA types being a cash, a stocks & shares, an innovative finance and a lifetime. There is also a Help to Buy: ISA which is not a separate ISA but a special kind of cash ISA where the cash ISA manager must adhere to additional Help to Buy: ISA scheme rules. As outlined in the chart above, the overall subscription limit (2018/19) to all ISA types in any one tax year is £20,000 with investors permitted to subscribe to one ISA of each type per tax year. It is important to note that the annual ISA allowance doesn't roll over into a new tax year meaning that any unused ISA allowance on the last day of the tax year (5 April) will be lost.

An individual could choose to the subscribe the full £20,000 to a cash ISA, a stocks & shares ISA or an innovative finance ISA. If the full £20,000 was subscribed to a cash ISA for example, the individual would not be eligible to subscribe to any other ISA type in that tax year. An individual could also, for example, mix and match and subscribe to the following ISAs in the 2018/19 tax year:

- Cash ISA - £5,000
- Stocks & shares ISA - £6,000
- Innovative finance ISA - £5,000
- Lifetime ISA - £4,000

The key point is that an individual should never subscribe to more than one ISA type and not more than £20,000 in total across all ISA types in any one tax year. Individuals could have subscribed significant sums to ISAs since their inception in 1999, including subscriptions to PEPs since 1987, which were effectively rebranded as stocks & shares ISAs in 2008. The table below shows the total amounts that could have been subscribed to ISAs.

Year	PEP AUT(1)	PEP AUT(2)	PEP TOTAL	SCP	ISA	Subscription years
1987	£420	£900	£2,400			Calendar Years
1988	£540	£750	£3,000			
1989	£540	£750	£3,000			
1989/90	£2,400	£2,400	£4,800			Tax Years
1990/91	£3,000	£3,000	£6,000			
1991/92	£3,000	£3,000	£6,000	£3,000		
1992/93	£6,000	£6,000	£6,000	£3,000		
1993/94	£6,000	£6,000	£6,000	£3,000		
1994/95	£6,000	£6,000	£6,000	£3,000		
1995/96	£6,000	£6,000	£6,000	£3,000		
1996/97	£6,000	£6,000	£6,000	£3,000		
1997/98	£6,000	£6,000	£6,000	£3,000		
1998/99	£6,000	£6,000	£6,000	£3,000		
1999/00					£7,000	
2000/01					£7,000	
2001/02					£7,000	
2002/03					£7,000	
2003/04					£7,000	
2004/05					£7,000	
2005/06					£7,000	
2006/07					£7,000	
2007/08					£7,000	If born before 6/4/50
2008/09					£7,200	
2009/10					£7,200	£10,200
2010/11					£10,200	
2011/12					£10,680	
2012/13					£11,280	
2013/14					£11,520	
2014/15					£15,000	
2015/16					£15,240	
2016/17					£15,240	
2017/18					£20,000	
	£51,900	£52,500	£67,200	£24,000	£186,560	£189,560

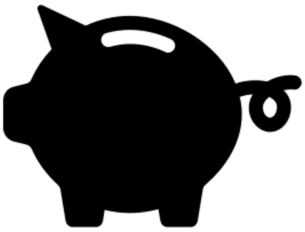
2014/15 subscription limit raised mid-year (from 1 July 2014)

Equity PEP (incl SCP) + ISA =	**£277,760**	**£280,760**
AUT only (PEP & ISA) =	£238,460	£241,460

AUT(1) = Maximum subscription to unit trusts if no other subscription made
AUT(2) = Maximum subscription to unit trusts if full subscription made

In addition to the annual ISA allowance, where an individual dies whilst holding an ISA at the time of death, the deceased's surviving spouse/civil partner will receive an extra ISA allowance, which they could subscribe to their own ISA, which is approximately the value of the ISA belonging to the deceased at the time of death. This will be covered in more detail later in this guide.

4 Cash ISAs



There were almost eight and a half million cash ISAs subscribed to in the 2016/17 tax year. The average subscription to each account in this tax year was £4,622 which is obviously well below the permitted £20,000 annual allowance.

Cash ISAs are generally deemed appropriate for short term savings objectives but not for longer term savings and are available to UK residents over the age of 16 (although some cash ISA managers do still stipulate a minimum age of 18).

The clear majority of cash ISAs are held in deposit accounts with UK banks and building societies and are typically held in variable rate, fixed rate, instant/easy access or regular saver accounts but the following investments also qualify to be held in a cash ISA:

- Deposit accounts with credit unions
- Alternative finance arrangements (often referred to as Sharia compliant products)
- FCA authorised money market and short-term money market funds
- National Savings & Investments (NS&I)

Cash ISAs pay gross interest which is tax free and this interest does not count towards an individual’s Personal Savings Allowance (PSA) which was introduced 6 April 2016. When funds are held in a non-ISA accounts, any interest received which exceeds the accountholder’s PSA is liable to tax. Basic-rate taxpayers would have to pay 20% tax on interest above their £1,000 PSA. For higher-rate taxpayers, it's 40% tax above their £500 PSA and for additional-rate taxpayers, it's 45% tax on all savings interest as these taxpayers are not entitled to a PSA.

