GIVE YOUR ISA SOME WELLY!

Whether you are building a nest egg for your children, buying a home or boosting your pension, there is an Isa that could help you. Don't just stick with a Cash Isa – check out the other options too

BY RUTH JACKSON-KIRBY

Just a few years ago, a Cash Isa was a great home for your savings. You could enjoy a reasonable return on your money and not have to hand a penny of it to the taxman. But these days the interest rates offered on Cash Isas are pitiful. The average rate is 0.84%, according to Moneyfacts, which is well below inflation. Add in the fact most of us can now earn £1,000 a year tax-free on our normal savings accounts and it's hard to see the allure of a Cash Isa.

But that doesn't mean you should write off Isas completely. There are a lot of other types of Isa that could seriously boost your nest egg.

We look at the rest of the Isa family and what they could do for you.

0.88%
Average interest rate on a Cash Isa
(Moneyfacts)

Build a nest egg

The most common reason to save into an Isa is simply to build a nest egg for the future. Most of us opt to do this with a Cash Isa but, depending on when you want the money and how much risk you're willing to take with it, there may be more rewarding alternatives. For example, you could consider an Investment Isa or Innovative Finance Isa.

Harry Row, 26, an anaesthetic practitioner from Cardiff, decided that he would start saving when he received a rebate from the taxman.

"The money had spent a number of months sitting in my current account, collecting dust, while I was wondering what best to do with it," he says.

"After doing some research, I decided to go with an Investment Isa, rather than a Cash Isa. The reasoning behind my decision was, although my capital is at risk, I could grow my money in far more substantial amounts if it were invested rather than left alone earning interest, given the low rates at present."

Harry has earned a 19.98% return on his £5,000 investment since opening his Isa two years ago.

"Over the long term, Stocks and Shares Isas are a great way of building a nest egg," says Sarah Coles, a personal finance analyst at Hargreaves Lansdown.

"Many of us avoid Investment Isas because we are worried about the risk of losing money in the short term on the stock market – despite the fact that as long as we hold if for five to 10 years or more, we can usually ride this out and take advantage of long-term growth."

CAN I HAVE MORE THAN ONE ISA?

You can pay into one of each type of Isa within any one tax year, and split your allowance between them however you like. Therefore, you can still pay into a Cash Isa if you wish, while trying out an alternative at the same time. You can pay in a maximum of £20,000 across all your Isas this tax year.

An Investment Isa acts like a tax-efficient wrapper around your choice of shares or funds. You can open an Isa with an investment platform such as interactive investor, Hargreaves Lansdown or Vanguard, then fill it with your choice of investments. Your investment can then grow free from income tax, capital gains tax and dividend tax.

Buy a house

The right Isa can also significantly boost your savings towards your own home. The Lifetime Isa (Lisa) can be opened by anyone aged between 18 and 39. You can deposit up to £4,000 a year and the Government will add 25% to anything you pay in, so you could boost your savings by £1,000 a year.

You can either use the money to buy your first home or access it when you are 60 or over, to help with your retirement.

You can make deposits into a Lifetime Isa until you are 50, so you could get up to £33,000 from the Government if you saved the maximum every year.

£5,114
Average amount held in a Cash Isa
(HMRC)

Lisas can hold cash or investments. Which to choose will depend on when you need the money.

If you need it to buy a home in less than five years' time, cash is the best option. The interest rates are not great – the best buy is 1.4% from Moneybox – but your money isn't at risk of stock market falls.

If you can tie up your money for five years or more, then investments are likely to outperform the return you would get on cash. Various firms, including AJ Bell, Forester, Hargreaves Lansdown, Nutmeg and The Share Centre, offer Stocks and Shares Lifetime Isas.

The best Cash Isa rates

Type of Account	Account	Interest Rate	Transfers In?	Notes
Instant Access	Al Rayan	1.36%	Yes	
Notice Account	Paragon	1.31%	Yes	120 days' notice to withdraw
One Year Fixed Rate	OakNorth Bank	1.41%	Yes	Earlier access subject to 90-day loss of interest
Two Year Fixed Rate	Al Rayan	1.50%	Yes	Offers an Expected Profit Rate
Five Year Fixed Rate	Coventry BS	1.75%	Yes	Matures on 31 May 2025
Junior Isa	Coventry BS	3.6%	Yes	

Source: Moneywise, 14/11/20

£10,124
Average amount held in an Investment Isa
(HMRC)

Supplement your pension

"People can choose to invest in an Isa alongside their pension to give them extra flexibility over how they structure their retirement income," says Helen Morrissey, a long-term savings specialist at Royal London.

"For instance, they may amass a sizeable amount in their Stocks and Shares Isa that they choose to access first so they can leave their pension untouched."

