



The Association of Investment Companies

Investment Companies and Individual Savings Accounts (ISAs)

Individual Savings Accounts (ISAs) offer UK savers a way to save or invest their money within a tax-favoured structure. This factsheet looks at the key features of ISAs and the benefits investment companies can offer as part of an ISA investment.

What are ISAs?

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ISAs were introduced in the spring of 1999 to replace Personal Equity Plans (PEPs) and Tax Exempt Special Savings Accounts (TESSAs) as a new way for UK savers to invest their money within a tax-favoured environment.

When you save or invest through an ISA, the income and growth from your savings and investments are free of income tax and capital gains tax and you do not have to declare an ISA on your tax return.

The overall annual investment limit is £10,680 for the 2011-2012 tax year. A tax year runs from 6th April one year to 5th April the following year. As of April 2011, the limit is being increased annually in line with the Retail Prices Index, which means that the limit will rise to £11,280 for the 2012-2013 tax year. An ISA is not itself an investment, but is often referred to as a "wrapper product". It is simply a "wrapper" within which an underlying investment is held.

Who can invest in an ISA?

Only those who are ordinarily resident in the UK can invest in an ISA. UK citizens who have moved abroad may continue to hold and receive tax relief on existing ISAs but may not make new investments whilst living outside of the UK.

Crown employees who are serving overseas are the exception to this residency requirement and may invest money into an ISA in the usual way. This also applies to spouses/civil partners of crown employees.

What are investment companies?

In a nutshell, investment companies are companies that invest in a diversified portfolio of assets to make money for their shareholders. Investment companies can be investment trusts, venture capital trusts, and offshore and AIM traded investment companies. Investment companies pool investors' money and employ a professional fund manager to invest in a wider range of assets than most people could practically invest in themselves. This way even people with small amounts of money can gain exposure, at low cost, to a diversified and professionally run portfolio, spreading the risk of their investment. Investment companies are listed on a stock exchange and there are over 400 investment companies in the UK responsible for the management of billions of pounds worth of assets on behalf of investors. For more information on investment companies please read our factsheet 'An introduction to investment companies'.

Features of ISAs

Savings and investment components

There are rules regarding the type of investment which you can hold within an ISA. Eligible investments are divided into two components, these are:

- Cash - which includes bank and building society savings accounts, National Savings etc.
- Stocks and shares - which includes investment companies, unit trusts, shares, bonds, certain eligible insurance products and so on.

When investing within an ISA you can include one or both of these components. There are, however, strict rules regarding the maximum amount allowed in each component and the overall amount you can invest in any one tax year.

Investing in the stock market

It's worth remembering that, although over the short term the stock market can be a volatile place, these ups and downs tend to even themselves out over time. Historically, the stock market has outperformed bank and building society deposits over the longer term. The sooner you start investing the longer and greater chance your money has to grow.

ISA structure

From 6 April 2011, the overall annual investment limit is £10,680 per tax year. You are able to invest all of this in stocks and shares, or a maximum of £5,340 in cash and the balance in stocks and shares.

In each year you can subscribe to one cash ISA and one stocks and shares ISA. You cannot subscribe to more than one cash ISA or more than one stocks and shares ISA in the same tax year.

You can hold your ISA accounts with either the same or different providers. For example, an individual will be able to save £1,000 in a cash ISA with one provider and £9,200 in a stocks and shares ISA with a different provider. You may choose different ISA providers for each new tax year.

From 6 April 2011, the ISA limit has increased in line with the Retail Prices Index (RPI) on an annual basis. The new annual limits will be rounded to the nearest multiple of 120, so that individuals who save monthly will be able to calculate their monthly savings more easily.

The new limit is calculated by reference to the RPI figure for the September preceding the new tax year. The RPI for September 2011 was 5.2% so the rounded 2012-13 limits will be an overall ISA subscription limit of £11,280 of which up to £5,640 can be subscribed to a cash ISA.