Savers’ money is protected by the Financial Services Compensation Scheme (FSCS) which protects the first £85,000 of a saver’s funds should the deposit taker (bank, building society) default and be unable to return the saver’s funds. This is an extremely rare occurrence.

5 Help to Buy: ISAs

These are a special type of cash ISA which have been available since 1 December 2015. They were designed to encourage first-time buyers to save for a deposit on a first home with the help of a government bonus. Cash ISA managers that wish to offer a Help to Buy: ISA must sign up and adhere to the Help to Buy: ISA scheme rules.

Savers are permitted to save a maximum of £200 per month along with an initial maximum deposit of £1,000. This permits a maximum subscription of £3,400 in the first year of opening followed by a maximum of £2,400 per year in subsequent years. Although a special kind of cash ISA, unlike other cash ISAs where individuals can subscribe to different ISAs in different tax years, an individual is only eligible to hold one Help to Buy: ISA (although transfers can be made to other Help to Buy: ISAs).

There is a government bonus payable of 25% of the amount held in the account, payable at the time of purchase, although savers must have at least £1,600 in the account (meaning a £400 minimum bonus) and a maximum of £12,000 (meaning a £3,000 maximum bonus).
Help to Buy: ISAs can be opened from age 16, subject to an individual provider’s terms & conditions, and savers must declare that they are a first-time buyer. This definition states that they don’t already own or have ever owned a residential property anywhere in the world (regardless of whether the property was purchased or inherited).

The bonus can be claimed providing the purchase price of the property is under £250,000 (or £450,000 in London). The property doesn’t need to be a new-build but individuals do need to take out a mortgage to qualify for the bonus meaning the bonus is not available for cash buyers. Help to Buy: ISA customers can purchase the property on a joint basis but there is no requirement for other purchasers to be first time buyers.

It is important to note that the government bonus is only payable at the time of completion and not at the point that contracts are exchanged. Where the purchaser is required to pay the vendor an exchange deposit, the bonus can’t be claimed at this point. It is the mortgage deposit (the deposit required at the point of completion) that the bonus goes towards. This approach is to help ensure that the government bonus is only paid when the property purchase completes.
It is also important to note that there is no necessity to have to use a Help to Buy: ISA to help towards a first property purchase. It is just a normal cash ISA which permits withdrawals to be made at any time without penalty, unlike the lifetime ISA which will be discussed later in this guide. A Help to Buy: ISA can also be transferred into a lifetime ISA but the amount transferred will count towards the £4,000 annual lifetime ISA limit.

6 Stocks & Shares ISAs

There were over two and a half million stocks & shares ISAs subscribed to in the 2016/17 tax year which is significantly fewer than the number of cash ISAs subscribed to. The average subscription to each account in this tax year was £8,623 which is still well below the permitted £20,000 annual allowance but almost double the average subscription to a cash ISA in the same period.

Stocks & shares ISAs can be opened with numerous types of ISA provider including banks, stockbrokers, insurance companies and various types of investment platforms and can be opened with or without advice being provided to the investor. Stocks & shares ISAs are available to UK residents from the age of 18.

Due to the nature of the investments held within this type of ISA, it is generally recommended that stocks & shares ISAs shouldn't be utilised for short term savings and should be held for the medium to long term (which is usually accepted as being more than five years).

There are a wide range of investments that currently qualify to be held in a stocks & shares ISA including:

- Shares in companies (including ordinary and preference shares)
- Securities in companies (often referred to as corporate bonds or bonds, debentures, loan notes or loan stock)
- Government securities including UK Gilt Edged Securities (GILTS)
- UK investment trusts
- UK funds authorised by the Financial Conduct Authority (FCA). Funds are a kind of collective investment scheme and UK funds are governed by the FCA's Collective Investment Scheme Sourcebook (COLL).
- European domiciled (registered) funds recognised for sale in the UK by the FCA
- Other domiciled funds (including Jersey, Guernsey and Isle of Man)
- Qualifying life insurance policies (offered by a small number of insurance companies and friendly societies)

The above investments could result in an ISA investor receiving different types of income into their ISA depending on the actual investments held. This could include dividends, interest and property income. The ISA protects the investor from any UK income tax on such income meaning that income is effectively tax free but, where non-UK assets are held in a stocks & shares ISA, there is the possibility that some kind of overseas tax may be due (although ISA managers may, in some cases, be able to reclaim such tax from the overseas country).

