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Individual Savings Accounts (ISAs)

ISAs first became available on 6th April 1999 and Junior ISAs on 1 November 2011.

Investors are not taxable on income received from ISA savings and investments, and no tax is payable on capital gains arising (capital losses are disregarded). ISA managers can not reclaim the 10% tax credit on UK dividends. Investment returns do not need to be declared in tax returns and in addition ISA income is ignored when calculating entitlement to personal allowances.

The exemption from income tax is contained in Sections 694 to 701 Income Tax (Trading and Other Income) Act 2005, and the exemption from Capital Gains Tax (CGT) is in Section 151 Taxation of Chargeable Gains Act 1992. The detailed rules however are to be found within the ISA Regulations 1998 (SI 1998 No 1870) and subsequent amendments.

The relative simplicity and longevity of ISAs means that they are a core product in the UK savings market and in particular offer an alternative tax efficient investment strategy for those individuals who can no longer benefit from tax relief on their pensions savings having contributed up to their combined annual allowance and carry forward facility.

Key Points

- Who can subscribe and subscription limits
- Qualifying investments for stocks and shares ISAs
- Qualifying investments for cash ISAs
- ISA Transfers
- Closing an ISA
- Junior ISAs (JISAs)

Who can subscribe and subscription limits

An individual investor must be aged 16 or over if subscribing to a cash ISA, or 18 or over if subscribing to a stocks and shares ISA. Investors can subscribe cash to either type of ISA. Where investments held outside an ISA are sold and the proceeds subscribed to an ISA then this constitutes a disposal for capital gains purposes.

The direct transfer of shares into an ISA is allowed only where the shares were issued to the investor under a savings-related share option, approved profit sharing scheme or Share Incentive Plan. The market value of the shares at the date of transfer counts as the amount subscribed to the ISA. The total of the share value and any other cash subscribed must not exceed the subscription limits. Investors must transfer shares within 90 days:
- after the exercise of option date under SAYE share option schemes
- after the shares ceased to be subject to a Share Incentive Plan

Parents who give money to their children (aged under 18) to invest in their cash ISA need to be aware that if gifts from a parent produce more than £100 gross income in a tax year, the whole of the income from the gifts is normally taxed as that of the parent (S629 ITTOIA 2005). The child's gross income includes income from cash ISAs, but excludes income from JISAs.

An investor must be resident and ordinarily resident in the UK (not the Channel islands or the Isle of Man). A Crown employee serving overseas and their spouse/civil partner may also subscribe. For those who fail to meet the residence criteria then existing ISAs can be retained but not subscribed to.

Cash subscriptions from the investor's employer may be accepted where the employer confirms that the payment will be treated as a relevant payment to an employee for the purposes of the PAYE Regulations and a payment of earnings for the purposes of Class 1 NIC.

In each tax year, ISA individuals may subscribe to one cash ISA and one stocks and shares ISA. Subscription limits are not affected by withdrawals and cannot be carried forward. The following annual subscription limits will in due course be increased in line with the Consumer Prices Index. Increases are rounded to £120 to allow for regular monthly payments. If the CPI is negative the limits will remain unchanged.

Subscription limits are as follows:

	2012/13 **£**	**2013/14** **£**
Overall limit	11,280	11,520
Of which cash	5,640	5,760
Of which stocks & shares	11,280	11,520

Example:

John opens a stocks & shares ISA with £7,000 in May 2013. A few months later he withdraws £4,000. Later in the same year, John decides to replace the money by putting new funds into the account. However, he can only replace £4,520. This is because the annual subscription limit for a stocks & shares ISA is £11,520 in 2013/14, and John already put in £7,000 when he first opened the account.

Regarding JISAs, a child can hold up to two JISAs throughout their childhood - maximum of one cash and one stocks and shares JISA. Limits as follows:

	2012/13 **£**	**2013/14** **£**
JISA	3,600	3,720

In the tax year in which a child turns 16 he/she can subscribe up to the JISA limit, and in addition from their 16th birthday subscribe up to 50% of the overall 'adult' ISA limit to a cash ISA.

