LIFETIME ISAs EXPLAINED

An ISA is a valuable tax wrapper around your savings and investments. Paying no tax means your savings and investments can grow faster.

The ISA limit you can pay for the current tax year is £20,000. As part of that allowance, you can contribute to a specialist type of ISA – the Lifetime ISA.

First launched in 2017, the Lifetime ISA can form up to £4,000 a year of the £20,000 yearly allowance. It can only be opened by those aged between 18 and 39.

WHAT IS THE LIFETIME ISA FOR?

A Lifetime ISA has two uses – you can save for a first home or an income boost in retirement.

What separates it from a standard ISA is the government's 25% bonus added to your monthly savings.

Since you can pay up to £4,000 a year, you can bank up to £1,000 in government top-ups.

Like a standard ISA, it can be opened as a cash or stocks and shares account, and there's no tax to pay on interest payments or investment returns.

USING A LIFETIME ISA FOR A FIRST PROPERTY

You can use a Lifetime ISA to buy a home worth £450,000 or less; that will be more than enough for some.

While the rules allow you to combine Lifetime ISAs to buy a property with someone else, the purchase limit stays at £450,000.

The rules of the Lifetime ISAs also state that you must buy with the intention of living in the home, rather than purchase the property as a buy to let and rent it out.

If you already have a Help to Buy ISA (closed to new applicants in November 2019), you can also have a Lifetime ISA. However, you won't be able to use the 25% bonus from both accounts towards buying your first property. That means you can keep both and use the Lifetime ISA towards retirement. Alternatively, you can transfer your Help to Buy ISA into a Lifetime ISA since it has higher deposit limits, so you can get a higher bonus towards buying a home.

USING A LIFETIME ISA FOR RETIREMENT

A Lifetime ISA offers benefits equal to the tax relief that a 20% taxpayer would receive on a workplace or personal pension contribution. You can save or invest until age 50, and then you can access the money in a Lifetime ISA from the age of 60.

The government bonus combined with long-term investment growth means you could end up with a decent sum by the time you hit age 60 that you can use in many different ways.

If you want to leave your pension invested for as long as possible, you can use your Lifetime ISA post-age 60 as bridging income until that point.

While most registered pension schemes will only allow 25% of the fund to be accessed free of tax, the Lifetime ISA has no such limit, and the full fund can be accessed without income tax.

However, one significant difference to saving in a workplace pension is that your employer will not contribute to a Lifetime ISA.

Another use for the Lifetime ISA could be if you want to contribute to a non-working partner's retirement savings.

The £4,000 annual limit on a Lifetime ISA could be used in addition to the £2,880 that can be paid into a pension. Including the government top-up bonus, you could stash away £5,000 a year in a Lifetime ISA as well as or instead of £3,600 for a pension.

WANT TO ACCESS THE MONEY?

If you withdraw money for any reason other than buying a home or when you reach age 60, there's a 25% exit penalty. That includes withdrawing the money early. That penalty is based on the combined amount, which means you will lose the government bonus plus some of your original investment.

Should you pay in £4,000 and receive the £1,000 bonus, you will be charged 25% of the whole fund, so you'll lose £1,250.

The only exception is if you are terminally ill with less than 12 months to live.

A HELPING HAND

Whatever your savings or investment goals, an adviser can help sift through which ISAs and other tax-efficient vehicles suit you and your family. Being tax-efficient means you can keep more of your hard-earned cash and potentially grow your wealth faster.

The value of your investments, and income from them, can fall as well as rise so you may get back less than you invest. HM Revenue and Customs practice and the law relating to taxation are complex and subject to individual circumstances and changes which cannot be foreseen.