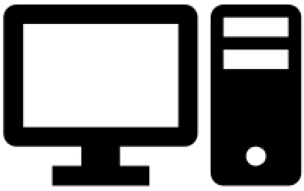
The other key tax benefit of a stocks & shares ISA is that there will be no potential capital gains tax (CGT) where investments are disposed of (sold) within the ISA. Dividend income received within a stocks & shares ISA doesn't count towards an individual's Personal Dividend Allowance (introduced 6 April 2016). The current dividend allowance is £2,000 for all taxpayers and dividend income received outside of an ISA (or pension) is charged at 7.5% on dividend income within the basic rate band, 32.5% on dividend income within the higher rate band and 38.1% on dividend income within the additional rate band. Like cash ISAs, interest payments received within a stocks & shares ISA do not count towards an individual's PSA.

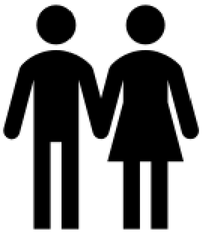
It should be noted that the above assets are not risk free and, as often stated in the small print of advertisements for such investments, the value of investments can go up as well as down. To reduce the risk and take advantage of fluctuations in asset values, many stocks & shares ISA managers permit ISA subscriptions to be made on a monthly basis rather than investors making a single lump sum investment. This approach, sometimes referred to as pound cost averaging, can smooth out some of the price fluctuations as more investments are purchased in those months when values fall resulting in investors potentially holding more investments at the end of the tax year than if they had invested a single lump sum.

Employees who have received shares through their company's Save as You Earn (SAYE) scheme or Share Incentive plan (SIP) are permitted to transfer such shares directly into a stocks & shares ISA (where permitted by the ISA manager). Such transfers still count towards the individual's annual ISA allowance.

Stocks & shares ISAs can have a variety of charges attached and it is important that investors are aware of these. Charges can include platform charges, transfers charges, annual management charges, exit charges, various types of dealing charges and other administrative charges.

7 Innovative Finance (IF) ISAs





This was a new ISA type introduced by the government on 6 April 2016 following a lengthy consultation with the industry. It permits two key investment types to be held, namely peer to peer loans and debentures (a type of bond). In the first tax year of this new ISA (2016/17), there were approximately 2,000 accounts subscribed to with a total of approximately £17 million subscribed. This equated to an average subscription of approximately £8,500.

Most of the currently available IF ISAs are offered by peer to peer platforms. There are several large providers in the market and many smaller providers with many others authorised by HMRC yet to physically launch their IF ISA products into the market. It is expected that the number of IF ISAs in the market will have risen significantly during the 2017/18 tax year and will continue to do so in subsequent tax years.

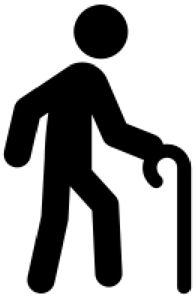
Peer to peer loans are still a relatively new phenomenon in the savings and investment world. In simple terms, these platforms match together individual borrowers or companies with individual savers typically looking for a home for their money where they will receive interest that exceeds that which can be typically achieved in deposit-based savings.

As with cash ISAs, the interest received within an IF ISA is tax free and doesn’t count towards an individual’s PSA.
This type of ISA is often positioned as being somewhere between a cash ISA and a stocks & shares

ISA on the risk scale. The obvious risk is that the money won’t be repaid by the borrower but peer to peer platforms do have various ways of structuring their products which mitigates or minimises this risk.

Although IF ISA managers are FCA authorised firms, savers’ money is not guaranteed by the Financial Services Compensation Scheme (FSCS) so the first £85,000 of savings are not protected as they would be if held in a deposit-based cash ISA.

8 Lifetime ISAs

The Lifetime ISA was launched on 6 April 2017 with the dual purpose of encouraging saving towards either the purchase of a first home or retirement. As with the Help to Buy: ISA, there is a government bonus available so there is some level of conflict with the Help to Buy: ISA and the pros and cons of the two ISAs will be summarised later.

The Lifetime ISA is a special ISA that permits a maximum subscription of £4,000 per year. The investments that can be offered are any of those currently permitted in cash and stocks & shares ISAs. The tax benefits are the same as for cash or stocks & shares ISAs, depending on the specific investments held. Although Lifetime ISAs are not officially split into cash Lifetime ISAs and stocks & shares Lifetime ISAs, this is effectively what they are in practice. So, a Lifetime ISA offered by a cash ISA provider for example is, in practical terms, a cash Lifetime ISA.

Lifetime ISAs can be opened by anyone who is over 18 but under the age of 40 at the time of application. Once opened, subscriptions can be made until the individual reaches 50. Like other ISA types, an individual is eligible to subscribe to different Lifetime ISAs in separate tax years.