ISA Limits

Number of accounts	One stocks and shares ISA and/or one cash ISA. These may be through different providers.	
Year	2011/12	2012/13
Cash ISA	Up to £5,340	Up to £5,640
Stocks and shares ISA	Up to £10,680	Up to £11,280
Maximum for the year	£10,680	£11,280

Qualifying investments for stocks and shares

There are strict rules that govern which investment companies, unit trusts, shares, bonds, and so on are eligible for inclusion in an ISA. For investment companies these rules include that their shares must be listed on an official list of a recognised stock exchange. This means, for example, that investment companies which trade on the Alternative Investment Market (AIM) are not eligible. The vast majority of investment companies qualify as ISA investments and you can find more information on these companies on our website.

What are the tax benefits of ISAs

One of the key benefits of investing within an ISA is that you do not pay tax on the returns you receive from your ISA investments.

In other words, you pay no tax on any of the income you receive from your cash or stocks and shares investments. This includes dividends and interest. You also pay no tax on capital gains arising on your

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ISA investments. However losses on ISA investments cannot be used for capital gains tax purposes against capital gains outside your ISA.

Additional tax benefits

- For those hovering on the threshold between one tax band and another investing within an ISA could make the difference between falling into the higher rate band or not, as income from an ISA is not included by HM Revenue & Customs in tax band calculations.
- For those over the age of 65, income received from investments held within an ISA does not erode the higher personal tax allowance they receive.
- For higher rate tax payers, dividends received from investments held within an ISA are not liable to any additional tax.

Changes to tax law

It is important to realise that HM Revenue & Customs law and practice does change over time - levels and bases of and reliefs from taxation are subject to change.

What are the benefits of investment companies?

Allows you to pool your money

When you purchase shares in an investment company you pool your money with all the other investors' money, providing potential economies of scale in terms of dealing costs and administration.

Allows you to spread your risk

Each investment company owns a range of investments, so buying shares in only one company effectively gives you a diversified portfolio. As you're not dependent on the success of just one or two investments, this spreads your risk. However, it must be remembered that investment company shares are equity investments and the price of the shares and the income from them can go down as well as up.

Uses professional management

Each investment company benefits from professional fund management expertise.

Many have low internal charges

Many investment companies have low internal charges. Because boards must act in the interests of shareholders, they work to ensure that 'costs' or the company's internal charges are not excessive and that the interests of shareholders are looked after. Low charges within the company means that more of your money is working for you right from the start of your investment.

PEPs

Personal Equity Plans (PEPs) were replaced by ISAs in 1999. From 6 April 2008, all PEP accounts ceased to exist and they became stocks and shares ISAs.

Features of ISA investment schemes

Investment company shares can be purchased through ISA wrapper schemes, which can be run by a company or a fund management group. Some of the key features of the ISA wrapper schemes are provided below.

Flexibility

It is flexible and convenient to invest in an investment company ISA. As long as you don't exceed the annual ISA limit you can increase or decrease your payments at any time, or even stop investing and start again at a later date. You can also make additional one-off lump sum payments into your investment. You can take your money out at any time (although some schemes do have a notice period, so check first). Remember that equity investment is for the longer term and you should carefully evaluate your objectives and reasons for investing before making a decision to change or dispose of your investment.

It is possible to hold several different investment companies within a single ISA scheme.

Low minimum investment

You can invest small lump sum amounts or make regular monthly investments. If you have a lump sum to invest, investing in an investment company ISA is simple and you can invest as little as a £250 lump sum in some ISA schemes. For those who prefer to save on a regular basis, you can invest from as little as £50 a month in to one of the many investment company ISA schemes on offer.

Regular Saving

One of the advantages of regular saving is known as 'pound-cost averaging'. Buying your shares monthly smoothes out the highs and lows of the share price over time. This is because you buy fewer shares when the price is high and more when the price is low, taking away some of the risk of market timing that can occur when buying shares with a lump sum. The result of this is that in a falling market the average price you pay for your shares over a given period is lower than the average market price.

Costs

An ISA scheme provider will collate the buying orders from all the monthly investors within a scheme for a given month and place the total as one bulk deal with a stockbroker. By pooling all the investors' money the manager is able to negotiate a discount on the dealing costs. These cost savings are passed on to investors, making investment schemes a cost effective way to invest regularly in the stock market.

