MPL WEALTH MANAGEMENT

What is an ISA?

ISA stands for Individual Savings Account, a tax-efficient wrapper offered under Government legislation as a way of encouraging you to save. The ISA wrapper sits over your choice of investments, sheltering them from tax on income and gains. You must be UK resident for tax purposes and over the age of 16 to open a Cash ISA or over 18 to open a Stocks and Shares ISA.

There are Cash ISA's and Stocks and Shares ISA's. The combined allowance for both in 2018/2019 is £20,000. The Junior ISA limit is £4,260. From 1st July 2014 ISAs were reformed into a simpler product, the 'New ISA' (NISA).

- It is worth noting that you can transfer existing Cash ISAs to a Stocks and Shares ISA without impacting on your current tax year allowance.
- You may only invest money in one Cash ISA and one Stocks and Shares ISA in any one tax year.

What makes a good Cash ISA?

Cash ISAs are simply bank accounts on which no Income Tax is deducted. The value of your money in a bank account does not fluctuate in line with the stock market, but instead earns interest for the duration it is invested. Therefore, in order to find the 'best' Cash ISA, you would generally look for the highest interest rate.

However, there are some differences to be aware of. The highest headline rate today may not be the best rate in the longer term. You should therefore either be prepared to keep checking rates on a regular basis and move your Cash ISAs around or you might choose a provider that offers slightly lower but consistently competitive interest rates. Some providers might tie your money up for a period of time. These accounts pay higher interest rates because the provider can plan their own investments better – but do not generally offer instant access to your capital. Always read the small print to see what, if any, rate guarantees and caveats apply.

Stocks and Shares ISAs permit a much wider choice of investments, including the individual shares of any company listed on a recognised stock exchange. However, whilst the allowance is a significant amount of money for many people, in share dealing terms it is not very much – and if it is all invested in just one or two companies, the lack of diversification can result in more volatility and capital loss. Therefore, the preferred option for most investors is to invest via collective investment schemes.

Collective Investments

By using a collective investment, your capital is being invested in many different companies or assets via a regulated fund. A fund manager will manage the fund's assets on your behalf. By this diversification, exposure to any one company is reduced and if a company underperforms there are other investments to help compensate for the loss.
Collective investments offer access to a whole range of different options. Some cover many asset classes under the one roof – equities, property and bonds for example. Others concentrate their efforts in just one – which could be anything from UK blue chip equities right through to Japanese bonds. Most collective investment funds are classified into sectors by the Investment Management Association (IMA) so that, at least loosely, you can identify what each fund is trying to achieve. For example, if you want a lower-risk fund that offers just a small exposure to equities, you may look at the 'Fixed Income' sector. If, however, you are looking to maximise long-term growth and you are prepared for a 100% exposure to equities, the UK All Companies sector might be more appropriate. For still more adventurous investors, there are 'Specialist' funds.

If you are seeking an income, the bond sectors may be more appropriate, or perhaps a sector which offers a mix of these and equities.

When making your choice, you should also be aware of the charges. For example, an index tracker fund which mirrors stock market's movements will be cheaper than a Japanese Smaller Companies fund which requires active management, in-depth research and a team of investment professionals.

Not all tax benefits are equal...

ISAs are well known for being tax-efficient savings and your choice of investment within the ISA can make a big difference to how beneficial they are for you. Whilst all the income and growth you receive from your ISA is tax-free in your hand each individual asset class within the ISA could be treated differently.

Cash ISAs for instance, are entirely free of Income Tax. Therefore, if you earn £1 in interest, you receive all the interest. On a normal bank or savings account, basic rate taxpayers currently pay tax of 20p on that £1 and higher rate taxpayers would be liable for another 20p or 25p. Therefore, you receive a greater total return from an ISA bank account than you would a non-ISA bank account. However, Cash ISAs make no capital gain.

For Stocks and Shares ISAs that invest into corporate bonds, the interest is also tax-free. The tax that is paid by companies distributing interest to bond holders is reclaimed on your behalf by your ISA provider and invested into your corporate bond fund to increase the number of units or shares you hold. Unlike cash ISAs, the capital value can fluctuate, and there is therefore the possibility of a tax-free capital gain as well as tax-free income.

There is also the chance of a capital loss if markets move against the investment - and also a risk to your income if a company defaults. As a result, corporate bonds generally pay a higher income than cash deposits as a way of compensating investors for taking on this additional risk.

The tax benefits on stocks and shares are a little different. Gains are taxed to Capital Gains Tax and under normal circumstances a personal CGT allowance of £11,700 applies and any gains less than this will not be taxed. Gains in excess of £11,700 are taxed according to your marginal rate of income tax – basic rate taxpayers currently suffer a 10% tax and a higher rate tax payer suffers a 20% tax (these rates increase when it comes to residential property and carried interest, with the basic rate set at 18% and the higher rate at 28%). Based on the historical performance, equities have offered greater long-term growth potential than any other asset class. With the exception of a few higher dividend paying companies, much of the benefit of investing in shares comes from capital growth which, under the terms of an ISA, is not subject to any Capital Gains Tax.

ISAs also offer a valuable relief on dividend tax. Normally dividends in excess of the £2,000 personal allowance are taxed - dividends then falling within the basic rate income band suffer a 7.5% tax, dividends falling into the higher rate income band are taxed at 32.5% and dividends falling into the additional rate income band are taxed of 38.1%. Clearly ISAs offer a great shelter for dividend paying investments.

Use it or Lose it!

You only receive one ISA allowance every tax year. You cannot carry your allowance over to the following year and therefore, if it is not used, it is lost forever. Your annual allowance can be used at any time during the tax year. For Stocks and Shares ISAs there is an issue of timing as a capital sum might be invested at a relative peak in the market. Therefore, using the facility of ‘drip feeding’ your allowance on a monthly basis could be a solution to enable you to benefit from ‘pound cost averaging’.

Can I change my mind if my investment manager under-performs?

You can transfer your ISA proceeds to a different manager at any time. In order to transfer the money and retain the tax benefits, you must complete a transfer request with your chosen new provider.

You must not close one ISA and then reinvest the proceeds in another as this is deemed to be a withdrawal. Once you withdraw, you lose all tax benefits on the funds withdrawn and you cannot reinvest, except where the amount falls below your current tax year’s unused allowance.

How do I monitor performance?

Your ISA provider will normally send you a valuation statement on a six monthly basis which will enable you to compare this to a previous statement and to see how your investment is progressing. For investors who require regular updates to their ISA valuation, many providers provide online access.

When can I withdraw my money?

Some accounts may have notice periods but you can give instructions to withdraw at any time. The provider will then divest your money and return the proceeds to you. You do not need to withdraw all of your money at the same time.

You can take just a proportion of your capital and leave the rest invested. Please note that some providers impose minimum investment levels.

If you would like to discuss any of the information provided in more detail, please contact your MPL adviser.

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