Government Bonus

The government bonus of 25% is due on the amount paid (excluding growth/income) into the ISA so with a maximum annual payment of £4,000, the maximum government bonus will be £1,000 per tax year. The bonus was paid in May 2018 for those who opened a lifetime ISA in the 2017/18 tax year but will be paid monthly from 6 April 2018 (where payments were received during that month). So, unlike the Help to Buy: ISA, where the government bonus is only payable on completion, the lifetime ISA bonus is payable within a month and must be paid into the ISA meaning the investor starts to benefit immediately from any potential growth/income.

Withdrawals can be made without charge in the following circumstances:

- First time residential property purchase
- From age 60
- Death
- Terminal illness

Withdrawal Charge

Withdrawals for any other reason will incur a 25% withdrawal charge, payable by the Lifetime ISA manager to HM Revenue & Customs (HMRC). The obvious thought is that the 25% withdrawal charge simply reimburses the 25% government bonus but that isn't the case. The government bonus is payable on the net lifetime ISA payment whereas the 25% withdrawal charge is levied on the gross amount withdrawn. So, where an individual has paid in the maximum £4,000, they would receive a government bonus of £1,000 (25% of £4,000) resulting in a total balance of £5,000 (ignoring growth and income). If this balance was fully withdrawn, the withdrawal charge would be £1,250 (25% of £5,000) resulting in only £3,750 being paid out to the investor.

First Time Property Purchase

It is important to note that a charge free withdrawal for property purchase can only be made once the Lifetime ISA has been open for at least 12 months. Where an individual has multiple Lifetime ISAs, the 12 month applies to each lifetime ISA. The rule doesn't apply to individual Lifetime ISA payments so for example, an individual could have opened a Lifetime ISA with a minimal payment of say £100 on 1 June 2017 followed by a subsequent payment of £4,000 on 1 May 2018. In this scenario, the total amount of £4,100 plus the government bonus can be withdrawn without charge from 1 June 2018.

As with the Help to Buy: ISA, individuals must never have owned a residential property anywhere in the world (regardless of whether the property was purchased or inherited).
When making a withdrawal for first-time property purchase, the total property price must be no more than £450,000 and must be purchased with a mortgage (meaning cash buyers would not be eligible). The property can be purchased jointly and there is no requirement for other purchasers to be first time buyers. Where there are joint purchasers, and both are Lifetime ISA holders, the property price must still not exceed £450,000. (this does not therefore permit a total purchase price of £900,000).

Lifetime ISAs V Help to Buy: ISAs?

It is permissible to open and subscribe to both a Help to Buy: ISA and a lifetime ISA at the same time.

The interaction of the two ISAs can be quite complex, but the key point is that an individual would not be eligible for the government bonus on both ISAs if used towards a first-time property purchase. Where an individual holds both a lifetime ISA and a Help to Buy: ISA they could:

- Transfer their Help to Buy: ISA to a lifetime ISA then use for either first home purchase and/or retirement
- Use their Help to Buy: ISA (including government bonus) to purchase their first home and use the lifetime ISA to save for retirement
- Use their lifetime ISA (including government bonus) to purchase their first home and withdraw funds from their Help to Buy: ISA (without govt. bonus) to put towards purchase

- Use their Help to Buy: ISA (including government bonus) to purchase their first home and withdraw funds from their lifetime ISA to put towards purchase (incurring the 25% withdrawal charge)

There has been much discussion about the best choice of ISA for those wishing to save for a first-time house purchase. There are pros and cons to both ISAs and the table below provides a comparison of the key features.

Feature	Help to Buy: ISA	Lifetime ISA
Opening Age	**16**	18
Annual Subscription	£2,400 (£3,400 in first year)	**£4,000**
Number of Accounts Allowed	1	**Multiple (in different tax years)**
ISA Restrictions	No other cash ISA	**None**
Investment Options	Cash	**Cash or Stocks & Shares**
Holding Period	**3 months**	12 months (per Lifetime ISA)
House Price	Max £250,000 (Max £450,000 in London)	**£450,000**
Bonus Payment	Claim post withdrawal	**Paid monthly to Lifetime ISA**
Minimum Bonus	£1,600	**None**
Maximum Bonus	£3,000	**None**
Withdrawal Penalty	**None**	25% (gross value 33%)

Retirement (Age 60)

In addition to withdrawals made for first time property purchase, the other key reason for opening a lifetime ISA is to help save towards retirement. Withdrawals (full or partial) can be made charge free at any point after the age of 60 for any reason. After age 60, a lifetime ISA can continue indefinitely and effectively becomes the same as any other ISA (except no further subscriptions can be made after the age of 50).

The obvious question is whether a lifetime ISA or pension is more advantageous when saving towards retirement. There is no easy answer to this and it will depend on many factors including an individual's tax status, the age they want to retire and whether they are eligible for any type of company pension scheme with employer contributions.

