EXPLANATORY MEMORANDUM TO

THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT No. 2) REGULATIONS 2014

2014 No. 1450

1. This explanatory memorandum has been prepared by H.M. Revenue and Customs (HMRC) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.

2. Purpose of the instrument

2.1 The instrument makes a number of changes to the rules governing the operation of Individual Savings Accounts (ISA) to implement the 'New ISA' announced by the Chancellor at Budget 2014. It increases the annual ISA subscription limit, removes restrictions on how much of this amount can be invested in a cash ISA, and provides that ISA funds can be transferred from a stocks and shares to a cash account. The instrument also increases the annual subscription limit for Junior ISAs and modifies the range of qualifying investments for ISA and Junior ISA.

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

3.1 None.

4. Legislative Context

4.1 An ISA is a tax-advantaged savings account. Legislation permitting this type of account was introduced in 1998 (Individual Savings Account Regulations 1998 (S.I 1998/1870) (ISA Regulations). An individual may save in an ISA without being taxed on any income or gains arising from those savings. The amount an individual may subscribe to an ISA in any one year is prescribed by legislation.

4.2 Sections 694 to 699 and 701 of the Income Tax (Trading and other Income) Act 2005 ("ITTOIA 2005") allow regulations to be made governing tax exemptions, investments, administration and management of 'individual investment plans', such as ISAs. These powers were formerly in sections 333 to 333B of the Income and Corporation Taxes Act 1988. Section 151 of the Taxation of Chargeable Gains Act 1992 ("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 Individual Savings Account Regulations 1998 (S.I. 1998/1870) ("the ISA Regulations"), which this statutory instrument amends, were made and laid on 31 July 1998 using powers now in sections 694 to 699 and 701 of the ITTOIA 2005 and section 151 of the TCGA 1992.

4.4 Regulation 4ZA of the ISA Regulations sets out the maximum amount which can be subscribed annually to an ISA and provides that only 50 per cent of that amount may be invested in a cash ISA. Regulation 4ZB sets out the maximum amount which can be subscribed annually to a Junior ISA.

4.5 Regulation 4C and 4D provide transitional provisions in relation to accounts that included insurance components at 6 April 2005, and accounts that were maxi-accounts, mini-accounts and TESSA only accounts at 6 April 2008.

4.6 Regulation 7 specifies the types of investments which qualify for a stocks and shares component of an ISA, and sets out a number of conditions that certain types of investment must satisfy to qualify for investment in a stocks and shares ISA.

4.7 Regulation 8 sets out the investments which qualify for a cash component of an ISA.

4.8 Regulation 21 sets out the provisions relating to the transfer of accounts and provides for cash ISA to cash ISA transfers, stocks and shares ISA to stocks and shares ISA transfers, and cash to stocks and shares ISA transfers. It does not provide for a transfer from a stocks and shares ISA to a cash ISA.

4.9 Regulation 23 provides for a flat rate charge representing tax on interest arising from un-invested cash held in a stocks and shares ISA.

4.10 Regulation 31 sets out the requirement for ISA mangers to provide certain information to HMRC.

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

- What is being done and why?

7.1 These changes are designed to increase the choice and flexibility available to ISA savers. They will implement the ‘New ISA’ announced by the Chancellor at Budget 2014.

7.2 With effect from 1 July 2014 the annual ISA subscription limit is being increased to £15,000 for 2014-2015. The Junior ISA subscription limit is being increased to £4,000 for the period.

7.3 The instrument removes the prohibition on investing more than 50 per cent of the annual overall subscription limit in a cash ISA. It also enables the transfer of ISA funds from a stocks and shares to a cash account and amends certain provisions in relation to such transfers in line with this change.

7.4 As a consequence, the tests used to define whether an investment qualifies for a cash ISA or a stocks and shares ISA (which are currently necessary because of the different subscription limits for these accounts) are no longer required. The instrument therefore removes certain eligibility conditions for the stocks and shares ISA relating to the tenor of an investment and its level of risk. With effect from 1 July 2014, new investments which do not satisfy these conditions may be eligible to be held in a stocks and shares ISA.

7.5 The instrument provides for core capital deferred shares issued by Building Societies to be qualifying investments for a stocks and shares ISA, and for certain money market funds to continue to qualify for a cash ISA. It also updates the ISA Regulations to remove otiose provisions in relation to accounts, including insurance components at 6 April 2005, and maxi-accounts, mini-accounts and TESSA only accounts at 6 April 2008.

7.6 The instrument also makes a number of consequential amendments and updates including the removal of the flat rate charge representing tax on interest on un-invested cash held in a stocks and shares ISA, and changes to the reporting requirements for ISA providers.

- Consolidation

7.7 There are no plans to consolidate the regulations governing ISAs.

8. Consultation outcome

8.1 The major changes within this instrument were announced at Budget 2014. This instrument has been subject to a technical consultation with specialists within the ISA industry. No issues or difficulties were identified with the substance of the consultation draft.

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/isa-guidance-notes.pdf

10. Impact

10.1 The impact on charities and voluntary bodies is expected to be negligible.

10.2 The impact on the public sector is negligible.

10.3 A Tax Information and Impact Note (TIIN) covering this instrument was published on the HMRC website on 19 March, alongside TIINs for other measures announced at Budget 2014. It can be found at http://www.hmrc.gov.uk/thelibrary/tiins.htm. It remains an accurate summary of the impacts that apply to this instrument.

11. Regulating small business

11.1 The legislation applies to small businesses that offer ISAs.

11.2 To minimise the impacts of the requirements on small firms employing up to 20 people, the approach taken is to apply the same basic requirements as apply to all businesses offering ISAs, and monitor the impact of these changes. The impact on small businesses is expected to be broadly similar to that for other businesses. No major issues specific to smaller businesses have been identified.

11.3 The basis for the final decision on what action to take to assist small business is that this instrument is designed to increase the choice and flexibility available to ISA holders and is not expected to impose significant costs on any business.

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

Simon Turner at H.M. Revenue and Customs can answer queries regarding the instrument on behalf of H.M. Treasury - Tel: 03000 546588 or email: simon.turner@hmrc.gsi.gov.uk.