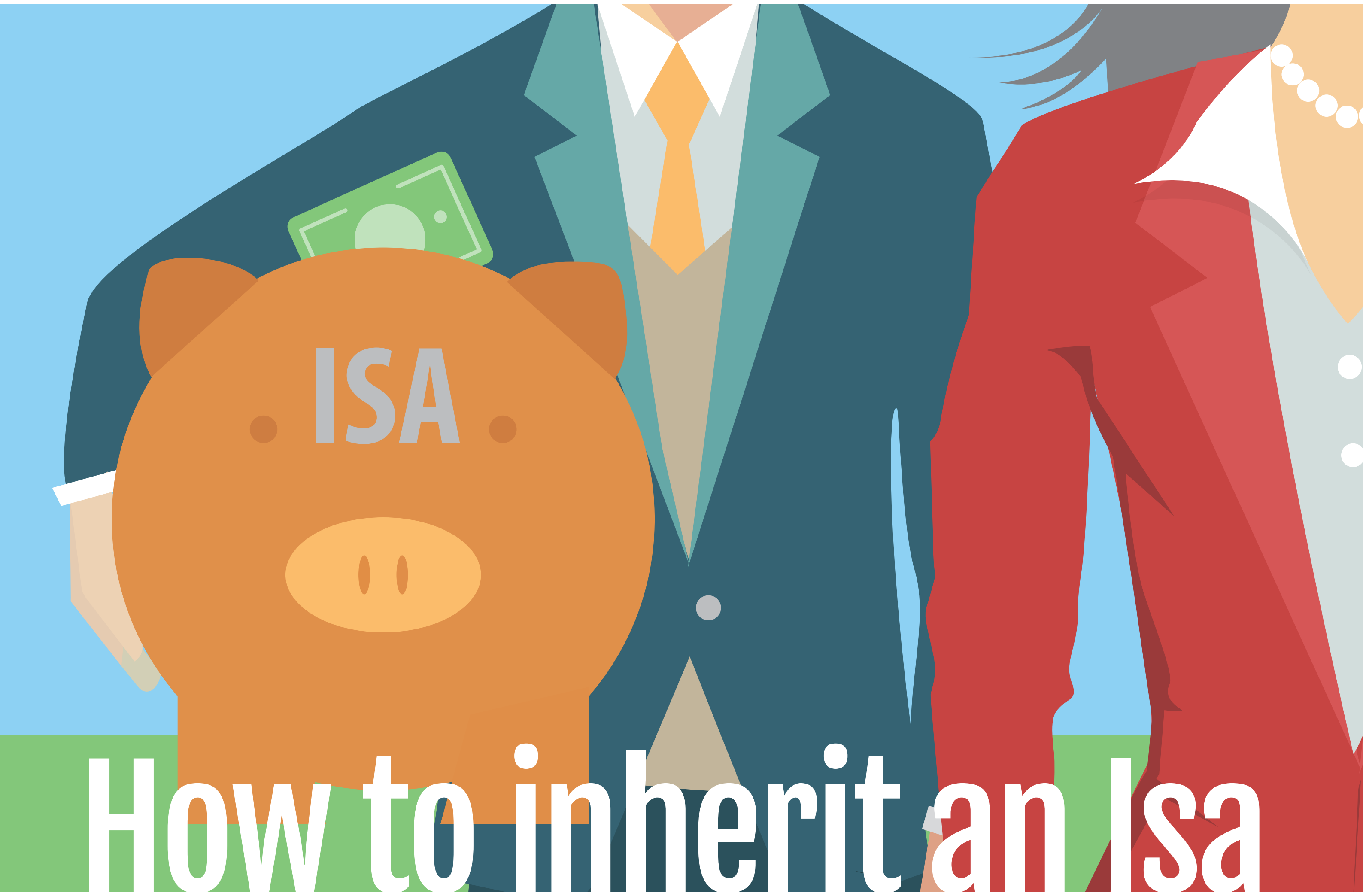

How to inherit an Isa

When a spouse or partner dies, you will want to keep their savings away from the taxman – now you can do this with an Isa

›BY RUTH JACKSON

SINCE THEY WERE created in 1999, Individual Savings Accounts (Isas) have proved to be incredibly popular with savers. By the end of 2013, the Office for National Statistics stated that 46% of the adult population had an Isa. The opportunity to build your nest egg free from the constraints of income tax, capital gains tax, and most dividend taxes has led to people putting thousands of pounds into Isas.

