Investors' Chronicle




# The IC Guide to ISAs



*Savers and investors take note. All of the money outside of your pension can be subject to taxes on profits and dividends. But the money in Individual Savings Accounts (Isa) is exempt from these taxes. That is why it is efficient to use up your allowance where you can.*

## Glossary:

- Capital Gains Tax: The tax you pay on the increase in value of the assets in your portfolio
- Dividend Tax: The tax you pay on the income you receive from stocks and shares
- Individual Savings Account (Isa): A wrapper that allows you to grow savings free of tax.
- ISA Allowance: The maximum amount you are allowed to save in your Isa each year

## What's in this guide?

P3-5. Types of ISA *From stocks and shares to innovative finance - understand your Isa types to make the most of the benefits.*

P6. Picking your ISA platform

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## ISA: The Basics

An Individual Savings Account (Isa) is a wrapper that allows you to grow savings free of tax.

You have an annual Isa allowance which is the amount you can add to the account in any given year - the current allowance is £20,000, a level it has been at since 2017.

There are different types of Isa but one allowance for all your accounts. You have until the 5th of April each year to use up your ISA allowance - if you don't it will be gone.

All UK residents can have Isas. Junior Isas are available for children under the age of 18 and must be set up by a parent or legal guardian before the child is 16. The current Junior Isa allowance is £9,000 a year. From 16, you can open your own cash Isa and from 18 you can open a stocks-and-shares Isa, innovative finance Isa (IFIsa) and lifetime Isa (Lisa) if you're under the age of 40.

**Use it or lose it and build your ISA over time**

You should start putting any spare savings outside of your pension into an ISA as soon as possible. You can access the money whenever you want, but you cannot roll your ISA allowance forward.

| Types of tax | Basic rate taxpayer | Higher rate taxpayer | Additional rate taxpayer | Isa investor |
|---|---|---|---|---|
| Capital gains | 10% | 20% | 20% | 0% |
| Dividend | 7.5% | 32.5% | 38.1% | 0% |
| Income (paid on fixed rate products) | 20% | 40% | 45% | 0% |




## Types of ISA

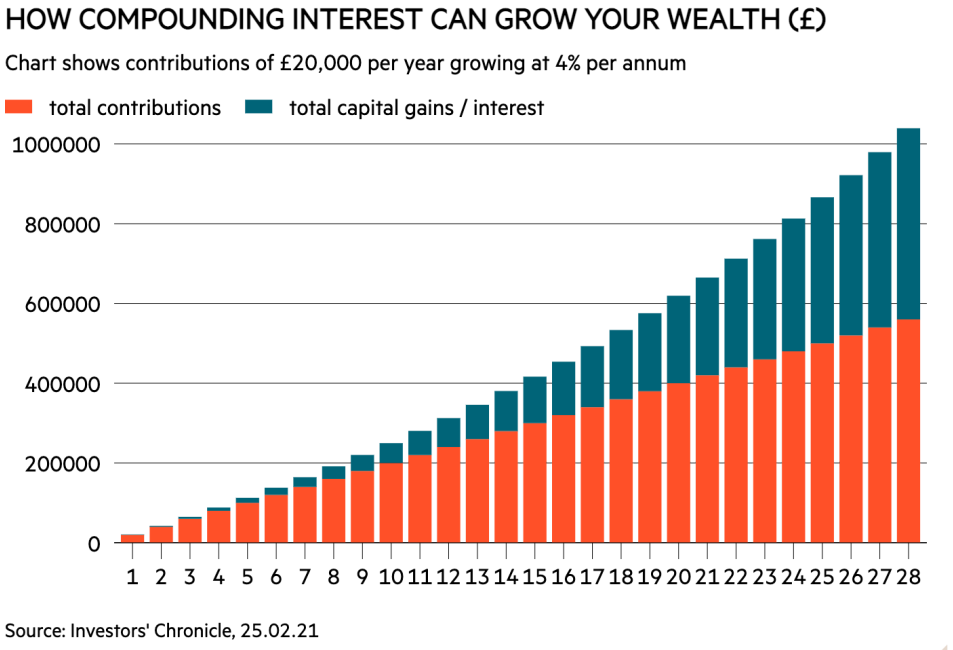
### 1. Stocks and Shares ISAs

By investing in the stock market, you can grow your money over time. It is generally advised that you invest with a time horizon of at least five years, to boost your chances of outperforming cash saved in the bank.

