

Tech Talk

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The new “new ISA”: inheriting an additional subscription

ISA regulations have been relaxed twice in the past year. The Budget on 19 March 2014 introduced the first steps: the relaxation of permitted investments; a generous increase in annual subscription limits; and increased flexibility in switching savings between cash and stocks and shares ISAs.

The second major relaxation was announced in the Autumn Statement: surviving spouses and civil partners will be able to inherit an additional subscription. From 6 April 2015 onwards, surviving spouses and civil partners will be able to take advantage of an additional subscription allowance equal to the value of ISA savings held by their spouse or civil partner on their death, so long as the first death occurs on or after 3 December 2014.

We will take a look at the additional subscription rules and the opportunities this can open up for inheritance tax planning using ISAs.

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Introduction

Surviving spouses and civil partners will be able to take advantage of a new subscription allowance where the first death occurs on or after 3 December 2014. The additional subscription allowance will be equal to the value of the ISA savings on death. The first additional subscriptions can be made from 6 April 2015 onwards.

The amended regulations prescribe time limits for taking advantage of the allowance, as well as restrictions on how the allowance can be used. It will be possible to use the existing stocks and shares held in the deceased's ISA to fund the additional subscription without having to liquidate the assets first. This will be extremely useful where an individual has invested in AIM-listed shares within their ISA as part of an IHT planning exercise.

Who is entitled to claim the additional subscription?

The additional subscription is only available to surviving spouses or civil partners who were living together at the time of death.

A similar condition applies on other tax reliefs, such as the married couple's allowance, and it is understood that HMRC's interpretation of "living together" will also apply to the additional subscription rules.

HMRC's existing guidance states that entitlement will not be lost as a result of spouses or civil partners living separately for the following reasons:

- living in a care home or residential care as a result of illness or old age;
- working away from home;
- undertaking a forces posting elsewhere;
- serving a custodial sentence; or
- being in training or education.

The additional subscription will not be available to cohabitants.

It is also important to remember that subscriptions can only be made by individuals who are UK resident during the tax year of the subscription.

EXAMPLE 1

Sybil and Basil have relocated to the French Riviera to enjoy their retirement. On Basil's death, his ISA savings are worth £200,000.

Sybil is not entitled to make any additional subscriptions to an ISA as she is not UK resident. The UK tax benefits of Basil's ISA therefore lapse on his death.

The additional subscription – calculating the value at death

The additional subscription which can be claimed by the surviving spouse or civil partner is the value of the ISA savings of the deceased at their death. Where the deceased held more than one ISA, the combined value of those accounts is the additional subscription available.

EXAMPLE 2

Terry dies on 1 February 2015 and leaves a widow, June. At Terry's death, his ISA savings are worth £100,000.

Terry's ISA savings of £100,000 were made up as follows:

- ISA Account No 1 with ISA Manager 1: stocks and shares worth £26,750.
- ISA Account No 2 with ISA Manager 2: cash savings of £73,250.

From 6 April 2015 onwards, June is entitled to make an additional subscription allowance of £100,000, the value of Terry's ISA savings on death. This subscription allowance is in addition to her own ISA subscription allowance of £15,240 for 2015/16.

There is no upper limit to the additional subscription.

Making the additional subscription – restrictions

The additional subscription must be made to an account held by the survivor and must be managed by the ISA Manager who managed the deceased's account, unless approval to use another ISA Manager has been given by HMRC. This means that the additional subscription may need to be split over a number of ISA Managers in proportion to the deceased's savings at their death.

It will not be possible to use the additional subscription to fund savings to a Junior ISA.

The new regulations allow the opening of additional ISA accounts, over and above the usual limit of one cash and one stocks and shares ISA in any tax year, to allow the surviving spouse or civil partner to make the additional subscriptions.

EXAMPLE 2 CONTINUED

When June makes the additional subscriptions, she will have to open up two additional ISA accounts, one with ISA Manager 1 and the second with ISA Manager 2.

She will be able to subscribe £26,750 to her new account to ISA Manager 1, either in-specie using the existing holdings, or using cash, or a combination of in-specie and cash subscriptions, and make a further subscription of £73,250 in cash to her new account held with ISA Manager 2.

She will still be able to open both a cash ISA and a stocks and shares ISA account with ISA Manager 3, the provider of her choice, in respect of her annual subscription allowance for 2015/16.