Indeed, the average Isa savings pot is worth around £20,000, according to government figures – and there are even some lucky souls who can class themselves as Isa millionaires. But the savings product always had a major drawback: when the account holder died, their Isas lost their tax-exempt status and any further growth would be taxed.

This led to a situation where couples who had saved together throughout their lifetime suddenly found themselves paying tax on their partner's savings after one of them had died. "It was unfair that the surviving partner lost tax benefits when their spouse died," says Patrick Connolly, a certified financial planner with Chase de Vere.

To address this, Chancellor George Osborne announced a change to Isas last year. From December 2014, spouses and civil partners could inherit each others' Isas. But it isn't as simple as switching your late partner's or spouse's Isa(s) into your name. As with so many things, the process is unnecessarily complicated.

"We are expecting further legislation changes to allow a more seamless transfer from one spouse to another," says Danny Cox, a chartered financial planner at Hargreaves Lansdown. For the time being, you will need to follow a complicated set of steps to get the money into your own name while keeping it safe from the taxman.

To make matters worse, many banks and building societies haven't yet trained their staff on the new Isa rules, so customers are being given inaccurate and often harmful advice if they ask how to go about inheriting an Isa.

Four steps to inheriting an Isa

1 Upon the death of your partner you are entitled to an Additional Permitted Subscription (APS).

2 Fill out an APS form and hand it in to the financial institution that holds your partner's accounts. This may mean filling out multiple APS forms.

3 A new Isa will be created in your name that you will need to fund within three years of your partner's death.

4 Once the account is open and funded, you can treat it like any other Isa in your name and transfer to any provider you like so long as it accepts Isa transfers.

Many providers haven't trained staff on the new Isa rules, so customers are being given inaccurate advice

"The confusing new rules surrounding inheriting Isa tax benefits will leave many people scratching their heads and, worse still, leaving funds in taxable accounts rather than a tax-free Isa," says Anna Bowes, director of independent savings advice site SavingsChampion.co.uk.

WHAT DO YOU NEED TO DO?

First, you need to understand that you don't actually inherit your partner's Isa. When they die, their Isa still loses its tax-fee status. The difference is that now the surviving spouse or civil partner is entitled to an Additional Permitted Subscription (APS), so they can invest the same amount as was held in their deceased partner's Isa.

This means that if Betty dies leaving £80,000 in her Isa accounts, then her widower Barney gets an APS worth £80,000. The APS is created the day Betty dies and Barney has three years from that date – rather than when the APS was requested – to use it.

In order to get the benefit of the APS, you need to fund it. To do this, you should fill out an APS application form with details of your marriage or civil partnership and the Isa account and file it with any bank, building society or investment firm in order to open up an Isa in your own name without affecting your own annual Isa allowance.

Unfortunately, it isn't easily done. As many financial institutions are being slow to train staff on the new rules, you may well encounter problems if you try to open an Isa using an APS with a different bank to the one that holds your deceased partner's Isas. This is because most don't have systems in place yet to accept APS transfers and it depends on the product's terms and conditions.

One exception is Nationwide, which is completely up to speed on the new inheritance rules and has created a specific Inheritance Isa account.

"There is no doubt that the loss of a spouse is a hugely difficult time for anybody and the thought of sorting out financial matters, such as savings, is often the last thing on people's minds," says Andrew Baddeley-Chappell, Nationwide's head of mortgage and savings policy. "Our figures suggest a large number of people are not taking advantage of the new APS. Failing to use the new tax relief means you could be missing out on important tax relief built up by your partner."

The simplest way to do things until the banks have sorted themselves out is to file your APS form with the institution that holds your partner's accounts. If they had accounts with more than one bank, you'll need to file a form with each of them. The bank or investment firm should set up an Isa in your name that you can then fund using the APS. Once that is done, the Isa is the same as any other you hold and you have the freedom to transfer it to another provider (providing they accept transfers to the limit of your total Isa pot).

One good thing about this incredibly complicated system is that you don't have to wait for your partner's estate to pass probate before you use the APS. As long as you can afford to fund the Isa out of your own money within three years of your partner's death, you can open it using the APS whenever you like. The only exception is you can't transfer stocks, funds and shares held in your partner's investment Isa into your name until probate is complete.

If you are still unsure about how to inherit the tax benefits of your partner's Isas (and especially if they had a sizeable amount built up), it is worth speaking to an independent financial adviser. They can then make sure you don't make any costly mistakes.

RUTH JACKSON is a freelance journalist. She also writes for *MoneyWeek*, *The Times* and *The Guardian*