The tax treatment of a registered pension scheme and a lifetime ISA are effectively the same, but there are key differences on the tax implications at the point of contribution and withdrawal. Pension contributions receive tax relief at source whereas the subsequent pension income received in retirement (excluding any available tax fee lump sum) is liable to income tax. ISA subscriptions, in contrast, are paid out of taxed income meaning there is no tax relief at this point however, all withdrawals after the age of 60 are tax free.

There are many other factors involved and it is not possible to provide a blanket answer however, most of the expert opinion to date suggests that, in most cases, the pension is the more appropriate product where retirement planning is the overriding goal especially where there is an eligible company pension that includes employer contributions.

9 Making Withdrawals from an ISA

Investors have the right to withdraw their funds or investments on request to their ISA manager. Some ISA providers don't permit partial withdraws and innovative finance ISA managers are permitted under the ISA rules to stipulate whatever withdrawal terms they wish.

Many ISAs, particularly stocks & shares ISAs, include the option for the investor to have the ISA income paid out directly to them. This interest could be in the form of interest, dividends or even property income depending on the type of investments held within the ISA.

It is permissible to make a withdrawal from a stocks & shares ISA by transferring the assets directly to the investor rather than selling the investments and paying the cash out to the investor. In such scenarios the ISA manager should provide the investor with the market value of the assets at the date of withdrawal. The appropriate method of calculation should be used depending on the type of assets being withdrawn. Such a process is often referred to as an in-specie transfer.

Where an ISA does not include flexibility in its terms & conditions, any withdrawals do not affect the annual ISA subscription limit. An individual who has already subscribed the maximum £20,000 for example in the 2018/19 tax year can make no further subscriptions to the ISA regardless of any withdrawals. In this scenario, the withdrawn amounts cannot be replaced.

Flexible ISA Withdrawals

Since 6 April 2016 it has been permissible, albeit not mandatory, for ISA providers to add flexibility to their ISA terms & conditions. These ISAs are generally referred to as flexible ISAs. A flexible ISA is an ISA whose terms & conditions allow the ISA investor to replace, in whole or in part, cash they have withdrawn, without the replacement counting towards their annual ISA subscription limit. Where a withdrawal is made from a flexible ISA, any subsequent subscriptions in the same tax year that would otherwise count towards the ISA subscription limit will do so only to the extent that previously withdrawn amounts have been fully replaced.

Only cash withdrawn from a flexible ISA can be treated as a withdrawal and subsequently replaced. Investments transferred out of an ISA to the investor therefore cannot be replaced under the flexibility rules. Flexibility can be offered in respect of cash, stocks & shares and innovative finance ISAs. Due to the restricted opportunities for making charge free withdrawals from a Lifetime ISA, flexibility cannot be offered with a Lifetime ISA. It is also not available within the scheme rules of the Help to Buy: ISA.

There are no limits as to the amounts that can be withdrawn and replaced within a flexible ISA. It is not uncommon to see stocks & shares ISA clients with funds and assets to the value of £1 million held within their ISA meaning that such clients could make a cash withdrawal of £1 million from a flexible ISA and replace the full amount before the end of the tax year.

It is up to the ISA provider to track payments and withdrawals into a flexible ISA.

Examples of flexible ISA withdrawals and subscriptions are provided on the following page:

Flexible ISA withdrawal example 1:

10 April 2018	*£20,000 subscription to a flexible stocks & shares ISA*
1 August 2018	*£15,000 withdrawal*
1 November 2018	*£10,000 replacement*
1 April 2019	*£5,000 replacement*

In this example, the investor is fully subscribed in the 2018/19 tax year and has fully replaced the £15,000 withdrawn from the ISA on 1 August 2018.

Flexible ISA withdrawal example 2:

6 April 2018	*£15,000 subscription to a flexible stocks & shares ISA*
1 July 2018	*£5,000 withdrawal*
1 November 2018	*£5,000 withdrawal*
1 March 2019	*£8,000 replacement*

In this example, the investor has made a 'net' subscription of £13,000 in the 2018/19 tax year.

Where a withdrawal of current year subscriptions is made, this then increases the investor's available headroom to other ISA types.

Flexible ISA withdrawal example 3:

6 April 2018	*£15,000 subscription to a flexible cash ISA* *Available ISA headroom for other ISAs = £5,000*
1 July 2018	*£5,000 withdrawal* *Available ISA headroom for other ISAs = £10,000*
1 December 2018	*£10,000 subscription to a stocks & shares ISA*

In this example, the investor has made a current year subscription of £15,000 followed by a withdrawal of £5,000. This results in a net subscription of £10,000 into the cash ISA meaning the investor has increased their available ISA headroom from £5,000 to £10,000 permitting them to make a £10,000 subscription to a stocks & shares ISA. Prior to the withdrawal the investor would only have been able to subscribe £5,000 to a stocks & shares ISA. The investor has now subscribed their full £20,000 ISA allowance in the 2018/19 tax year.

