

The case for individual savings accounts

With the end of the financial year fast approaching the need to choose an investment for your individual savings account (ISA) becomes ever more pressing. It's a case of use it or lose it – and the tax concessions on ISAs are worth having, particularly if you are a higher rate taxpayer.

You can invest up to £7000 in an ISA before 6 April, of which £3000 can be in cash (Table 1). After that date the limit rises to £7200, of which £3600 can be in cash (Table 2). This allows a sizeable investment of £14 200 or £28 400 for a couple over the two tax years.

Under the current rules you can put the full £7000 into a stocks-and-shares maxi ISA or you can take out two mini ISAs, of which up to £3000 can be invested in cash and the remaining £4000 can be invested in shares or an equity-based investment like a unit trust or investment trust that holds a range of shares and spreads the risk.

If you do not have cash to invest, you can move holdings in a portfolio of shares or unit trusts into ISAs to shield these from future capital gains tax, although

capital gains tax may be payable at the time of moving them. Investments held in an ISA accumulate free from capital gains tax, with interest from bonds and gilts being tax-free, although the 10% tax credit accompanying dividends may not be reclaimed.

Changing transfer rules

From April, savers can transfer existing cash ISAs into stocks and shares ISAs without losing tax benefits. The rules

Those aged over 65 years are eligible for an increased personal tax allowance – £7550 for those aged 65–74 years or £7690 for those aged 75 years or over (figures for the 2007–8 tax year). But if you have gross income in excess of £20 900 (the current age allowance limit for 2007–8) you lose £1 of age allowance for every £2 of gross taxable income over a threshold of £20 900. However, ISA income does not count towards the £20 900 threshold.

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Table 1. Individual savings accounts (ISA) limits for tax year 2007–8

	Cash	Stocks and shares	Maximum investment
Mini-ISA	£3000	£4000	£7000
Maxi-ISA	–	£7000	£7000

Table 2. Individual savings accounts (ISA) limits for tax year 2008–9*

Cash	Stocks and shares	Maximum investment
£3600	£3600	£7200
–	£7200	£7200

* In the tax year 2008–9 mini and maxi ISAs will no longer exist. Instead, ISA savers will be able to invest in a cash ISA and/or a stocks and shares ISA

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will also be simplified to remove the distinction between maxi and mini ISAs, with ISAs being classified either as stocks and shares accounts or cash accounts. In addition, existing personal equity plans (PEPs) will be re-designated as stocks and shares accounts. It will be important to consider investing any cash which is currently held in a PEP, as interest on this will be subject to tax at 20%. Existing PEP or ISAs transferred into an ISA do not affect the annual investment limit but you cannot transfer any ISA funds invested in stocks and shares into cash.

Boosting your pension

The tax advantages of investing in an ISA – and the ability to take tax-free income (other than the inability to reclaim the tax credit on dividends) at retirement or earlier – can be a good way of enhancing your pension. So it can make sense to use up all your ISA allowance first, before considering investing extra in a pension.

Stocks and shares ISAs should be viewed as vehicles for long-term investments, particularly if they are intended to provide additional retirement savings. Eligible investments for equity-based ISAs include individual shares – both UK and foreign stocks quoted on any recognized stock exchange – unit and investment trusts, corporate bonds, gilts and funds investing in these fixed interest securities.

Insurance company investments, including some with-profits funds, fall within the definition of stocks and shares ISAs and can be seen as investments that should show better returns than cash but without the volatility of a direct investment in shares.

For some people it makes sense to invest in a range of investments that spread the level of risk, such as that in a with-profits fund. **BJHM**

The above information does not constitute financial advice. For further information please speak to your financial adviser.