



Finance Matters - Tax free savings

It is very rare that the Government provides something which shelters your money from tax – but an Individual Savings Account (ISA) is one of those things. Introduced in 1999, it has now become the primary savings vehicle for adults, with a total of over £215 billion now invested by more than 16 million people¹.

Each year, you are able to invest up to £7,000 in an ISA, up to £3,000 of which can be in cash. Once invested, you have no further liability for income or capital gains tax on any profits you receive - indeed, you do not even have to tell the taxman that you have the ISA.

Within the ISA, there are thousands of different investment options available – from cash and bonds through to property, equities and even overseas companies. You can therefore be confident that, whatever your aims and objectives, we can find a suitable home for your money – and as your professional financial adviser, it is my job to help you.

So 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. An ISA sits over your choice of a number of different investments to shelter them from further tax liability on any income or gains earned. Each tax year, you receive an ISA allowance of £7,000. Up to £3,000 of this can be invested in cash deposit accounts and up to £4,000 in stocks and shares. Alternatively, if you do not wish to use the cash allocation, the whole £7,000 can go directly into stocks and shares.

To help you allocate this money, there are two types of ISA available – the Maxi and the Mini. The Maxi ISA is offered by a single provider and can allow investment either across cash and stocks and shares under the one account or in stocks and shares alone. In reality, however, with the exception of some of the high street banks, it is very rare to find a Maxi ISA provider offering the separate cash component. Instead, most concentrate on offering a range of investment funds for your full £7,000.

If you do wish to use the cash allocation, it may be better to consider Mini ISAs. It is unusual to find a provider who offers both top interest paying deposit accounts and top performing investment funds. Rather than potentially having to compromise on one or other, you can instead use Mini ISAs - one cash and one stocks and shares - to split your money and thereby target the best provider for each.

What makes a good Cash ISA?

Cash ISAs are simply bank accounts which sit within the tax benefits of the ISA wrapper and are therefore amongst the most straightforward products in the financial market. The capital in a

deposit account will not grow, but it is secure (ie: the value will not go down) and earns interest for the entire time it is invested. Therefore, in order to find the best one, you would generally just need to look for the highest interest rate.

However, there are some differences to be aware of. Some providers will hike their rates up for a short period to win your money but then cut them once you are invested. You should therefore consider their reputation for rate levels in the past and also read the small print to check for any rate guarantees or caveats. Some providers might tie your money up for a period of time. These accounts pay higher rates because the provider can plan their own investments better – but you may have to wait up to 90 days if you make a withdrawal. In essence, even the seemingly simplest of products needs some research. Make sure you make the right choice before you get tied in.

Collective investments in an equity ISA

By investing in a collective investment, you are accessing not just one or two shares but shares in many different companies or holdings. Known as diversification, this approach means that should one company lose money, there are lots of others to help to 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. To make the choice easier for you, most unit trust and OEIC (Open Ended Investment Companies) funds are sorted into sectors by the Investment Management Association (the IMA) so that, at least loosely, you can identify which are trying to achieve what.

Therefore, if you want a low risk fund which offers just a small exposure to equities, you may look at the 'Cautious Managed sector'. If you are looking to maximise long term growth, and are prepared for a 100% exposure to equities, the UK All Companies sector is a good place to start – but if you want to be more adventurous, there are equity fund sectors for every country in the world. Finally, if you are after an income, the bond sectors may be more appropriate, or perhaps a sector which offers a mix of these and equities.

Charges

When making your choice, you should also be aware of the charges. A collective investment includes all the necessary research, share dealing and paperwork required to ensure you are up to date and getting the most from your investment. In return, you will pay an upfront and small ongoing fee, the level of which will vary to reflect the complexity of the investment product. Therefore, a straightforward index tracker fund which mirrors a stock market's movements will be cheaper than a Taiwanese Smaller Companies fund which requires active management, in-depth research and a team of investment professionals to support it, although even the latter will rarely cost more than 2% a year.

Use it or lose it!

One thing is not up for debate: you only get one allowance every tax year. You cannot carry your allowance over to next year and therefore, if you do not do something about it, you will lose it.

Your £7,000 allowance can be used at any time during the tax year. Indeed, when the deadline of April 5th begins to advance, this helps to concentrate the mind and we witness an increase in ISA investments. However, you do not have to wait. You can use your allowance at any time – and many would suggest that the earlier the better, particularly with Cash ISAs where the earlier you get in the more interest you make.

For stocks and shares ISAs, there is an argument for trying to 'time' your investment so you buy in when the assets are cheap (in order to make more when they recover later). However, if anyone had really uncovered the truth about how to time the market, we would all be millionaires by now. For the sake of a few pounds, if you are that concerned about investing in shares, perhaps you should reconsider whether the risk is appropriate for you. Or, try drip feeding your allowance in on a monthly basis instead so that you can take both the rough and the smooth as markets fluctuate. Regardless of how or where you decide to invest your money, you must get in before April 5th. At the end of the tax year, your allowance is gone.

Make your decision, have your conversations, do your research, but start it now and make sure you don't lose out!

1: Source, www.hm-treasury.gov.uk as at 1 Jan 07