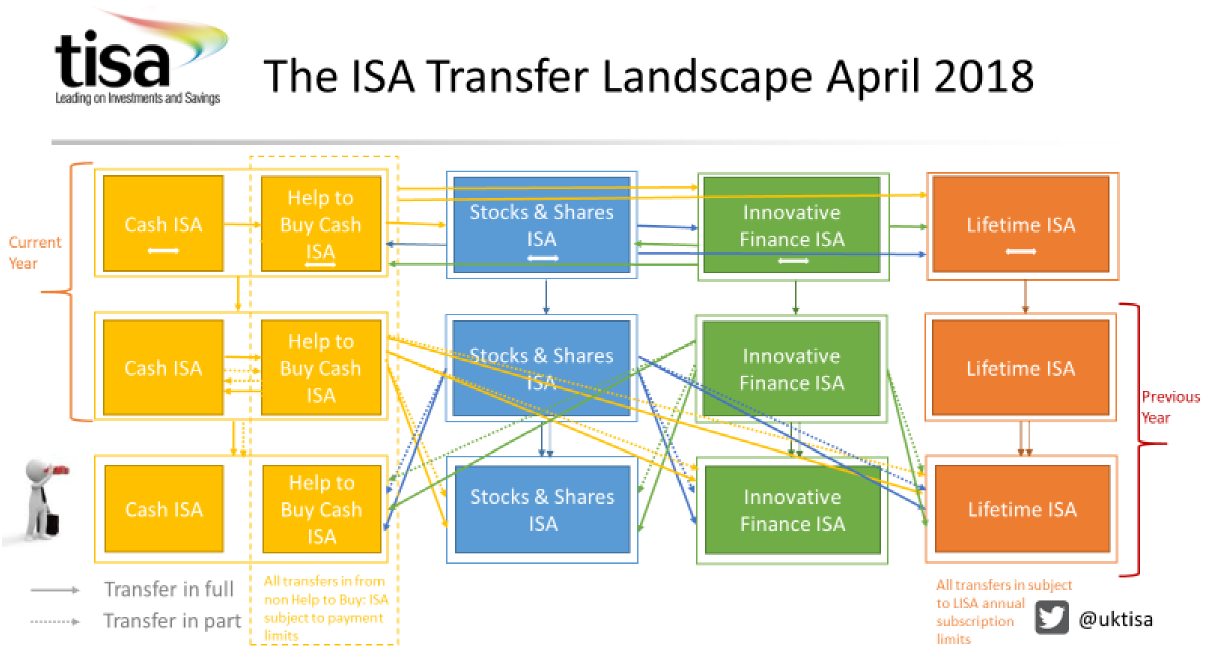
So, the withdrawal of current year subscriptions effectively permits the withdrawn funds to be subscribed to a different ISA type in the same tax year.

10 ISA Transfers

ISA investors have the right to transfer their ISA whenever they want, and this right must be included in the manager's ISA terms & conditions. Some ISAs terms & conditions state that any transfer out must be a transfer of the whole ISA, so investors may want to check the terms & conditions of their own ISA. The majority of ISA managers do permit partial ISA transfers out.

The exception to the above rule is for peer to peer loans and/or debentures held in innovative finance ISAs. Due to the illiquid nature of such investments, the government permits innovative finance ISA managers to stipulate whatever terms & conditions they wish for these investments. The rules do apply however to cash that is held in an innovative finance ISA.

There is now total flexibility regarding ISA transfers meaning that any ISA type can be transferred to any other ISA type. Previous ISA regulations were far more restrictive.



Don't Self Transfer!

It is vitally important to note that investors should never attempt to transfer their ISA themselves by withdrawing the funds from one ISA and trying to then use these funds to open another ISA. In such a scenario, the new ISA manager would have to treat the funds as a new ISA subscription (subject to the annual £20,000 ceiling) meaning the investor could be seriously disadvantaged. The ISA investor should arrange that the transfer be carried out directly between the two ISA managers. This would typically be achieved by approaching the new ISA manager who would, having requested the completion of the necessary documentation, forward a request to the current/old ISA manager to request the transfer.

Transfer Options

ISA transfers can be carried out in various ways and the options available to the investor will depend on the type of ISA, the type of investments held within the ISA and individual ISA managers' terms & conditions. Transfers can be carried out in cash or by re-registering investments directly to the new ISA manager, often referred to as in-specie transfers. A transfer could also include a combination of these two methods.

