

Cash ISAs vs equity ISAs

Should you save in a cash ISA or invest in an equity ISA?

In the last tax year just over 13,000,000 new [ISAs](#) were opened according HM Revenue & Customs and around 88% of them were cash ISAs.

But while they are more popular with consumers, average cash ISA interest rates have more than halved from almost 5% last year to just over 2% now, with best buys only reaching 3.61%.

So is now the time to ditch the cash account in favour of a higher risk strategy?

Invest for the long term

Equity ISAs are simply tax-free wrappers around investments of up to £7,200 a year. You do not pay Capital Gains Tax on any growth of your investment, but dividends are taxable (though non-tax payers can claim this back).

The investments that are 'ISA-ble' are many and varied but are often pooled investment funds where your money is added to that of others and invested in a range of shares or bonds. There are hundreds of these funds catering for different attitudes to risk. Some aim to grow your money, others to provide a regular income and it is essential you choose an equity ISA that suits your needs. To do this it is a good idea to seek independent financial advice.

The most important thing to remember is that your money is not protected. You could put £2,000 in an equity ISA only to see it reduce to £1,000 in a year's time, or to nothing. Alternatively it could have risen in value. That is the risk you take.

The potential rewards can be significantly higher than a cash ISA, but equity ISAs are best suited to medium to long-term investment. The stock market experiences peaks and troughs but has historically increased in value over the long term. However, though there are no guarantees this will always be the case and the only way to guarantee your money is protected is with a cash ISA.

Cash is King

Cash ISAs are still the most popular choice with consumers because they are simple and safe. They work like a standard [savings](#) account, but you don't pay tax on the interest you earn on savings up to £3,600 a year. You can choose from online, postal, telephone or branch accounts and you can get a fixed rate of interest or a variable one. Cash ISAs are available from banks and building societies, and through services such as Confused.com.

What they all have in common is that the amount you invest is safe. This is clearly a great benefit for those who simply want to protect their money from the taxman and keep it safe. Even in the current environment where there are legitimate concerns over the safety of our banks, your cash ISA deposits are still protected up to £50,000 per institution by the Financial Services Compensation Scheme.

The downsides of cash ISAs are the current rates, which peak at around 3.61% tax-free (equivalent to around 3.8% on a taxable savings account).

For those who require greater potential growth and are willing to take the risk, an equity ISA could be worth exploring. But if you want safety first when it comes to your savings, it has to be cash.

About the Author

Find out more about [Cash ISA or Equity ISA](#) at <http://www.confused.com/savings>

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