ISA providers, including those offering stocks and shares, usually make an additional charge to cover the costs of administering the scheme. These costs will be detailed in the provider's literature, and you should investigate the total costs involved before investing.

Transferring an ISA

If you wish to transfer your ISA to another manager this must be arranged directly by your current manager. Check the terms and conditions with your ISA manager to find out if you will be charged for transferring. You cannot arrange a transfer yourself by closing the first ISA and paying the money to another ISA manager.

You can also transfer some or all of the money saved in previous tax years from cash ISAs into stocks and shares ISAs. Money saved in the current tax year in cash ISAs can also be transferred into stocks and shares ISAs but these transfers must be for the whole amount that you have saved in that cash ISA. Please note that you cannot transfer funds in a stocks and shares ISA to a cash ISA.

If you accumulate a number of ISA schemes over the years, it is important to review them from time to time. This is because your investment needs may have changed or it could be that the funds that you have invested in have not performed as well as you might have expected.

Administration

ISAs can save you time on administering your investments. This is because any money invested in an ISA does not have to be mentioned on your self-assessment tax return and you do not have to report any income and capital gains from ISA savings and investments.

More Information

ISA schemes are usually run by the management companies of the relevant investment company and most investment company shares are available through these schemes. The AIC website www.theaic.co.uk has details of the ISA schemes offered by Member companies and their managers.

Important information about investment companies

Investment returns are not guaranteed and past performance is not necessarily a guide to the future. Exchange rate fluctuations may cause the value of the underlying investment to go up or down.

Investment companies can borrow money or “gear” to invest in more shares using the existing portfolio as collateral. Companies that use significant levels of gearing may be subject to sudden and large falls in value and you could get back nothing at all.

An investment company's share price may not reflect the underlying value of the shares, known as its net asset value (NAV). Commonly investment company shares trade at a discount to their NAV, for example where a company's NAV is £1 and its share price is 90p it will be trading at a 10% discount. Conversely, if the share price is 110p and the NAV is 100p then it will be trading at a 10% premium. The level of discount/premium of a share price and whether it is rising or falling can be a factor when deciding to buy or sell an investment company's shares.

Certain investment companies issue different classes of shares which have different rights and entitlements within the company. The different classes of share are designed to meet different investors' needs. These are known as split capital investment companies ('splits'). Splits are more complex and may be higher risk than conventional investment companies.

It is important to realise that HM Revenue & Customs law and practice relating to ISAs does change over time and that levels and bases of and reliefs from taxation are subject to change.

How to invest

Investing with advice

You can go to a professional financial adviser, who will give you advice on what to invest in. Together you can work through all the factors that affect your decision, including your needs and available funds, the performance figures for different companies, and the outlook for different sectors. Your adviser can then recommend investment companies which may be a suitable investment for you and advise you on how to make your investment.

The AIC website www.theaic.co.uk has further information about seeking financial advice. Alternatively you can find a Certified Financial Planner by calling the Institute of Financial Planning on 0117 945 2470 or by going to www.financialplanning.org.uk

Investing without advice

If you are prepared to select your own investment company you can choose whether to go direct to a stockbroker or an execution only dealing service to buy shares for you. If you prefer you can also approach a fund management group to invest via a wrapper product. The AIC website www.theaic.co.uk has further information on wrapper schemes.

Summary

Investment companies are a good way for private investors to benefit from an effective and cost-efficient investment vehicle and to gain exposure to a diversified portfolio. The flexibility and accessibility of investment companies can make them suitable for a wide range of financial planning objectives, including ISA investments, because of their low minimum investment levels and spread of risk. Investors who are unsure whether this investment is suitable to them should obtain independent advice from their professional adviser.

For further information

Visit our website

Our website is a good place to start if you want to learn more about investment companies and find detailed information on all our member companies. You can find it at www.theaic.co.uk.

Information factsheets

The AIC publishes a range of factsheets which are available free of charge by calling 0800 085 8520 or can be downloaded from our website.



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