

EXPLANATORY MEMORANDUM TO

THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT) (No.2) REGULATIONS 2012

2012 No. 1871

1. This explanatory memorandum has been prepared by H.M. Revenue and Customs and is laid before the House of Commons by Command of Her Majesty.

This memorandum contains information for the Select Committee on Statutory Instruments.

2. **Purpose of the instrument**

- 2.1 This statutory instrument amends the Individual Savings Account Regulations 1998 (S.I. 1998/1870) (“the principal regulations”) to provide changes to the rules concerning the operation and management of Individual Savings Accounts (ISA) (including Junior ISAs) in certain circumstances. These include changes which allow that subscriptions may be made which do not count towards the annual subscription limits where there has been a default or failure in relation to an ISA. Other changes include those that relax some of the requirements relating to ISAs transferred in bulk between account managers; allow The Share Foundation to open and manage Junior ISAs in respect of certain “looked after children”; and allow account managers to provide more favourable terms in relation to cash ISAs that are connected with other tax advantaged accounts.

3. **Matters of special interest to the Select Committee on Statutory Instruments.**

- 3.1 In exercise of the powers contained in section 701(4) of the Income Tax (Trading and Other Income) Act 2005 (c. 5) (“ITTOIA 2005”) and section 151(2) of the Taxation of Chargeable Gains Act 1992 (c. 12) (“TCGA 1992”), regulations 6, 16(b) (c) and (d), 18(a) and (b) and 19, and regulations 5(b) to (d) (so far as they relate to those amendments), in this statutory instrument have effect from 9th November 2011 (the date on which the change was announced). Regulations 5(a) and 13 in this statutory instrument have effect from 1st November 2011 (the date on which Junior ISAs were introduced). Section 701(4) ITTOIA 2005 allows regulations to have retrospective effect if they do not impose or increase a liability to tax. The changes in this instrument are administrative and technical, and do not impose or any liability to tax.

4. Legislative Context

- 4.1 ISAs are tax advantaged savings accounts, introduced in 1999. They allow eligible individuals to save in a cash or stocks and shares account, without being taxed on any income or gains arising from, or received in relation to, those savings. Junior ISAs were introduced on 1 November 2011 for children aged below 18 years who are not eligible to hold a Child Trust Fund account.
- 4.2 Sections 694 to 701 of ITTOIA 2005 allow regulations to be made governing the tax exemptions, investments, administration and management of 'individual investment plans', such as ISAs. Section 695A of ITTOIA allows regulations to be made in relation to investment plans for children, such as Junior ISAs. Section 151 of the TCGA 1992 allows regulations to be made entitling investors to relief from capital gains tax on gains accruing under an individual investment plan.
- 4.3 The principal regulations, which this statutory instrument amends, were made and laid on 31 July 1998 using powers now in sections 694 to 701 of ITTOIA 2005 and section 151 of TCGA 1992. These regulations have been amended a number of times, notably by the Individual Savings Accounts (Amendment No. 2) Regulations 2011 (S.I. 2011/1780) which introduced Junior ISAs.

5. Territorial Extent and Application

- 5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

- 6.1. As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

- 7.1 The principal regulations set out the relevant ISA rules - including the maximum amount that can be subscribed to an account in a year, the administrative procedures to be followed where an ISA is transferred between managers, rules concerning the opening and management of an account, and restrictions on favourable terms and conditions for cash ISAs being made conditional upon the holding of another account with the same provider.
- 7.2 The instrument makes provision for certain ISA investments to be made over and above the normal annual subscription limit, following the failure of a cash ISA manager or the payment of compensation in respect of a stocks and shares ISA investment.

- 7.3 Under current ISA rules, an individual can pay into their ISA a total amount up to the relevant subscription limit each year. The 2012-13 subscription limit for “adult ISAs” is £11,280, of which £5,640 can be in cash. The Junior ISA limit is £3,600. Where an ISA is affected by the failure of a cash ISA manager, or certain compensation is paid in respect of a stocks and shares ISA investment, reinstatement of sums held in the account at that point, or investment of any subsequent compensation received, is usually treated as a new ISA subscription, and therefore counts towards the normal annual limit.
- 7.4 This instrument contains general provisions under which investors will be permitted, in certain circumstances, to make an ISA investment outside of the normal subscription limit. Where a cash ISA manager is declared in default by the Financial Services Authority or the Financial Services Compensation Scheme, investors may make a single reinvestment up to the balance of their ISA at the time of the default. Where an investor receives compensation in respect of an investment held in a stocks and shares ISA, they may make a single investment up to the value of the compensation received. These changes will apply equally to Junior ISAs and other ISA products.
- 7.5 The amendments include 2 exceptions to the general principles for stocks and shares accounts as described above. Where a failed stocks and shares investment was held by Keydata Investment Services (Keydata) or administered by Keydata on behalf of another manager, the investor can reinvest up to the amount originally subscribed for the failed investment. Where Lehman Brothers was the sole counterparty underwriting the ISA investment at the time of its collapse (15 September 2008), the investor can reinvest up to the value of the investment at that date. Both of these exceptions apply whether or not the investor receives a payment of compensation, and regardless of the amount of compensation received.
- 7.6 The current ISA transfer rules, require an investor (or in the case of a Junior ISA, the registered contact for the account) to make a fresh application to the new account manager on transfer. This is the case even where the transfer is instigated by the ISA manager rather than the investor. Where a bulk transfer of accounts takes place, or where an ISA investment is transferred to a separate ISA held by the investor with the same or a different manager, each investor is therefore required to provide a fresh ISA application.
- 7.7 For the ISA transfers specified above, a fresh ISA application will only be required where subscriptions are to be made to the account following the transfer, and the new manager does not already hold a valid application from the investor or registered contact. In the case of the transfer of ISAs between managers within a group of companies, it will be sufficient for the transferring manager to make the original ISA application available to the manager that is receiving the account.