She will only be able to transfer the accounts with ISA Manager 1 and ISA Manager 2 to ISA Manager 3 as existing accounts once the additional subscriptions have been made. She will not be able to make the additional subscription to ISA Manager 3 directly (unless HMRC approves this).

Time limits for the additional subscription

The permitted period for a subscription using the in-specie option is 180 days from the date that the distribution was made to the survivor by the deceased's estate.

The time limit is extended for cash subscriptions to the later of:

- No more than three years after the deceased's death; and
- No more than 180 days after the administration of the estate is complete.

Deaths occurring between 3 December 2014 and 5 April 2015 inclusive are treated as occurring on 6 April 2015.

EXAMPLE 2 CONTINUED

Although Terry died on 1 February 2015, his death is treated as occurring on 6 April 2015. The shares held with ISA Manager 1 are distributed to June on 1 March 2016 and the administration of the estate is completed on 1 September 2016.

June wants to make the in-specie contribution to ISA Manager 1 and a cash subscription to ISA Manager 2. She will have to make the additional subscriptions within the following time limits:

- To ISA Manager 1 by 28 August 2016 (180 days after 1 March 2016); and
- To ISA Manager 2 by 6 April 2018 (3 years after Terry's deemed date of death), as this is later than 180 days after the completion of the administration of the estate.

If June does not make the in-specie contribution by 28 August 2016, she will be able to fund the additional subscription to ISA Manager 1 using cash. Her additional subscription to ISA Manager 1 if cash is used must also be made by 6 April 2018.

Making the additional subscription using in-specie subscriptions

In order for non-cash assets to be eligible to fund the subscription in-specie, title to those assets must have continually been held in the name of the Account Manager since the deceased's death. The in-specie contribution can be made using the inherited assets in full or in part, and can only be made if the assets are inherited by the survivor.

EXAMPLE 2 CONTINUED

June inherits the shares held in the ISA account with ISA Manager 1. The title has been vested in ISA Manager 1 continually since Terry's death. She can either make the subscription to ISA Manager 1 using the shares and units held by Terry at his death, or by making a further cash subscription or any combination thereof.

She decides to make the additional subscription to ISA Manager 1 using £25,000 of the shares inherited and £1,750 cash.

June will not be able to use any of the shares to make a subscription to ISA Manager 2 unless HMRC approves this.

The value of any non-cash subscriptions is the value on the date of the additional subscription.

Where shares rise in value between the date of death and the date of the additional subscription,

this will mean that not all of the shares inherited can be re-invested. Conversely, a fall in the value of shares means that cash can be used to top up the additional allowance.

EXAMPLE 3

Mildred dies on 6 April 2015, leaving her estate to her husband, George. She held 20,000 units in a FTSE 100 tracker fund in her ISA which were worth £50,000 on her death.

The FTSE 100 experiences a sustained rally between Mildred's death and the date that George makes the subscription in September 2015, when the units are now worth £52,000.

George's additional subscription has a value of £50,000, which means that he will have to retain

£2,000 of units outwith the ISA to keep within the subscription limit. If he wants to use these assets to fund part of his personal allowance, he will need to sell the units first to make a cash subscription, as in-specie subscriptions are not otherwise permitted.

If, by contrast, the FTSE 100 had experienced a period of falling value, and the units were only worth £47,500 in September 2015, George would be able to make a further cash subscription of £2,500 to use up the additional allowance.

There is no requirement in the regulations that the survivor must have inherited the ISA accounts to be able to claim the additional subscription, and it would appear that the additional subscription can be inherited even if the assets held within the ISA are paid to another beneficiary.

EXAMPLE 4

Alf dies and leaves an estate worth £700,000. The estate consists of £80,000 in ISA savings, £220,000 in cash savings and his half share of the marital home, his share being worth £400,000. His wife, Else, has an identical estate. He leaves one daughter, Rita.

Under Alf's will, Rita receives his ISA savings and the cash savings. Else receives Alf's half share of the house.

Else will still be able to make a subscription of £80,000 using her own cash savings as an additional subscription allowance, even though the ISA savings were inherited by Rita.