An Isa should be the first port of call for new investors. The tax benefits on offer can protect both capital gains and income.

Key Points:

- Investment account
- £20,000 allowance
- No dividend tax or CGT payable




If you put £20,000 into an Isa at the start of every year, for example, and the investment grew by 4 per cent per year, after 20 years your portfolio would be worth £619,384. After 28 years, you'd have over £1m – and almost half of it would be taxable if it were not inside an Isa.




## 2. Cash ISAs

If you have a low risk tolerance or think you might need access to your Isa money within the next few years, it might be more sensible to put money into a cash Isa. Cash Isas currently pay very low levels of interest so the tax benefits may be minimal, but it is good to keep as much money as possible within the wrapper.

Make sure you shop around for a good interest rate for the duration of the term you are looking for, and keep an eye out for high rates that drop after their initial period. You can always transfer an Isa between providers later if you find a better rate elsewhere.

Key Points:

- Savings accounts
- £20,000 allowance
- Tax free interest

## 3. Innovative Finance ISAs

These are for peer to peer lending - a form of investing where you lend money to borrowers and businesses for a fixed amount of time and they pay you back with interest.

Like all other Isas, your money is free from UK income and capital gains tax.

Interest rates can look very generous on these products, but, generally, the higher the rate - the more likely you are to lose money.

It is very difficult to do due diligence on these products so unless you really know what you are doing it is probably best to steer clear.

Key Points:

- Peer-to-peer lending
- £20,000 allowance
- Tax free interest




## 4. Lifetime ISAs

Lifetime Isas were designed to give a boost to people when buying their first property. You can set one up between the ages of 18 and 40, and put up to £4,000 into it each year. You can keep contributing until your 50th birthday, and the government will add an extra 25 per cent, up to £1,000 a year.

Both cash and stocks and shares Lifetime Isas are available from a variety of providers. Remember that you should only consider investing in the stock market if you don't plan to spend your money within the next five years.

There are strict rules about when you can take money out of a Lifetime Isa without paying a withdrawal charge. You can access your money if you're buying your first home (with a purchase price of up to £450,000), or if you are over the age of 60.

Key Points:

- Savings or investment account for house or retirement
- £4,000 allowance, govt adds 25% to contribution.
- Government bonus paid monthly (or whenever you contribute)
- Bonus paid back if not used for house purchase (first time buyers only) or retirement.

### LISA vs Help to Buy ISA

Before Lifetime Isas were introduced in 2017, Help to Buy Isas were the vehicles used to help people save for homes. They are now closed to new investors.

Help to Buy Isas have a total government bonus up to £3,000 in total and get paid directly to your solicitor or conveyancer when you buy your first home.




## Managing your stocks and shares ISA

### Step 1: Pick your platform

To make the most of your Isa allowance you must first pick the correct provider.

You can only use one provider for your Isa allowance in the current tax year, but you can use a different provider in subsequent years and transfer existing Isa money among providers.

Stocks and shares Isas are offered by a range of platforms - with varying ranges of cost, service levels and product offering. Here are our current top rated Isa providers as voted for by IC readers.

| Platform | Website and app accessibility | Value for money | Customer service | Data and research | Range of investments | Average Overall |
|---|---|---|---|---|---|---|
| **Freetrade** | 4.7 | 4.9 | 4.6 | 3.7 | 4.2 | 4.4 |
| **iWeb** | 4.2 | 5 | 4.1 | 3.2 | 3.6 | 4 |
| **AJ Bell Youinvest** | 4.1 | 4 | 3.8 | 3.6 | 4.3 | 3.9 |
| **interactive investor** | 4 | 4.2 | 3.5 | 3.4 | 4.2 | 3.8 |
| **Fidelity Personal Investing** | 4.5 | 3.4 | 3.6 | 4 | 3.6 | 3.8 |

It is also important to assess the impact of costs when picking your platform as hefty fees can eat into your returns over the long-term.

