WHAT IS A LIFETIME ISA (LISA)?

The new LISA is becoming an attractive savings vehicle particularly for the better off however beware the pitfalls of early encashment.

1. SUMMARY OF THE LISA

Adults under the age of 40 (up to the day of their 40th birthday) can open a LISA and pay in up to £4,000 (2021/22 tax year) each tax year up to the age of 50. The government will add a 25% bonus to these contributions so those who save the maximum will receive a £1,000 bonus each year from the government.

Tax-free funds can be withdrawn from the LISA from age 60 for any purpose. LISA holders can also access their savings if they become terminally ill. Withdrawals at any time for other purposes can be made but with a 25% government charge applied (charge does not apply in year 1 as the bonus isn't added until the end of the year).

2. MECHANICS OF THE LISA

2.1 Opening A LISA

ISA managers (such as banks, building societies or investment managers) can offer the LISA subject to HMRC approval.

Individuals will be able to open a new LISA any time from their 18th birthday up to and including their 40th birthday. After this date they will not be able to open a new LISA but they will still be able to pay into an existing account until their 50th birthday and can also transfer their LISA between ISA managers, including to a new manager.

Individuals will be able to open more than one LISA during their lives, but will only be able to contribute to one LISA in each tax year.

As with all long-term investments, individuals will need to consider whether a LISA is appropriate for their current circumstances and future savings needs. The FCA will publish a consultation this autumn on the regulatory framework for the LISA.

2.2 Saving Into A LISA

Individuals will be able to make contributions of up to a total of £4,000 per tax year. There will be no monthly contribution limit. They will be able to contribute to their LISA up to and including their 50th birthday. If individuals pay more than they are allowed into a LISA account, the excess contributions will be removed from the account and will not count as a withdrawal.

Payments to a LISA must usually be made in cash, although as with stocks and shares ISAs it will also be possible to transfer shares from certain tax-advantaged employee share schemes or from another ISA into a LISA. Any investment which is currently eligible for a cash or stocks and shares ISA can be held in a LISA. Only individuals' own money may be contributed to their LISA accounts.

New amounts contributed to a LISA will count against the overall ISA limit for the year (£20,000 in 2021/22), as well as the LISA limit. However, where a previous year's funds or investments are transferred to a LISA from an ISA of a different type, the value transferred to the LISA will count against the £4,000 LISA limit but not the overall ISA limit for the year.

If individuals withdraw money from a LISA, this will not increase the amount that they are able to pay into a LISA during that year.

Savers will be able to contribute to one LISA in each tax year, as well as a cash ISA, a stocks and shares ISA, and an Innovative Finance ISA, within the new overall ISA limit of £20,000.

Only UK residents, Crown employees and their spouses or civil partners may save into a LISA.

2.3 The Government Bonus

The government will provide a bonus of 25% on all contributions to a LISA within the limits. The bonus will be paid only on the amount paid in, and not on any interest or investment growth. This means that if an individual invests £4,000 in a year, but after investment the pot increases or decreases before the claim is made, they will still receive a bonus of £1,000.

The ISA manager will claim the bonus from HMRC and pay this into the individual's LISA. Managers will not be required to hold government bonus payments separate from other LISA funds or invest them differently. There will be no statutory minimum size of bonus that a provider can claim. ISA managers will submit claims to HMRC and the bonus will be paid on a monthly basis.

Where contributions that have not yet received a bonus are withdrawn, the ISA manager will still be able to claim a bonus on the contributions in the same way as if the funds had not been withdrawn.

2.4 Transfers

Individuals will be able to transfer their LISA between ISA managers. An account must be transferred within 30 days of an account holder's request.

Where individuals transfer funds that have not yet received a bonus, it will be the responsibility of the ISA manager to whom the funds have been transferred to claim any bonus due on the transferred funds from HMRC. The bonus will still be calculated on the total contributions to the LISA account during the relevant period.

Where funds or investments are transferred to a LISA from an ISA of a different type, the value transferred to the LISA will count against the LISA contribution limit but not the overall ISA limit for the year. Partial transfers of funds from previous years' ISA contributions will be permitted. However, where funds are transferred that contain contributions made in the same year, those contributions must be transferred in full.

Contributions to a Help to Buy: ISA made on or after 6th April 2017 can still be transferred to a LISA, like any transfer from an ISA of a different type, but will count against the LISA contribution limit for the year in which they are transferred.

Individuals can transfer funds from their LISA to another type of ISA, but this will count as a chargeable withdrawal from the LISA. The same will apply where funds are transferred to any account that is not an ISA, or to any financial institution that is not an ISA manager.

3. WITHDRAWALS

3.1 Purchasing A First Home

First Time buyers of UK residential property worth less than £450,000 can use their LISA (including the government bonus) as a deposit after they have held the LISA for 12 months.

3.2 If You Are Terminally Ill

If a LISA holder is terminally ill and has less than 12 months to live, they will be able to withdraw all of the funds (including the bonus) without any government charge, regardless of their age. There will be no restrictions on how they are able to contribute to a LISA in the future.

3.3 On Reaching 60

Full or partial withdrawals can be made without charge from an individual's 60th birthday. The withdrawal (including the bonus) can be used for any purpose, and will be paid free of tax or the funds can remain invested in the LISA and any interest and investment growth will be tax-free.

3.4 Other Circumstances

If you withdraw all or some of your LISA for other reasons than prescribed above you will suffer a 25% charge. This is best explained by example:

Maximum LISA Payment For 10 Years	£40,000
Plus 25% Government Bonus	£10,000
Total Invested	£50,000
Growth @ 4% net of all charges	£10,031
Total Value after 10 years	£60,031
25% Early Redemption Penalty	(£15,008)
Net funds received by client	£45,023
Effective Net Return	2.60%

There will be no restrictions on how they are able to contribute to a LISA in the future.

The government is continuing to consider whether there should be the flexibility to borrow funds from the LISA without incurring a charge if the borrowed funds are fully repaid, and whether there should be other specific life events where individuals can have access to their LISA without a government charge. However, the government has decided that these will not be a feature of the product in its initial years.

4. TREATMENT IN OTHER CIRCUMSTANCES

4.1 Means Tested Benefits

Funds held in a LISA will be treated like funds held in an ISA in cases where an individual's capital needs to be assessed. Such assessment will recognise the need to deduct the 25% charge to access the funds where appropriate. This includes welfare and social care means tests, divorce, bankruptcy etc.

4.2 On Death

LISAs will have the same inheritance tax treatment as other ISAs. Upon the death of the account holder, the account will form part of the estate for inheritance tax purposes. The spouse or civil partner of a deceased LISA holder will have an Additional Permitted Subscription (APS) equal to the amount held in all their ISAs, including the LISA, at death (including any government bonus in the LISA). The money will no longer be inside a LISA wrapper, so no government charge will apply on withdrawals. If the individual chooses to do so and is eligible, they will be able to pay up to £4,000 per annum of this into their own LISA subject to the normal subscription criteria.

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