Transfers including Current Year ISA Subscriptions

Where any ISA is transferred to a new ISA manager and the transfer includes a subscription made in the current tax year, ISA managers must transfer the whole of the current year subscriptions, plus any associated income, to the new ISA manager. This is referred to as the current year rule.
Where a transfer includes a current year subscription, the subscription is deemed to be and reported as a current year subscription made to the acquiring manager's ISA.

Current Year ISA Transfer example:

10 April 2018	*£10,000 subscription to a cash ISA with Manager A*
15 October 2018	*Transfer to a stocks & shares ISA with Manager B – including £10,000 current year subscription*
1 February 2019	*£5,000 subscription to stocks & shares ISA with Manager B*

The client has now made a total subscription of £15,000 to the stocks & shares ISA with Manager B in the 2018/19 tax year and this will be reported to HM Revenue & Customs (HMRC). The customer is deemed to have made no subscription to a cash ISA with Manager A.

Where an individual has subscribed £10,000 to a cash ISA in the 2018/19 tax year for example and now wishes to transfer this to a new cash ISA in the same tax year, all the £10,000 subscription, in addition to any interest paid, must be transferred to the new ISA manager. It is not permissible, for example, to only transfer £5,000 to the new ISA manager as this breaches the current year rule.

Where an individual has subscribed £10,000 to a stocks & shares ISA in the 2018/19 tax year for example and now wishes to transfer this to a new stocks & shares ISA in the same tax year, all the investments purchased with the £10,000 subscription, in addition to any income paid (dividend, interest or property), must be transferred to the new ISA manager. This could be achieved by selling all the investments and transferring the cash proceeds to the new ISA manager or by re-registering the assets directly to the new ISA manager (or a combination of the two). It is not permissible, for example, to only transfer half of the investments purchased with the £10,000 subscription to the new ISA manager as this breaches the current year rule.

How long will an ISA transfer take?

A common question asked by ISA customers who wish to transfer their ISA is 'how long will the transfer take?'. There are effectively two sets of rules regarding transfer timelines. Apart from the transfer of cash ISAs to other cash ISAs, the key rule is that an ISA transfer should not exceed 30 calendar days starting from the date that the transfer request is received by the current ISA manager. Where cash ISAs are transferred to other cash ISAs, there are separate rules that came into force in January 2011 because of the government's desire to speed up the time taken to transfer cash ISAs. The rules, in summary, state that a cash ISA transfer should take no more than 15 working days beginning with contacting the chosen new ISA manager and ending with the opening of the new cash ISA. This time period includes two days for post between the two ISA managers where the transfer is manual.

The majority of cash ISA transfers are now carried out electronically through the BACS system. With such transfers, both the funds and the relevant information are passed between ISA managers using an electronic messaging system so transfers are typically carried out in a fraction of the time compared to manual transfers where physical correspondence and sometimes cheque payments are still sent. It should be noted that the ISA rules do not mandate electronic cash ISA transfers although this may change in the future.

There is also an equivalent electronic process that can accommodate the transfer of stocks & shares ISAs where funds are being transferred between ISA managers. The company that facilitates these transfers is called TISA Exchange (TeX). The funds and ISA information are, in a similar way to the BACS system for cash ISA transfers, transferred electronically through an electronic messaging system within a standard legal framework. This was an industry driven process resulting from pressure from the Financial Conduct Authority (FCA) to improve and speed up the transfer of funds between financial providers. Again, the use of this process is not mandated in the ISA rules.

Transfers involving Lifetime ISAs

There are some special circumstances to be aware of regarding lifetime ISA transfers. Where either cash, stocks & shares or innovative finance ISAs are transferred into a lifetime ISA, it is important to note that the maximum amount that is transferred mustn't exceed the lifetime ISA annual limit (£4,000 20118/19). Were a lifetime ISA to be transferred to either a cash, stocks & shares or innovative finance ISA, the investor would be liable to pay the 25% withdrawal charge from the lifetime ISA as this is treated in the same way as a withdrawal from a lifetime ISA.

11 ISAs at death

When an ISA client dies, up until 5 April 2018, their ISA (whichever type) effectively died with them and lost its tax status on the date of death. From the date of death onwards, the investments held in the ISA were treated for tax purposes as if they were held outside of an ISA and all tax benefits were lost. This was always deemed to be unfair, especially where the investments held within the ISA were inherited by a surviving spouse or civil partner. There have been two recent changes to the ISA rules which have attempted to address this perceived unfairness.