In the tax year in which a child turns 17 he/she can subscribe up to the JISA limit, and subscribe up to 50% of the overall ISA limit to a cash ISA.

From the start of the tax year a child turns 18, he/she can use their whole JISA subscription limit (even though the JISA will be held for a part-year only); and subscribe 50% of their overall 'adult' ISA limit to a cash ISA; and from their 18th birthday, invest in a stocks and shares ISA, subject to the normal 'adult' subscription limits.

Strictly, all ISA applications must be made by the investor (see later for JISAs). An ISA manager may however accept an application by someone legally appointed or authorised to act on behalf of the investor if the investor is not able to complete the application form by reason of mental disorder or incapacity, or physical disability, illness or old age.

Qualifying investments for stocks and shares ISAs

Stocks and shares ISAs can include:

- shares and corporate bonds (with at least five years to redemption when first held in the ISA) issued by companies officially listed on a recognised stock exchange anywhere in the world.
- Gilts issued by the UK government, similar securities issued by governments of other countries in the European Economic Area and 'strips' of all these securities.
- units or shares in funds authorised by the Financial Services Authority (unit trusts or Open Ended Investment Companies (OEICs)).
- units or shares in non-UCITS (Undertakings of Collective Investment in Transferable Securities) retail schemes authorised by the FSA for sale to retail investors in the UK.
- shares and securities in investment trusts.
- units or shares in UCITS funds based elsewhere in the European Union (these are similar to unit trusts and OEICs authorised by the FSA).
- any shares which have been transferred from an HMRC approved SAYE share option scheme or Share Incentive Plan.
- stakeholder medium-term products.
- Life insurance policies on the life of the ISA investor (unit linked or with profits policies)

Life insurance policies must meet a number of conditions to qualify and only those specially designed for ISAs can be included. The policies may be the ISA manager's own policies, or the manager may offer policies from different insurers.

Cash may also be held in a stocks and shares ISA but only to invest in qualifying investments. Cash includes cash subscriptions, interest and dividends, and proceeds from disposals of qualifying investments that have not yet been reinvested. Managers should therefore monitor all stocks and shares ISAs, to ensure that cash on deposit is held for the purpose of investment in qualifying investments. This includes the situation where the investor is awaiting a suitable investment opportunity. The ISA manager may pay interest on this cash. There is no income tax to pay on the interest, but the manager must deduct a flat rate 20% charge before crediting it to the account. This deduction is then paid by the manager to HMRC. The interest does not have to be declared on the individual's tax return.

Where an investor wishes to take income from a stocks and shares ISA, the manager's system may accumulate income received over a period of time (often three or six months) pending pay away. In strictness, this cash should not be retained in the ISA (because it is not held for the purpose of investing in qualifying investments). In practice, however, managers may retain the cash in ISA provided it is paid out to the investor on a regular basis, not remaining in the ISA for more than twelve months.

Qualifying investments for cash ISAs

- cash deposited in bank and building society accounts
- National Savings and Investments products that are specially designed for ISAs (but not other National Savings and Investments products such as the Investment Account, Savings Certificates or Pensioners' Guaranteed Income Bonds)
- alternative Finance arrangements, such as Shari'a compliant products
  shares in companies and collective investment schemes that fail to meet the qualifying conditions for stocks and shares ISAs
- life insurance policies that fail to meet the qualifying conditions for the stocks and shares ISAs
- the stakeholder cash product
- stakeholder medium-term products that fail to meet the qualifying conditions for stocks and shares ISAs

ISA Transfers

Subscriptions to a stocks and shares ISA can only be transferred to another stocks and shares ISA. However, subscriptions to a cash ISA can be transferred to another cash ISA, or to a stocks and shares ISA. Investments and/or cash transferred are not new subscriptions.

