28 Individual Savings Accounts

This information sheet contains basic information on the Individual Savings Account, or ISA. The Individual Savings Account gives individuals a way of saving without paying tax. The Individual Savings Account was introduced in April 1999, and replaced two previous tax-free saving schemes – the TESSA and the PEP.

Help the Aged can't give individual financial advice. This information sheet is intended to provide basic information on ISAs and how they work, so that you can decided whether or not an ISA will meet your needs. If you need personal advice on managing your savings and investments, Help the Aged recommends that you speak to an independent financial adviser.

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What is an ISA?

ISAs were introduced by the Government in April 1999, and are intended to encourage more people to save and invest for the future. An ISA acts as a ‘tax shelter’, which means that you don’t have to pay tax on any interest paid on your savings, or growth in your investments. So these tax benefits cover interest on a bank or building society account, as well as income generated on a life assurance bond, unit trust or on company shares.

ISAs replaced the two previous Government tax shelters – the TESSA (Tax Exempt Special Savings Account) for savings and the PEP (Personal Equity Plan) for investing.

What are the tax benefits of an ISA?

You do not pay any income tax, or Capital Gains Tax (CGT), on any investments you hold in an ISA. You do not even need to give details of your ISAs on your tax return, if you need to complete one – ISAs operate completely outside the tax system.

What types of ISAs are there?

ISAs have been criticised for being too complex. They are certainly more complicated than TESSAs and PEPs, but are not too difficult to understand when broken down into their different types and sizes. The key point to remember is that ISAs come in **three main types** and **two different sizes** – the mini ISA and the maxi ISA.

The three main types of ISA are:

- **Cash ISA**. This essentially replaces the TESSA and is widely available from banks, building societies, friendly societies, many supermarkets and other financial institutions. The improvement on the TESSA is that you can easily get hold of your cash, without losing any tax benefits. (With a TESSA your money was tied up for 5 years – if you withdrew any funds early the interest was no longer tax-free).

- **Insurance ISA**. This gives tax relief on savings products developed by the insurance industry – for example, the widely promoted 'with-profits bond'. These offer higher returns than most bank or building society deposit accounts and are much less risky than stock market related investments.

- **Stocks and Shares ISA**. This basically replaces the PEP. A stocks and shares ISA gives tax relief on stock market related investments such as unit trusts, investment trusts and shares in individual companies. Unlike PEPs, share holdings are not restricted to UK and European markets and can cover investments in any part of the world.

How much can I invest in an ISA each year?

The investment limits given here will apply until **April 2006**.

The maximum overall amount you can invest in an ISA is £7,000 in each tax year. However, each different type of ISA has a separate investment limit:

- **Cash ISA investment limit**: £3,000 per year.

- **Insurance ISA investment limit**: £1,000 per year.

- **Stocks and Shares ISA investment limit**: Up to £7,000 a year.

What is the difference between a mini ISA and a maxi ISA?

Mini ISA. This allows you to invest in different types of ISA up to the overall ISA limit of £7,000 in a tax year. For example, you could place up to £3,000 in a Cash ISA with a building society, the £1,000 annual maximum in a life assurance ISA product, and up to £3,000 with a unit trust company in a Stocks and Shares ISA. Each of these separate ISAs is referred to as a mini ISA. **You can only open one of each type of mini-ISA per year.**

Maxi ISA. A maxi ISA **must** involve investment in stocks and shares. When you open a maxi ISA, you place your entire investment for that year (up to £7,000) with **one** financial institution. So the maxi ISA is effectively an ISA investment portfolio with one provider acting as an ISA manager for you. Your investment portfolio can be made up of a mix of ISA types, as agreed between you and your provider.

As noted, a maxi ISA **must** contain stocks and shares, but it **may** also contain cash and insurance. The rules governing the management of the portfolio do not allow you to move funds from one component to another (eg from cash to shares or vice versa) after the investments are made.

How many ISAs can I have?

You can open one maxi ISA **or** one of each type of mini ISA in any one tax year. So even if you place only a few pounds in a Cash ISA, this will means that you cannot take out a maxi ISA that year. However, it would not stop you taking out a separate Insurance ISA or Stocks and Shares ISA if you wished.

Why take out an ISA?

If you don’t pay income tax there is no advantage for you in taking out an ISA. You can stop tax being deducted from your savings by registering as a non-taxpayer with your bank or building society; ask your bank or building society for form R85.