April 2015 – Introduction of Additional Permitted Subscriptions

On 6 April 2015, the government introduced new rules which permitted the surviving spouse or civil partner of a deceased ISA client to receive an additional ISA allowance that equated to the value of the ISA at the date of death. This allowance was in addition to the surviving spouse/civil partner's individual annual ISA allowance. So, for example, Mr Client dies on 10 January 2018 and at the time of death he held a cash ISA with ABC Bank worth £72,000. He leaves behind a surviving spouse, Mrs Client, who will now receive an additional ISA allowance of £72,000 in addition to her annual ISA allowance of £20,000 (2018/19). This allowance is referred to as the additional permitted subscription (APS) allowance. Mrs Client can make use of this extra allowance and make a cash additional permitted subscription any time within three years from the date of death. This period can be extended to a period of 180 days from the completion of the administration of the deceased's estate if this is longer than 3 years.

When is the APS allowance received?

It is important to note that a surviving spouse or civil partner will receive their additional APS allowance in all cases regardless of whether they inherit the funds or assets that are held within the deceased's ISA. So, in the above example, if Mr Client leaves all the £75,000 to the RSPCA in his will, Mrs Client will still receive her £75,000 APS allowance. If she has surplus funds available she may still choose to make an APS payment.

Transferring the APS allowance

The surviving spouse/civil partner also has the option of transferring their APS allowance to another ISA manager of their choice permitting them to make an APS payment to their chosen new ISA manager. They may choose to do this because the deceased ISA manager doesn't accept APS payments (which they are not obliged to do under the ISA rules) or simply because they prefer to do business with another ISA manager. This APS allowance can only be transferred once, and it must be transferred in full.

What type of ISA can an APS payment be made to?

An APS payment can be made to any ISA type offered by the ISA manager regardless of the deceased ISA type. In the example above therefore, Mrs Client could choose to make a £75,000 APS payment into either a stocks & shares ISA or an innovative finance ISA (even though the deceased ISA was a cash ISA). If they are eligible, they could also make an APS payment into a lifetime ISA but importantly, no more than the £4,000 lifetime ISA annual limit can be subscribed. Making an APS payment doesn't breach the one ISA per tax year rule.

Example:

Mrs Client has an APS allowance of £50,000
She chooses to make a cash APS payment of £50,000 into a cash ISA with Manager A
She also makes a £20,000 ISA subscription into a different cash ISA with Manager B fully utilising her annual ISA allowance

This is perfectly valid as the APS allowance is separate (and in addition to the annual ISA allowance) and is treated as a previous, and not current, year ISA subscription.

(Note: this approach does not apply to lifetime ISAs and payments, including APS payments, can only be made to one lifetime ISA per tax year).

In-specie transfers

Where the deceased's ISA was a stocks & shares or innovative finance ISA and the surviving spouse inherits the ISA assets, they may have the option to make use of their APS allowance by transferring the assets directly into their own stocks & shares or innovative finance ISA. This direct transfer of assets, as mentioned earlier in the guide, is referred to as an in-specie transfer. The ISA rules refer to this payment option as 'non-cash assets' meaning the APS payment is not being made in cash. This option would benefit the surviving spouse/civil partner in cases where they wished to retain the ISA assets rather than sell them. Once the surviving spouse/civil partner becomes the legal beneficiary of the assets, the ISA rules permit the assets to be transferred into the survivor's ISA within 180 days. Just to note that some ISA managers may not permit in-specie transfers and may insist on a cash APS payment.

Transfers after an APS payment has been made

Once an APS payment has been made, there is no distinction between this ISA and any other meaning that the client is free to transfer their ISA to another ISA under the usual transfer rules, outlined earlier in the guide.

New Rules - post 6 April 2018

On 6 April 2018 the ISA rules were amended so that on the death of an ISA client, where the death was on or after 6 April 2018, the ISA becomes a 'continuing account of a deceased investor' (referred to as a continuing account) and maintains its tax efficient status rather than it ceasing on the date of death. Despite the name change, the ISA effectively continues after the date of death albeit no further subscriptions can be made to the account. The account maintains its tax efficient status until either the account is closed by the ISA manager or after three years from the date of death if this is sooner. In practice, the account will be closed by the ISA manager once they have received the necessary executors' instructions, informing them of who the legal beneficiaries are, at which point the funds or assets will be paid or transferred out.

This change impacts on the APS rules, outlined above, in that a surviving spouse or civil partner's APS allowance could be either the value of the ISA on the date of death or the value of the continuing account at the point it is closed. The surviving spouse/civil partner is, in most cases, entitled to the higher of the two values. These rules changes will be of most benefit to spouses/civil partners where the deceased ISA was a stocks & shares ISA as the assets held in the ISA could in some cases increase significantly in value between the date of death and the date that the continuing account is closed.

Where the spouse/civil partner inherits the ISA assets, this rule change will permit them to transfer all these assets into their own stocks & shares ISA with no tax liability. So, ISA assets could move from the deceased's ISA into a continuing account then into the surviving spouse's ISA without a break in the chain meaning the assets never become liable to tax. This is one of the outcomes that the government wanted to achieve with these rule changes.