ISAs – Increasing Flexibility for Investors

Overview

There have been a number of changes to ISAs over the last few years. Some of these changes appear largely cosmetic (New-ISA/NISA) but some, such as the changes to the inheritability of ISAs, are potentially very useful. We have also seen an evolution in the rules governing Junior ISAs (JISAs) and the introduction of Help to Buy ISAs (HtBISAs).

All of these ISAs offer some significant tax advantages but each type of ISA has its own rules and restrictions. This document sets out to explain these differences.

New ISAs

In July 2014 the government replaced existing cash and investment ISAs with New ISAs (NISAs). Savers can now invest their annual ISA allowance (£15,240 for the 2015/16 tax year) into any combination of cash and/or stocks and shares they wish.

ISAs are free from all forms of personal taxation; any income received is not subject to any further Income Tax and any gains generated are free from Capital Gains Tax. As such ISAs enable individuals to build up savings in a tax efficient environment from which capital or income can be drawn as and when required.

'Flexible' ISAs

From 6th April 2016, ISAs will become even more flexible as it will be possible for investors to replace any withdrawals made earlier in the tax year, without impacting on the annual allowance. As an example, if an individual invested the maximum £15,240 on 6th April and subsequently made a withdrawal of £5,000 in the same year, it would be possible to make an additional investment of £5,000 before April 2017. Currently any further contribution would be regarded as an additional subscription and therefore breach the annual allowance.

Inherited ISA allowance

A significant change relating to the inheritability of ISA tax advantages was introduced in December 2015. Previously, when an investor died, their ISA investments would lose any future tax advantages. Following the changes the surviving spouse or civil partner can inherit these benefits. The mechanism is not particularly straight forward; rather than the ISA investments passing from one spouse to another, an additional subscription limit, equal to the value of the deceased's ISA at date of death, is added to the survivor's existing ISA allowance. Even where the assets within the ISA are left to somebody else, or used to meet expenses from the estate, the surviving partner is still entitled to use the additional allowance to top up or invest into an ISA.

There is a timeframe in which the additional allowance must be utilised; those in respect of cash subscriptions must be made within three years of death and "in specie" subscriptions for non-cash assets must completed in 180 days. The additional investments can either be made as a lump sum, or, depending on the provider, as a number of instalments.

The end to dividend tax credit confusion

The proposed changes to tax on dividends from April 2016, outlined in our *Changes to Dividend Taxation* article, will see the scrapping of the dividend tax credit, which is applicable to stocks & shares ISAs. This will not mean that investors will receive more in dividends from April as the tax credit is entirely notional and no tax is actually deducted from the dividends before they reach the investor. Dividends are currently "grossed up" after the dividend is declared by the company and "netted back" before being paid out to the shareholder, with the 10% tax credit ensuring basic rate tax payers have no additional tax liability. The planned changes, which will take effect on 6th April this year, will see an end to the grossing up and netting down of dividends and investors will simply see no change to the level of dividends they receive.

JISAs – Junior ISAs for UK resident children

Junior ISAs (JISAs) were introduced in 2011 to replace Child Trust Funds (CTFs) which were first launched in 2005. CTFs are no longer open to new business or government investment, although parents can continue to contribute into existing contracts. In our experience JISAs offer investors a much wider range of investment choices, greater flexibility and, typically, at a lower cost. The maximum permitted annual contribution into a JISA (or CTF) is currently £4,080 and this limit will remain in place for the 2016/17 tax year.

Both investment wrappers enable savings for children to build up in the same tax-efficient environment as ordinary ISAs, though once a CTF matures (upon the child's 18th birthday), the funds automatically lose their preferential tax treatment. JISAs on the other hand automatically become ISAs once the child turns 18 and retain their tax-exempt status. From April 2015 it has been possible to transfer an existing CTF to a Junior ISA, thereby preserving the tax advantages at maturity and also providing access to a wider investment choice.

Once a child turns 16, they can apply for a JISA in their own name or take control of the investment selection within their existing JISA. No withdrawals can be taken from JISAs before a child's 18th birthday. The only exceptions are terminal illness or death.

It is also possible for a child to open an "adult" cash ISA from their 16th birthday, meaning that between the ages of 16 and 18, a child could potentially contribute £15,240 into a cash ISA in addition to the maximum JISA investment of £4,080.

HtBISAs – Help to Buy ISAs

In December 2015 the government introduced Help to Buy (HtB) ISAs, a form of "cash" ISA tailored for first time buyers. These ISAs hold the same advantages as ordinary ISAs, free from all forms of personal taxation, whilst in addition, Help to Buy savers are eligible to receive a tax-free bonus to help towards the purchase of their first property.

At the point at which the saver buys their first home, the Government will add a bonus of 25% of the total value of the ISA savings as a tax-free lump sum, subject to a maximum bonus of £3,000. The government bonus can only be used towards a first home located in the UK with a purchase price of up to £250,000 (or

£450,000 in London). Furthermore, the saver must intend on living in the relevant property; the bonus is not available for buy to let properties or holiday homes.

There is a restriction on the level of contributions that can be made; the maximum monthly saving is £200, with the opportunity to deposit an additional £1,000 when the account is first opened, and if any contribution is missed, it cannot be made up in subsequent months. As such it will take approximately four and a half years to build up savings that will qualify for the maximum bonus.

As Help to Buy ISAs are treated as a type of cash ISA, savers are not permitted to pay into both a HtBISA and into cash within their (N)ISA in the same tax year.

Summary

	NISA	JISA	HtBISA
Contribution limits (p.a.)	£15,240	£4,080	£1,200 in first month, £200 thereafter
Age restrictions	From age 18 for stocks & shares ISA or 16 years for cash ISA	Up to age 18	From 16 years
Investment choice	Cash or equities	Cash or equities	Cash savings only
Choice of provider	Range of banks, building societies and investment management companies Can use different providers or funds and can transfer ISA providers at any stage	Range of banks, building societies and investment management companies	Range of banks and building societies Must use the same provider for the duration of the HtBISA
Restrictions	UK Residents only Can pay into one cash ISA and/or one stocks & shares ISA in same tax year	UK Residents only Cannot hold both a CTF and JISA, an existing CTF must be closed and transferred to JISA Child cannot withdraw money until age 18 Registered contact is the parent(s) until age 16, at which point authority can be transferred to child	UK Residents only First time buyers only Not available for buy to let or holiday home purchases Mortgaged purchases up to £250k (£450k in London) Cannot pay into HtbISA and cash ISA in same tax year
Other e.g. tax incentives	Possible to inherit spouse's ISA tax advantages	JISA automatically becomes an ISA at maturity (age 18)	25% tax –free lump sum bonus applied at point of first property purchase Bonus of up to £3,000 is significantly greater than any cash ISA interest rate

ISAs are extremely tax efficient and the recent changes are positive and helpful (particularly given increasing restrictions on pensions). The inheritability of ISAs will simplify and improve the position when an ISA investor dies and the new Help to Buy ISA is a useful additional mechanism for building up a modest deposit for a first home.

If you require any specific advice on ISA investments please speak to your usual contact at Dewhurst Torevell.

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