



## 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?

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.

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 £7,200 for the 2009-2010 tax year. However from 6<sup>th</sup> October 2009, if you are over 50 the maximum total annual contribution will be raised to £10,200. The overall annual investment in the 2010-2011 tax year will be increased to £10,200 for everyone. A tax year runs from 6th April one year to 5th April the following year.

## Investment Companies and Individual Savings Accounts (ISAs)

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An ISA is not itself an investment, but is what is often referred to as a “wrapper product”. It is simply a “wrapper” within which an underlying investment is held.

### What are investment companies?

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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'.

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## 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

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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 the longer and greater chance your money has to grow.

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### ISA structure

The overall annual investment limit for an ISA is £7,200 for the 2009-2010 tax year. You can invest a maximum of £3,600 in cash and the balance in stocks and shares. From 6<sup>th</sup> October 2009 this limit will increase to £10,200 for over 50s and from 6<sup>th</sup> April 2010, the increase will apply to everyone. The limit for cash will increase to £5,100. Please see table opposite for further details.

In each year you can subscribe to one cash ISA and one stocks and shares ISA. You cannot subscribe to two (or more) cash ISAs, or two (or more) stocks and shares ISAs in the same tax year.

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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 £6,200 (or £9,200 after the changes) in a stocks and shares ISA with a different provider.

### ISAs from tax year 2009 and 2010 onwards

Number of accounts	Up to two accounts with two different ISA providers and one for a stocks and shares ISA	
	From 6 April 2009 to 5 April 2010*	From April 2010 *(from 6 October 2009 for over 50 year olds)
Cash ISA	Up to £3,600	Up to £5,100
Stocks and shares ISA	Up to £7,200	Up to £10,200
Maximum for the year	£7,200	£10,200

### 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 benefits of ISAs

The tax benefits of investing within an ISA are 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 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. Their personal tax allowance is currently reduced by £1 for every £2 of income exceeding the annual age related income allowance set by HM Revenue & Customs.

- For higher rate tax payers, dividends received from investments held within an ISA are not liable to any additional tax.

### Changes to tax law

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

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## 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 uses professional fund management expertise.

### May have low internal charges

Most investment companies have low internal charges. Because the 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 more of your money is working for you right from the start of your investment.

Combine the benefits of investment companies and ISAs and you have an effective and tax-efficient way to invest in the stock market.

### PEPs

Personal Equity Plans (PEPs) were replaced by ISAs in 1999. From 6 April 2008, all PEP accounts have ceased to exist and they have become 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 wrappers 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 (but some 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.

Each ISA scheme may offer several investment companies that can be held within it, normally those under the management of the scheme operator. You can hold more than one company's shares within an ISA scheme.

#### Low minimum investment

You can invest small lump sum amounts or even invest monthly. 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 one of the many investment company ISA schemes on offer. Or you could invest up to £600 per month to use your full £7,200 annual allowance or £850 per month to use your full £10,200 annual allowance.

#### Regular Saving

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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.

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#### 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 you, 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

You can transfer your ISA to another ISA manager. Your ISA must be transferred directly between your existing ISA manager and the new one. Ask your existing ISA manager to arrange the transfer. 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. In addition, you can transfer money saved in the current tax year in cash ISAs into stocks and shares ISAs but these transfers must be the whole amount that you have saved in that cash ISA on the day of transfer.

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 been invested in have not performed as well as you might have expected.

### Administration

ISAs can save you time on administering your investments since 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

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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](http://www.theaic.co.uk) has details on the ISA schemes offered by Member companies and their managers.

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#### Important information about investment companies

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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.

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

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### 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 advise you on whether investment companies are a suitable investment for you and how to make your investment.

The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has further information about getting financial advice or 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](http://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. Or you can approach a fund management group to invest via a wrapper product. The AIC website [www.theaic.co.uk](http://www.theaic.co.uk) has further information on wrapper schemes.

### Summary

Investment companies can be a good way for smaller 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](http://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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### Disclaimer

This factsheet is produced as a general guide and is based on our current understanding of law and practice. This can change over time and information contained within this factsheet is based on our understanding as at time of print.