An investor can transfer

- all of the current year's ISA subscriptions, the investments bought with those subscriptions, and any income arising on those investments (current year account), and/or
- some or all of the previous years' ISA subscriptions, the investments bought with those subscriptions, and any income arising on those investments (prior years account).

Where current year subscriptions are being transferred from a cash ISA to a stocks and shares ISA, the current year subscriptions are transferred in whole (including any related income), and are treated for all ISA purposes as if they had been made to the stocks and shares ISA. This means that the investor is regarded as never having subscribed to the cash ISA. Within the overall subscription limit, therefore, the investor may subscribe to a cash ISA later in the current year.

Closing an ISA

The ISA manager may close a particular ISA where the terms and conditions allow. For example where the balance falls below a particular level.

Under ISA regulations, investments must remain in the beneficial ownership of the investor. However, under the Insolvency Act, a bankrupt's estate vests in a trustee meaning that ISA investments cease to be in the beneficial ownership of the investor. Accordingly, an ISA manager notified of the bankruptcy of an investor must close it with effect from the date on which the trustee's appointment takes effect (or, in the case of the Official Receiver, the date on which he becomes trustee).

An ISA ceases on the death of the investor. Any interest, dividends or gains that arise after the date of death to the date of closure are not exempt from tax. There is no loss of exemption on interest, dividends or gains which arise before the date of death. Subject to the ISA terms and conditions, the ISA manager should advise the personal representatives that they have the choice of the ISA investments being transferred to them (or a beneficiary) or of the ISA manager selling the investments and paying the proceeds to them.

Where there is a life insurance policy within the ISA, it will pay out on death. Any gain treated as arising as a result of death is exempt from tax.

Where an ISA is found to be invalid (eg the subscription is invalid) then in certain circumstances the ISA can continue after corrective action, or 'repair'. Invalid accounts that cannot be repaired must be voided meaning that all income in respect of the invalid subscription is to be taxed and all the invalid subscription and the (taxed) income has to be removed from the ISA. Valid subscriptions from previous (and possibly later) years are unaffected. If the ISA contains an insurance policy, and any of the excess subscription to be removed is assigned to that policy, it must be removed in full. An insurance policy cannot be repaired: it must either all stay in the ISA or all be removed.

Junior ISAs (JISAs)

A JISA application can only be made by a person aged 16 or over. Where the child is aged 16 or over, either the child or a person with parental responsibility for the child can apply to open the account. Where the child is under 16 only a person with parental responsibility for the child can apply to open the JISA.

When application is made the child must be under age 18, and not an eligible child for Chid Trust Fund purposes.

The account must be held in the name of the child but any person can subscribe to it. Simplified due diligence will apply to the opening of a JISA so full Money Laundering checks are not required on the child or the applicant for the JISA. The person subscribing need not be resident in the UK, nor do they have to be related to the child. It must be made clear to the person subscribing that they are making a gift to the child which cannot be repaid if at a later date the subscriber changes their mind.

The only amounts that can be withdrawn prior to the child's 18th birthday are to meet certain provider management charges and other specific expenses, or where the child is terminally ill. Should the child die before attaining 18 the JISA will close and the investments will become part of the child's estate. In all circumstances other than death or terminal illness of an account holder, a JISA must run until the child's 18th birthday.

As with adult ISAs, accounts can be transferred between account managers.

The types of investments that can be held in these accounts mirror the 'adult' ISA rules (with the exception that a stocks and shares JISA cannot hold shares acquired under a SAYE scheme, profit share scheme or SIP).

Uninvested cash held in a stocks and shares JISA is not subject to the flat rate charge although when the child turns 18, a stocks and shares JISA becomes a stocks and shares ISA, any interest arising on the cash from that date onwards will become subject to the charge.

Once the child turns 18, any savings in the JISA that are not immediately withdrawn will stay within a tax free wrapper albeit that the rules specific to JISA will fall away. The ISA manager may continue with the same account number or allocate a new one depending on what suits it's systems and processes.