- 7.8 These changes will generally apply equally to Junior ISAs and other ISA products. However, the special rules applying to Junior ISAs, which prevent the holding of more than one of each of a cash account or stocks and shares account and (unlike other ISAs) provide the possibility for funds to be transferred from a Junior ISA stocks and shares account to a Junior ISA cash account, are not affected by these changes.
- 7.9 The principal regulations also set out the conditions to be met when opening a Junior ISA for a child under 18, and who can make an application for such an account. For a child under 16 the application can only be made by a person who has parental responsibility for the relevant child. For a child aged 16 to 18 the application can either be made by a person with parental responsibility or by the child themselves. Parental responsibility is defined in regulations with reference to the Children Act 1989, the Children (Northern Ireland) Order 1995 or the Children (Scotland) Act 1995. There is no provision for a Junior ISA to be opened by anyone other than a person with parental responsibility, or by the child themselves.
- 7.10 In all cases the individual who applies for the account is the initial registered contact for that account. While a Junior ISA is held in the child's name, instructions on the management of the account can only be given by the registered contact.
- 7.11 On 22 March 2011 the Chancellor announced that the Government would work with charities and interested parties to develop proposals for the support of looked after children through Junior ISAs. In November 2011 the Parliamentary Under-Secretary of State for Education provided details of the Government's intention to make a payment of £200 into a Junior ISA for each eligible looked after child. On 28 February 2012, following a three month tender process, the Department for Education appointed The Share Foundation to manage these arrangements, which will commence later this year.
- 7.12 This instrument will make provision for The Share Foundation to open, to manage, or to assume responsibility of a Junior ISA on behalf of a looked after child. In addition, these regulations require the consent of The Share Foundation in circumstances where another person wishes to assume management of the Junior ISA in place of the Foundation (other than where the child reaches 16 and wishes to assume responsibility for the account themselves, or where a court so orders).
- 7.13 The principal regulations also prohibit connections between ISAs and other cash based savings products where, by virtue of the connection, the ISA would enjoy more favourable terms.
- 7.14 The prohibition was devised to prevent the artificial increase of tax free returns through the manipulation of interest between tax

advantaged and taxable accounts. This instrument removes this prohibition where the accounts which are connected are both tax advantaged. This will allow an account provider to offer more favourable terms for an ISA where another ISA or a CTF is held with them, whether it is held by the account holder or another person. These changes will apply equally to Junior ISAs and other ISA products.

7.15 A similar change is being made to the Child Trust Fund Regulations 2004 (SI 2004/1450).

8. Consultation outcome

8.1 This instrument implements measures which were announced on 22 December 2010 (<http://www.hmrc.gov.uk/isa/bulletin28.pdf>), 9 November 2011 (<http://www.hmrc.gov.uk/isa/bulletin39.pdf>), 5 December 2011

<http://www.publications.parliament.uk/pa/cm201011/cmhansrd/cm111205/wmstext/111205m0001.htm#1112052000001>) and 29 March 2012 (<http://www.hmrc.gov.uk/isa/bulletin42.pdf>).

8.2 Draft regulations were published for comment on 22 December 2010 (<http://www.hmrc.gov.uk/isa/bulletin28.pdf>), 29 March 2012 (<http://www.hmrc.gov.uk/isa/bulletin42.pdf>) and 14 June 2012 (<http://www.hmrc.gov.uk/isa/bulletin44.pdf>). Representative groups, ISA managers and other interested parties who responded to these announcements were generally supportive of the change, and respondents identified no major difficulties with the proposed change or the relevant draft legislation

9. Guidance

9.1 HMRC's Guidance Notes for ISA managers will be updated to reflect the changes to the ISA rules. The Guidance Notes are available at <http://www.hmrc.gov.uk/isa/isagn.htm>

10. Impact

10.1 The impact on charities and voluntary bodies is negligible.

10.2 The impact on the public sector is nil.

10.3 A Tax Information and Impact Note covering this instrument will be published on the HMRC website at <http://www.hmrc.gov.uk/thelibrary/tiins.htm>.

11. Regulating small business

11.1 The legislation applies to small business. All ISA managers could benefit from the changes, regardless of size. The changes could reduce

the costs or burdens for ISA managers, or increase the marketing and other opportunities available to these managers.

12. Monitoring & review

12.1 HMRC will continue to review compliance with the ISA rules using the information provided annually by ISA managers.

13. Contact

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