CAMPBELL & McCONNACHIE

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Creating an effective ISA strategy

Integrating ISAs into your savings strategy.

It's not a secret that cash ISA rates have been poor for a number of years. Gone are the days where you could deposit money into a savings account and expect a healthy return.

Yet nowadays the ISA market extends far beyond cash accounts. This is not to suggest that ISAs are particularly complicated.

However, the wide range of options available can make it hard to identify which type of savings account you need to achieve your specific goals.

By acquiring a basic knowledge of how they work and understanding which are appropriate for your needs, ISAs can be an important component of your savings strategy.

The basics

ISAs provide individuals with a tax-free way to save money. You are able to deposit up to £20,000 into an ISA in the 2017/18 tax year. This allowance covers each type of ISA: cash, stocks and shares, Lifetime, Help to Buy and innovative finance.

The individual allowances for the Lifetime ISA and Help to Buy ISA are lower than £20,000, so you would need to combine these types of ISAs with others to make full use of your allowance.

Anything placed into any of these accounts will become exempt from both income and capital gains tax.

ISA rules enable you to split the allowance between different types of ISA. For instance, you can choose to put half of the total allowance into a cash ISA and the other half into a stock and shares ISA. Or you could split the allowance 3 ways between cash, innovative finance, and stocks and shares ISAs. Remember, you cannot exceed the £20,000 threshold.

You can transfer savings between providers and into different types of ISA. However, if you want to transfer any money deposited in the current tax year you must transfer it all.

If your ISA is flexible you can take cash out and put it back in later in the same tax year without reducing your annual allowance.

Types of ISA

Cash ISAs

Cash ISAs are the simplest kind of ISA and allow anyone over the age of 16 to deposit cash into a tax-free savings account. Saving outside of an ISA will expose you to tax at your marginal rate on interest earned on savings exceeding the personal savings allowance (currently £1,000 for basic rate taxpayers and £500 for higher rate taxpayers).

Cash ISAs come in different varieties. Instant access accounts have no restrictions on when you can withdraw your savings but tend to pay lower rates of interest.

Earning a higher return will require you save into a fixed rate account and tie your money up for a set period of time. You can still access any funds in a fixed rate account but the provider will charge a fee for doing so.

Stocks and shares ISAs

These ISAs are used exclusively for reducing tax on investments such as equities, bonds and units of a collective investment scheme.

Unlike cash ISAs, you must be 18 in order to open a stocks and shares ISA.

Investments worth up to £20,000 can be placed within these accounts, exempting you from tax on any profit made. This includes income earned from dividends and bond interest payments, and capital gains derived from selling investments at a profit.

Stocks and shares ISAs are administered by online brokers, fund supermarkets and fund management groups. Unlike cash account providers, organisations may charge for withdrawals, yearly platform service fees and when you make changes to your investments.

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Lifetime ISAs

The Lifetime ISA is the latest innovation in the savings market and was introduced by the government last month to provide assistance for people saving either for a first home or for their retirement.

You can deposit up to £4,000 each year into a Lifetime ISA and the government provides a 25% bonus on any amount saved. For instance, putting £2,000 into a Lifetime ISA during the 2017/18 tax year will see the government contribute £500. The bonus is based on your contributions and not on any interest and investment profits.

There are several details to be aware of when looking at Lifetime ISAs. Firstly, you must be aged between 18 and 40 to be eligible. You can, however continue saving into a Lifetime ISA until your 50th birthday, provided you opened the account before you turned 40.

Secondly, the 25% government bonus is contingent upon you using your Lifetime ISA savings to either put down a deposit for a first home or to save for retirement. Making withdrawals for any other purpose will result in a 25% penalty.

Help to Buy ISAs

These accounts have been designed solely to assist people getting onto the property ladder. Opening a Help to Buy ISA will allow you to save up to £1,200 in the first month and up to £200 a month thereafter.

Similarly to Lifetime ISAs, the government will provide a 25% bonus when you put down a deposit for a home.

Bonuses are calculated based on the total value of the account (including interest) and not just on your contributions.

There are 2 important things to bear in mind regarding the bonus. Firstly, there must be at least £1,600 saved in the account before the government provides the bonus.

Secondly, bonuses are only paid on savings of up to £12,000, giving you a maximum government contribution of £3,000.

Innovative finance ISAs

Any interest or capital gains made through peer-to-peer loans (P2P) can now be tax-exempt through the use of an innovative finance ISA.

Providers offer a higher rate of interest compared to cash ISAs. This reflects the greater degree of risk involved with P2P lending – especially considering these investments are not covered by the Financial Services Compensation Scheme.

Junior ISAs

Parents can save on behalf of their children into a tax-free account called a Junior ISA. The annual savings allowance for Junior ISAs is £4,128, substantially lower than the adult equivalent.

Like normal ISAs, you can split the allowance between cash deposits and investments. Junior ISAs are opened in the child's name but parents or guardians with parental responsibility manage the account. The child will gain control over the account when they turn 16 but they will be unable to access the savings until their 18th birthday.

We can help you decide which type of ISA is right for you.

3 things to consider

Setting savings goals

You must understand why you want to save, how much you want to save and when you need to access your savings. This is especially important when investing in higher risk products. Your goals will dictate which type of ISA and which specific accounts are suitable for you. As such, your savings strategy should be built around these goals.

Saving or investing?

These days ISAs are more than mere savings accounts. Cash accounts remain good options for simply locking your money away and receiving a small amount of interest in the process.

However, when thinking about making investments through an ISA or providing a P2P loan over the internet, things become more complicated.

Innovative finance ISAs and stocks and shares ISAs necessitate careful thinking about your appetite for risk and the duration of your investment.

Contact us to discuss your investment plans.

The personal savings allowance

The personal savings allowance allows individuals to earn up to £1,000 in interest without paying tax.

Savings within this allowance will already be tax-exempt, making cash ISAs somewhat redundant from a tax planning perspective.

However, if you have a large amount of savings earning more than £1,000 interest a year, cash ISAs are a valuable way of extending your tax exemption – particularly if you pay the higher or additional rates of tax.

We can help you develop a savings strategy.