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ISAs and PEPs

Summary

1. ISAs replaced PEPs from April 1999, and are now due to continue indefinitely.
2. ISAs provide a tax-efficient investment wrapper; the investment medium should dovetail with your overall investment strategy. For example, if you were planning to invest £10,680 into an equity unit trust/OEIC then it makes sense to use your ISA allowance. However, if you were not planning to make such an investment, then your decision should not be affected by the availability of an ISA.
3. The returns from ISAs are exempt from additional income and capital gains tax, with no minimum holding period or minimum subscription. Please note that some providers may charge penalties for withdrawal of funds within an initial period.
4. Even those who do not wish to invest in stocks and shares can benefit by using a Cash ISA to hold deposit account funds.
5. It is anticipated that 'Junior ISAs' will also be available from Autumn 2011 for all under 18 year olds who do not already hold a Child Trust Fund.

Individual Savings Accounts (ISAs)

Tax Advantages

- There is no income tax applied to the interest or dividend income generated by investments within the ISA.
- From 6 April 2004, ISA managers have not been able to claim back the deemed tax of 10% deducted from UK equity dividends. This may make equity based ISAs tax inefficient for non tax payers, and tax neutral for those basic rate tax payers who are also not likely to use their annual Capital Gains Tax exemption. However, tax on interest on bond funds is fully deductible so here even basic rate tax payers benefit.
- There is no Capital Gains Tax levied on capital gains on the underlying assets.
- There are no Inheritance Tax benefits.

ISA Rules

There were originally three investment components: cash, insurance and stocks and shares, but the insurance component was later combined with the stocks and shares component. The distinction between maxi ISAs and mini ISAs has been removed. The only distinction now remaining is between cash ISAs and stocks and shares ISAs.

For 2011/12, the maximum amount that an individual can invest into ISAs of any kind is £10,680. Of this, up to a maximum of £5,340 can be placed into a cash ISA.

Investors must be aged over 18, and resident & ordinarily resident in the UK. For cash ISAs, the minimum age is 16.

There is no minimum holding period, and part or all of the investment and/or growth can be withdrawn at any time. However, please check with individual providers for penalties.

- The cash component may be able to be transferred into stocks and shares, but not vice versa.
- Child Trust Funds will be able to be rolled into ISAs on maturity at age 18.

Risk Warning: The past is not necessarily a guide to future performance. The value of your investment and the income from it can fall as well as rise and is not guaranteed. You may not get back the full amount invested.

Our views are based upon our understanding of current legislation. Levels and bases of, and reliefs from, taxation are subject to change and their value to you will depend upon your personal circumstances. You should not act on any of the information without seeking professional advice.

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Personal Equity Plans (PEPs)

PEPs were replaced by ISAs in April 1999, and no new PEP investments were allowed after this date. All existing PEPs became stocks and shares ISAs on 6 April 2008.

Permitted Investments

Cash

Requires little explanation, with most providers paying premium rates over ordinary deposit accounts. Rates will vary, as with ordinary deposit accounts, according to the length of notice required for access to the funds, and the type of access to the account (internet, telephone, post etc.).

Insurance Company Funds (allowed within the Stocks and Shares ISA component)

These offer both with profit and unit linked contracts, investing in portfolios of cash, gilts, bonds, property and equities. Insurance funds are subject to internal tax on income and capital gains, even within an ISA. This, combined with the previously low maximum investment, has meant that insurance ISAs are not especially common.

Stocks and Shares

These can invest in individual equities, gilts and bonds, traded on a recognised Stock Exchange in the UK or overseas. Alternatively, collective investments such as Unit Trusts or OEICs can be used. The stocks and shares ISAs give the flexibility to switch from capital growth oriented investments (equities) in earlier life, to income producing (gilts and bonds) investments after retirement. Products providing cash like returns (e.g. where capital is at least 95% protected on a five year view) will not be eligible for a stocks and shares ISA.

ISAs for Children – Anti-Avoidance Provision

Although children aged 16 and 17 are not able to invest in stocks and shares within an ISA, they are allowed to invest the maximum relevant amount in a cash ISA. Please note that an Inland Revenue anti-avoidance provision applies on gifts from parents (not grandparents/others), as described in the extract from IR2008 below:

“ISAs for 16 and 17 year-olds are intended primarily for those in full or part-time employment, including those still at school with, for example, Saturday jobs, but ISAs will also be used by some young people to save money given to them by their parents. If you give your child money to invest into an ISA account, and the total investment income arising on all gifts from you, not just in ISAs, exceeds £100 in any tax year, all the income arising will be treated as part of your income for that tax year for income tax purposes. You should report that income to your Tax Office.

This rule does not prevent you from giving your child money to invest in an ISA - you just have to take care not to give your children too much. The £100 income limit for each child applies to each parent, not to both taken together.”

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Junior ISAs

It is anticipated that Junior ISAs (a replacement for Child Trust Funds) will be available from Autumn 2011. Based on the current proposals (which are of course subject to change), these will take the following form:

- All UK resident children (aged under 18) who do not have a Child Trust Fund will be eligible for Junior ISAs. This includes those born before the start of CTF eligibility, in September 2002, as well as those born after 3 January 2011.
- Children will only be able to hold up to one cash and one stocks and shares Junior ISA at any one time (but transfers are permitted).
- There will be a £3,000 per tax year limit (applies to the combination of any payments into a cash and stocks and shares element).
- After age 16 they can also open a normal Cash ISA without that impacting on the Junior ISA limit.
- At age 18 the Junior ISA becomes either a normal Cash ISA or a normal Stocks and Shares ISA – i.e. the child becomes absolutely entitled to the funds at this point. No withdrawals can be made earlier, except in the event of terminal illness or death.
- From age 16, the child can open a Junior ISA themselves; before that age an adult with parental responsibility will need to open and manage the ISA for them (although contributions can be made by anybody).
- Income over £100 won't be taxed as the parent's, as described above.

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