DT Dewhurst Torevell

ISA Investment Options (2017 Update)

Overview

In our last ISA summary we outlined the different ways in which ISAs had become more flexible, including the introduction of Help to Buy ISAs to assist first time property buyers, 'Flexible' ISAs (where any withdrawal can be replaced within the same tax year), Junior ISAs, and the inheritability of ISAs between spouses.

Over the last 12 months the government has introduced further legislation surrounding ISAs; this document summarises each in turn and the impacts for investors.

2017/2018 ISA allowances

The annual ISA allowance was increased to £15,240 (from £15,000 previously) in April 2015 and this allowance is set to increase again in April 2017 to £20,000. As is currently the case, this can be invested entirely into an equity or cash ISA, or into a combination of both.

This substantial increase is an opportunity for investors to add significant sums to their ISA portfolios each year and thus build up tax-efficient savings more quickly, particularly given the increasing restrictions on pension contributions. As a reminder ISAs are free from all forms of personal taxation; any income is not subject to any further Income Tax and any gains generated are free from Capital Gains Tax. ISAs are free to accumulate to any value and there are no restrictions on when and how much income can be taken.

The Junior ISA limit is also set to increase for 2017/18 although the increase is rather more modest from £4,080 to £4,128.

As covered in our last ISA article, where death occurs on or after 3rd December 2014, a surviving spouse can now inherit their partner's ISA tax advantages (previously ISA investments lost their tax-exempt status on death). An additional subscription limit, equal to the value of the deceased's ISA at date of death, is added to the survivor's own ISA allowance, which may be invested into cash or stocks & shares. "In-specie" transfers for non-cash assets must be made within 180 days from completion of the administration of the estate whilst cash subscriptions must be made within three years of death (or 180 days after administering the estate if later).

Lifetime ISAs

A new breed of ISA, namely the Lifetime ISA (or LISA) was announced in the 2016 Budget, which is set to launch this April. This ISA differs in that savings are locked away until age 60, unless used towards the purchase of a first home. Contributions are restricted to £4,000 per tax year however investors are eligible to receive a government bonus of 25% of the funds contributed within that year, i.e. a maximum bonus of £1,000 pa.

A major caveat is that LISAs are only available to investors aged between 18 and 40 (although the bonus will continue to be paid until age 50). The LISA is intended to provide an alternative means of saving for retirement, with the bonus effectively replicating the tax-relief available on pension contributions, or alternatively support for first time home buyers saving for a deposit.

LISA vs Help to Buy ISA

The LISA is intended to provide assistance with house deposits in a similar way to the existing Help to Buy ISAs (HtBISAs). HtBISAs were launched in December 2015 but these are being phased out, with applications only available until 2019 and contracts only open to new contributions until 2029. There are a number of key differences; firstly the LISA bonus will be added at the end of the 2017/18 tax year and monthly thereafter, rather than at the point the individual purchases their first home, thus allowing savings to accumulate more quickly. In addition there is scope to save considerably more into a LISA compared with a HtBISA, where contributions are limited to £200 per month (after the initial month's allowance of £1,200) and the total bonus available is capped at £3,000. LISA savers could potentially receive a total maximum tax-free bonus of £32,000 if maximum contributions are made from age 18 through to 50. Furthermore the LISA fund may be used towards properties valued up to £450,000 anywhere in the UK, whilst HtBISAs have a reduced limit of £250,000 for purchases outside London.

LISAs offer greater investment flexibility as investments may be made into cash or stocks and shares, reflecting the long term investment horizon of savings which accumulate until retirement, whereas HtBISAs are limited to cash and restrict contributions into any other cash ISA in the same tax year. LISA savers are also able to contribute into both a cash ISA and an equity ISA in the same year, provided total contributions fall within the new ISA allowance of £20,000.

The drawback of LISAs is that if funds are withdrawn prior to age 60, other than to fund a first home purchase, the withdrawal will be subject to a tax charge of 25%, effectively taking away the government bonus (although this charge will not apply during 2017/18).

Investors can continue saving into existing HtBISAs or alternatively these funds can be transferred into a new LISA, where they will still be able to receive a bonus on the transferred savings. Investors could also save into both a HtBISA and LISA at the same time although only one bonus could then be used towards a first property purchase.

Personal Savings Allowance

Prior to April 2016 savings interest was paid net of 20% tax with higher or additional rate tax payers having to declare any further tax liability via their annual tax return. Interest is now paid gross and a Personal Savings Allowance (PSA) is available to basic and higher rate tax payers; interest received up to £1,000 for basic rate tax payers is free from income tax whilst higher rate tax payers have a tax-free limit of £500. There is no PSA available for additional rate tax payers.

Whilst income tax, or indeed any tax, is not applicable to ISAs, the introduction of the PSA may mean that some investors are able to find similar or greater levels of tax-free interest on normal deposit accounts rather than cash ISAs. For individuals whose savings interest falls within the relevant allowance, a higher interest deposit account will win over a cash ISA. For those with more substantial savings (above their PSA) cash ISAs will generally remain the more favourable option; a normal savings rate would need to be 25%, 66% and 82% higher to compete with a cash ISA for basic, higher and additional rate tax payers respectively.

Summary

	NISA (New ISA)	LISA	HtBISA
Contribution limits (p.a.)	£15,240 £20,000 for 2017/18	£4,000 pa Falls within overall ISA allowance of £20,000 across LISA, cash and stocks & shares	£1,200 in first month, £200 thereafter Falls within overall ISA allowance of £20,000. Balance may be invested into stocks & shares not a cash ISA.
Age restrictions	From age 18 for stocks & shares ISA or 16 years for cash ISA	Applications available from age 18 -40. Bonus available on contributions until age 50.	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, although a number of providers have stated their products may not be ready in time for the launch on 6 April 17	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 Any withdrawal, other than for the purpose of purchasing a first home, will be subject to a tax charge of 25% before age 60.. Mortgaged purchases up to £450k Not available for buy to let or holiday home purchases	UK Residents only First time buyers only Government bonus capped at £3,000 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 Possible to replace any funds withdrawn within the same tax year, although limited providers currently facilitate this	25% government bonus applied at the end of 2017/18 tax year and monthly thereafter, thus funds benefit from compounding growth Maximum government tax-free bonus of £32,000 available	25% tax –free lump sum bonus applied at point of first property purchase Bonus of up to £3,000 available.

The proposed ISA allowance increase will provide investors with further flexibility in terms of adding to their ISA portfolios and scope to build up greater levels of tax-free savings each year. The increase will also be an opportunity for pension savers to build up significant tax-efficient savings elsewhere, potentially as an alternative income source in retirement.

Much of the LISA legislation is still being finalised and may still be subject to change however the proposed 25% tax-free annual bonus appears very attractive, dwarfing any return available from ordinary cash ISAs or savings accounts. For those who are eligible, the product should provide either significant support in saving for a first home or an incentive to build up additional funds for retirement.

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

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