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FACTSHEET

Individual Savings Accounts (ISAs)

How to shelter income and capital gains

For long-term investors, Individual Savings Accounts (ISAs) are a very tax-efficient wrapper that can hold cash savings as well as investments in stocks and shares. Savvy investors are also able to shelter income and capital gains.

ISA FLEXIBILITY

You can contribute up to £15,240 to an ISA in the 2016/17 tax year. Cash that you withdraw from a flexible ISA can be replaced during the same tax year without counting towards your annual ISA allowance, which is known as 'ISA flexibility'. What sets ISAs apart from other savings and investment accounts is that any interest on cash savings, gains from investments or income from dividends are tax-efficient, although tax-efficiency may now be achievable for some outside an ISA if the income or gains are covered by a dividend allowance, personal savings allowance and Capital Gains Tax (CGT) allowance. You don't have to declare ISAs on your tax return.

ADDED ADVANTAGE

Because of their tax benefits, ISAs can help your savings and investments grow faster over time. Investing your ISA in stocks and shares has the added advantage of helping safeguard you from a potential Capital Gains Tax (CGT) bill in the future. CGT is a tax on the gain you make when you sell or dispose of assets such as investments. It is currently charged at 20% for higher-rate taxpayers on gains made that exceed the yearly tax-free allowance. Currently, the CGT allowance is £11,100.

ADDITIONAL ALLOWANCE

Rules on ISA death benefits introduced in April 2015 allow for the transfer of an extra ISA allowance to the deceased's spouse if they passed away on or after 3 December 2014. If applicable, the surviving spouse can use an additional one-off allowance, which is equal to the value of their partner's ISA savings, as well as enjoying their own usual yearly allowance. An additional permitted subscription (APS) can be used in certain situations.

INHERITANCE TAX

You qualify for the additional allowance whether or not you inherit the actual assets of the ISA. The deceased's ISA assets are distributed according to the terms of the will or intestacy rules, and any Inheritance Tax liability will remain in the usual way (except ISAs qualifying for Business Property Relief, for example, Alternative Investment Market [AIM] ISAs). No actual funds are transferred, and the extra allowance can be made up from your own assets. Also, as well as being married or in a registered civil partnership with the ISA holder, you need to have been living together – if you were separated, either under a court order, Deed of Separation or any other situation that was likely to become permanent, you can't use the additional allowance.

COMPOUNDING EFFECT

Long-term investors who can afford to invest at the start of the tax year rather than at the last minute not only gain a year's performance, but these extra gains will be reinvested in the market until they need the money. Over time, the effect of compounding can be significant. The more you invest, the greater the potential impact of early investing. Likewise, the longer you are investing for, the larger the compounding effect. Also, investing early in the tax year to benefit from compounding is most pertinent not only for those saving for retirement but also for parents investing for their children's future through dedicated Junior ISAs (JISAs). ■

BUILDING A LONG-TERM INVESTMENT STRATEGY

If you are unsure about the suitability of your investments, you should always obtain professional financial advice. For the effects of compounding to work, two things are required: the re-investment of earnings, and time. The more time you give your investments, the more you are able to accelerate the growth potential of your original investment, which takes the pressure off you. To discover how we can help you build a long-term strategy for your investments, please contact us – we look forward to hearing from you.

Authorised and Regulated by the Financial Conduct Authority.