There are several benefits to this. First, as soon as you start drawing an income from your pension the amount you can pay into it drops from £40,000 a year to £4,000 a year. Using your Isa first means you can carry on paying into your pension and enjoying the associated tax relief.

Second, if you die your pension can be passed on to your beneficiaries free from inheritance tax (IHT), while an Isa counts as part of your estate for IHT purposes. So it can make sense to spend your Isa savings before you start using your pension.

"Isas can also prove useful to those people unable to top up their pension due to lifetime or annual allowance issues," says Morrissey. "Being able to put that money into an Isa offers a further option for people to benefit from tax-efficient investment growth."

Unlike pension income. cash taken out of an Isa in retirement will not be subject to tax.

Save for your children's future

If you plan to set aside money for your children, then a Junior Isa (Jisa) is the best place to put it. Protecting your child's money from tax may seem strange, but in the eyes of the taxman they are the same as an adult.

Children have to pay income tax and capital gains tax in just the same way. While it is unlikely they will exceed their personal allowances and have to pay tax as a child, it's worth getting their money into a tax-efficient wrapper now, so it's protected when they are older and earning enough to pay tax.

If you deposited the full allowance each year – and it grew by 3% a year – your child would have just over £100,000 already beyond the taxman's reach when they turn 18.

Most parents opt for a Cash Jisa, but you are likely to get a better return if you choose an Investment Jisa.

"The fact Jisas are out of reach until your child is 18 means it's a great way to build a tax-free nest egg," says Coles. "While investments can go up and down in value, over 18 years there is usually plenty of time to see these out and take advantage of more potential long-term growth from the stock market than from cash."

However, bear in mind that your child will take over control of any Jisa in their name when they turn 18 and may not have the maturity to make sensible spending decisions.

Become a profitable lender

Another way to boost the return on your savings is to start lending your cash to other people. The Innovative Finance Isa (Ifisa) allows you to put peer-to-peer (P2P) investments in an Isa wrapper. You put your money into the Ifisa and then it is lent to other individuals or businesses.

Mike Best, 39, a software developer from Edinburgh, has an Ifisa with Funding Circle.

"I was initially attracted because of the return. You can earn several times what you could with a Cash Isa," he says. "Over the long term, my Ifisa has yielded 6%. It forms part of my long-term investment plan, including for my retirement as an alternative to a Sipp. I also have a Stocks and Shares Isa."

The reason you get a better return with an Ifisa than a Cash Isa is because you're taking on more risk. There is always the chance someone you lend to could fail to pay you back.

"Some businesses you lend to will have hard times, but the key to controlling risk is diversification," says Best. "I currently lend to over 200 businesses, with each making up less than 0.5% of my portfolio."

1,000
– the number of Isa millionaires

A major risk with an Ifisa is your money is not covered by the Financial Services Compensation Scheme. This means if the Ifisa provider goes bust you could lose your money. Different Ifisa providers operate using different

INHERITING ISAS

When someone dies, their Isas don't die with them. Isa accounts can be inherited by a spouse or civil partner, meaning they can continue to enjoy the tax benefits. When your partner dies, you are given an additional permitted subscription (APS). This is a one-off Isa allowance that is equal to the value of your partner's Isa holdings when they died. For example, if your partner died with £80,000 in Isas, you would be given an Isa allowance of £100,000 for that tax year (your own Isa allowance of £20,000 plus the value of their accounts).

£20,000
Annual Isa allowance

£4,368
Junior Isa allowance in the 19/20 tax year

Whichever Isa you choose to boost your returns, don't forget your Cash Isa completely

models, so choose your provider carefully and be cautious of returns that seem too good to be true.

When P2P firm Lendy collapsed in May 2018, investors were owed about £152 million. Many could receive back less than they invested, as funds were not ring-fenced as they believed – this means Lendy investors' money could end up being paid to insolvency practitioners and creditors instead of being returned.

"When choosing an Ifisa option, we suggest people look primarily at the underlying asset class they'll be investing in," says Natasha Wear, chief executive of P2P at Zopa.

"P2P platforms offer a variety of asset classes, including lower-risk personal loans through to higher-risk small businesses and property loans."

The FCA introduced new rules to protect P2P investors in 2019. The regulations mean retail investors can only have 10% of their investible assets in P2P loans unless they have received regulated financial advice. The aim is to ensure that investors do not over-expose themselves to risk.

Don't forget your rainy day fund

Whichever Isa you choose to boost your returns, don't forget about your Cash Isa completely. We all need to have access to cash in a hurry should an emergency arise, so keeping some of your savings in an easy access account is still a good idea.

"You can always divide your Isa allowance between cash and stocks and shares, in whatever proportion leaves you comfortable," says Francis Klonowski, a certified financial planner. mw

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