Download our latest price comparison figures via this link.




## Step 2: Asset allocation

Whatever stage you are at in your investment journey, it is good to think about the structure and balance of your portfolio - otherwise known as asset allocation..

The level of risk you should take depends on your ability to sit comfortably through spells of turbulence This is partly a question of personality but more importantly, it's about having the capacity not to have to sell holdings when they're down and crystallise losses.

That balance differs depending on your investment goals, your stage of life and the size of your portfolio.

You can find out more about the right model asset allocation for you on our website.

**Read more:**

Getting asset allocation right in your Isa

Investors' Chronicle's model asset allocations

## Step 3: Pick your investments

Once you have decided which types of asset you would like to own, you need to pick some investments to fill your portfolio.

Make sure you do your research and pick assets that you are comfortable with - there is nothing worse than an investment that keeps you up at night.

A subscription to the IC can provide you with plenty of ideas. Find out more here.

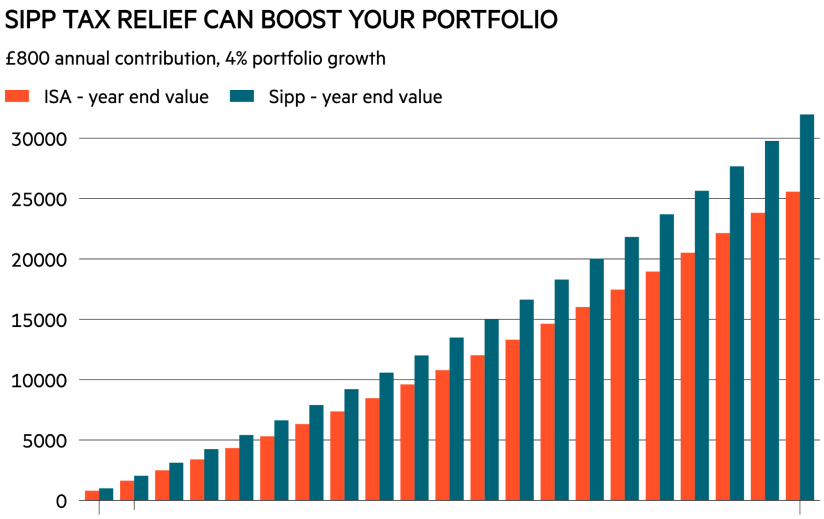



## Comparison: Sipp vs Isa

The main tax benefits from the Isa and Sipp come at different times. Your Sipp savings are tax free at the point of investment because the money added to a Sipp receives tax relief at the rate you pay income tax. This means that the after-tax cost of a payment into a Sipp is much lower than it is for an Isa and that can have a big impact on returns.

For example, an investor who generates 4 per cent growth from an £800 annual investment in their Isa every year for 20 years will be left with a portfolio worth £25,575. The same investment in a Sipp by a basic-rate taxpayer will have tax added back, meaning £1,000 is invested every year. After 20 years the portfolio would be worth £31,969.

The Isa wrapper comes into its own when you want to spend the money you have invested. All of the money is free of capital gains and income tax and there are no restrictions on when this can be taken, unless it's in a Lifetime Isa. By contrast, only 25 per cent of the money in a Sipp can be taken as a tax-free lump sum (although as income drawn down thereafter is taxed in the same way as a salary, you might be able to receive some income tax free) and it is only accessible from the age of 55.




### Understand your allowances

The Isa allowance is set at a fixed level every year (currently £20,000) and cannot be rolled over. Your annual pension allowance is tied to your income (you can pay 100 per cent of your annual earnings into your Sipp up to a maximum of £40,000) and contributions to a workplace pension will use some of this up. You can roll over your pension allowance for three years.

### Start early

As a general rule of thumb, any money earmarked for a certain purpose prior to your retirement should be saved in an Isa, other investments should go into your Sipp.

But picking the right account matters less than saving early and often.

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