Using ISAs as part of IHT planning

Since 28 August 2013, individuals have been able to hold AIM shares in ISAs. Certain AIM shares qualify for business property relief (BPR) for IHT once they have been held for two years. The shares can be left to the survivor on the first death and the in-specie additional subscription can be used to retain the ISA benefits on the shares following the first death.

The two year BPR clock starts when the shares are purchased within the ISA wrapper. So long as both spouses or civil partners are UK domiciled, the shares will be covered by the inter-spousal exemption for IHT on the first death. The two year BPR clock will continue to run during the administration of the estate. The survivor can then make an in-specie contribution of the AIM shares to fund their additional ISA subscription without breaking the two year clock.

EXAMPLE 5

Spouses Jerry and Margo have a potential IHT problem, as their half shares of their chargeable estate are worth £1m. Together their combined IHT exposure is £540,000 (£270,000 each). Jerry has built up savings of £300,000 in his stocks and shares ISA, and when it became possible to invest in AIM shares in August 2013, he sold his existing holdings within the ISA tax free and purchased an AIM portfolio of shares which can qualify for BPR.

Jerry dies in March 2015. None of the shares in his ISA have been held for two years to qualify for BPR.

The AIM shares are transferred to Margo in July 2015. She immediately uses these shares to fund her additional subscription of £300,000. Margo's estate is now worth £2m. Her IHT liability is still £540,000.

In August 2015, the AIM shares purchased in August 2013 have been held for two years and qualify for business property relief. The IHT liability on Margo's estate decreases to £420,000.

If Margo had not made the in-specie contribution directly but had, instead, made the additional subscription using cash and purchased identical holdings, the two year clock would have re-started. She would not get the benefit of BPR until July 2017.

The relaxations in place since 1 July 2014 also allow individuals to use any cash previously saved in a cash ISA to purchase AIM shares. Many savers may

now be considering using their ISA savings to build up a substantial AIM portfolio within their ISA to mitigate their IHT exposure on the second death.

EXAMPLE 5 CONTINUED

Margo has her own cash savings of £200,000 in a cash ISA. In May 2015, she uses these savings to purchase an AIM portfolio of shares. The shares will be eligible for BPR once they have been held for

two years. In May 2017, the shares qualify for BPR, reducing the IHT liability on her estate by a further £80,000.

Comment

The introduction of the additional subscription allowance inherited on a first death should be viewed as extremely welcome for ISA investors and opens the door for further inter-spousal tax planning using inheritance tax efficient investments held within an ISA. However, it is important to understand the detail of the rules surrounding the additional allowance to ensure that maximum tax savings can be achieved.

The deceased's ISA benefits will only be reinstated once an additional subscription is made by the survivor. It is therefore in the surviving spouse or civil partner's interests to make the additional subscription as soon as possible to take the maximum benefit from the tax-friendly environment offered by the ISA; during the administration of the deceased's estate, the deceased's ISA savings held by the executors will be held on bare trust for, and therefore taxable on, the survivor.

In any event, in-specie contributions should be made as soon as practicable in a rising stock market to ensure that as many of the inherited shares as possible are retained within the ISA wrapper of the survivor.

It is important to remember that the option of investing in an AIM portfolio and the opportunity for the survivor to make an in-specie contribution are only available if permitted by the ISA provider. There is no obligation on the ISA Manager to offer either. Due to the short timeline between the introduction of the draft legislation and 6 April 2015 when the first in-specie contributions will be permitted, some providers may not initially offer this option and a cash subscription will be the only option available for the survivor.

As the additional subscriptions must generally be made to the existing ISA Manager, advisers should therefore review their clients' products now to ensure that they are held with providers who will be offering the additional contribution in-specie and, if desired, investment in an AIM portfolio.

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Comment continued

Even if the in-specie contribution is not permitted by the existing ISA Manager or is not made by the surviving spouse or civil partner within the 180 day time limit prescribed, the new rules still ensure that all is not lost. It will still be possible to take advantage of the cash subscription option with the longer time limits and re-purchase the shares, although the re-purchase of qualifying AIM shares held within the ISA will start the two year BPR clock running again.

However a surviving spouse or civil partner ends up funding their additional subscription, the end result is that ISA savings can continue to be held in a tax-friendly environment following the first death. All investors should be reviewing their investment strategies and their ISA savings in particular to take advantage of the new rules and the new tax planning opportunities available.

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