If you are a taxpayer, the obvious advantage of an ISA is that any interest on your savings, or growth on your investment, is not taxed. However, it is important to shop around before opening an ISA. ISA interest rates, restrictions on getting hold of your money and management charges can vary widely. Because of this, the Government has introduced the CAT mark to help small savers and investors identify products that are neither costly in terms of charges nor restrictive in terms of access or rules.

What does the CAT mark guarantee?

CAT stands for **Charges, Access** and **Terms**. CAT standards have been set up by the Government to try and ensure that ISAs are both cheap and easy to understand. If an ISA has a CAT mark, it means it meets the following conditions:

- **Cash ISA**. To qualify for a CAT mark, a Cash ISA must not include either one-off or regular charges. The minimum deposit, and withdrawal, has been set at £10 and savers must be able to get access to the money within seven working days. In addition, the interest rate paid must be no more than two percentage points below base rates.

- **Insurance ISA**. To qualify for a CAT mark, the maximum annual charge allowed is 3 per cent of the value of the fund. The minimum premium is set at £25 a month or £250 a year. Additionally, if you cash in your Insurance ISA after three years, you will be guaranteed to receive back at least the sum you have paid into your fund.

- **Stocks and Shares ISA**. To qualify for a CAT mark, a Stocks and Shares ISA must have an annual management fee of no more than 1 per cent of the value of the fund. The minimum investment has been set at £50 a month or £500 year.

> Remember that CAT marks apply only to charges, access and terms. They do not guarantee the best available interest rates, or guarantee the performance of the investment or the level of financial return.

Can I have an ISA as well as a TESSA and PEP?

Yes – it does not matter how many PEPs and TESSAs you have; you can still open an ISA up to the maximum overall investment. You cannot buy new PEPs or TESSAs anymore; these have been completely replaced by the ISA. However, PEPs and TESSAs that were set up before 6 April 1999 will continue to run.

If you have a PEP you cannot put new funds into it, although the funds that are already in it will continue to grow tax-free. You can also transfer any PEPs you have from one fund manager to another, so long as you do not sell any funds for cash. If you do this, you lose your tax-free PEP benefits completely on the fund.

If you have a TESSA, you can carry on paying into it until the account matures, five years after you took it out. During this period you will be able to put up to £1,800 a year into your TESSA, tax-free. When the TESSA matures, you can transfer the invested capital (but not the interest earned) into a separate TESSA-only ISA, which is treated separately from your standard ISA allowance. Another option would be to transfer your TESSA capital sum to a Cash ISA.

Should I get professional advice on opening an ISA?

It is highly recommended that you seek independent financial advice before taking out an Insurance ISA; independent advice should definitely be taken before investing in a Stocks and Shares ISA. This is because a stocks and shares ISA can be a risky investment – this type of ISA is subject to stock market fluctuation and so its value can go down as well as up. IFA Promotion can give you details of independent financial advisers in your area. Telephone **0800 085 3250** for further information.

Independent financial advice is not essential for standard Cash ISAs taken out with banks and building societies as these are backed by the usual investor compensation schemes. However, it is still very important to shop around for a good rate of interest, and to make sure that you are happy with the terms attached to the ISA.

Where can I find out more about ISAs?

All financial institutions operating ISAs produce information on their own products. But bear in mind that this is not impartial information and advice – each company wants you to take out an ISA with them.

Independent information can be found in the money and personal finance columns of the broadsheet newspapers, and in some of the tabloids. Monthly investor magazines, and the consumer publication 'Which?', regularly review financial products and companies, identifying their 'best buys'. Most large libraries will stock these titles. If you need personal advice, consult an independent financial adviser.

The Financial Services Authority publishes the 'FSA guide to ISAs'. Call the FSA Consumer Helpline on **0845 606 1234** for a free copy. The Inland Revenue produces a booklet called 'ISAs, PEPs and TESSAs'. To get hold of a copy, contact the Inland Revenue Leaflet Orderline on **0845 9000 404**.

For further information contact:

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London N1 9UZ
Tel: 020 7278 1114

People with access to the Internet can download our information sheets and advice leaflets by logging on to: **www.helptheaged.org.uk**

SeniorLine is the **free** welfare rights advice and information service run by Help the Aged for senior citizens. It is free, confidential and impartial. Trained advice workers can help with the following:

- Welfare and disability benefits
- Community and residential care
- Housing options and adaptations
- Access to health and community services
- Equipment to assist independence
- Support for carers
- Agencies offering local practical help

Telephone: **0808 800 6565** Textphone (Minicom): **0800 26 96 26**
9am to 4pm, Monday to Friday. Your call will be free of charge.

If you are in **Northern Ireland**, call SeniorLine on **0808 808 7575**.

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