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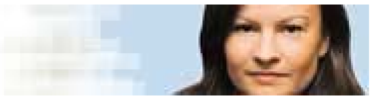

A beginner's guide to stocks and shares ISAs

Each of us can save £10,680 a year tax-free in a stocks and shares ISA. But how do they work, and what do you need to bear in mind before investing?

David Jones - PA

It's easy to see why an ISA is a great idea if you've got a little extra money. You can save and invest up to £10,680 this tax year, watching it grow safe in the knowledge that the taxman can't get his hands on it.

With a cash ISA you just squirrel your cash away in a tax-free savings account and reap the benefits - albeit fairly unexciting ones. But if you fancy a slice of the potentially far greater pie on offer from higher-risk equities, then a stocks and shares ISA (also known as an equity ISA) could be the answer.

Here are some quick tips on opening a stocks and shares ISA.

Four investments for risk avoiders

Back to basics

Every year, each UK resident is entitled to save a chunk of money in an ISA without incurring further tax on its (hopefully) growing value. This tax year that amount - otherwise known as your ISA allowance - is £10,680.

As much as half of your allowance can be saved in a cash ISA with a single provider. However, you are entitled to use up to the full allowance (minus anything you put into cash) through your stocks and shares ISA if you so choose.

That means you can invest tax-free in anything, including government and corporate bonds, unit trusts and investment trusts. You could pick one or a selection of funds, or buy individual shares through what is known as a self-select ISA.

But remember, stocks and shares ISAs are higher risk than their cash equivalent and your investments can fall in value as well as rise, but the possible rewards are also greater.

Why invest in the stock market?

The truth about tax

Cash ISAs really are totally tax free, but stocks and shares ISAs are a bit more complicated. If you have investments that offer you interest, like government or corporate bonds, you won't pay any income tax on that interest. You will have to pay a 10% tax on any dividends - although it's important to note that this is deducted at source, so you won't be hit with a bill once you receive your returns.

That's still preferable for higher-rate taxpayers, who would normally pay 32.5%, plus everyone's ISA earnings are exempt from capital gains tax.

Don't forget that you can transfer money between stocks and shares ISAs, as well as from your cash ISA, but you'll have to transfer them directly, as opposed to withdrawing and then re-depositing if you want to keep the tax benefits.

Is a stocks and shares ISA right for me?

"Make sure that you have cleared any 'bad debt' such as credit cards, store cards or expensive loans before you begin to invest, because the interest you will pay on these is going to outweigh the potential investment return over the long run," said Peter Chadborn of independent financial adviser Plan Money. "And have a 'rainy day' reserve to cover anything unexpected so you do not need to dip into your investment."

Investing isn't for those who like to be sure of their money, and who aren't willing to risk it, he adds.

"Before you dive into stocks and shares investing, have a good think about your feelings on risking your money. Like most things in life, investment risk and reward go hand-in-hand, and a fund that has had impressive performance recently may also have fluctuations in value that you're not comfortable with."

But don't feel that you can only deal with one extreme or the other. You can put a range of different investments inside your ISA's protective 'wrapper' that carry different levels of risk. That way you can match up your investments with the level of risk that you're prepared to take.

Whatever you choose, be prepared to tie up your money for five years or more to make the most of your investments and to smooth out the market ups and downs.

Find stocks and shares ISAs on Bing

How to invest

If you're very confident of your decisions and are happy to take responsibility for your choices, you'll need a stockbroker if you're after stocks, or you could go directly to a bank or fund manager for your funds.

Alternatively, buying funds through a discount broker or fund supermarket online will help reduce management charges - this way you'll be able to create your own mix of investments, and it will be easier to switch your investments.

But, if you're anything other than absolutely sure, you may be better off talking to an independent financial adviser before doing anything rash. They will help you choose the right funds for your investment goals, timescales and attitude to risk.

If it turns out that the advice you receive is inappropriate you can complain to the Financial Ombudsman Service. This is an opportunity you won't get if you go it alone, though it must be noted that losing money on your investments doesn't automatically mean you received bad advice.

Find an independent financial adviser near you

Where to invest
Fund selection is a very personal thing, and the importance of individually-tailored financial advice can't be stressed strongly enough. Nonetheless, the professionals often have their favourites.

"For new or cautious investors, the 7IM Balanced MultiManager could be ideal for the investment beginner because the fund manages risk very well," said Peter Chadborn. "It is a good solid performer, which is what you want from this type of fund."

"In terms of a medium-risk strategy, investors could look for funds investing in sectors such as healthcare, telecoms and tobaccos," said Darius McDermott of investment adviser and discount broker Chelsea Financial Services. "The Invesco High Income fund is our choice here, but cautious investors should know that equity investments can be subject to high volatility and should only make up a part of a balanced portfolio."

If you're willing to embrace risk for the potentially large rewards, McDermott suggests the Aberdeen Emerging Markets fund could be worth a look.

We should reiterate again that it's important to consider seeking independent financial advice before you make any major investing decisions.

Charges and other pitfalls
Investing in funds can be expensive as you'll have initial charges (which can be up to 5%, though these can usually be avoided by going to a fund supermarket), plus an annual management charge (usually 1-2%). These can quickly build up and eat into any returns on your money.

And if you go for a self-select ISA - effectively a pick 'n' mix of your own investment choices - there are also share-buying and selling costs to add on. If you don't watch the costs of all the associated charges, fees and commissions they can mount up to cost more than you get back in performance.

"And watch out for some brokers or fund management companies who will only let you buy their products, rather than giving you the whole market to play with," adds McDermott. "ISA investing is supposed to be more flexible than that."

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