## EXPLANATORY MEMORANDUM TO

## THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT) REGULATIONS 2023

## 2023 No. 264

### 1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) on behalf of His Majesty's Treasury and is laid before the House of Commons by Command of His Majesty.

### 2. Purpose of the instrument

2.1 This instrument amends the Individual Savings Account (ISA) Regulations to reflect developments in other legislation, clarify the position in cases of doubt and provide additional safeguards for investors.

### 3. Matters of special interest to Parliament

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

3.1 None.

### 4. Extent and Territorial Application

4.1 The extent of this instrument (that is, the jurisdiction which the instrument forms part of the law of) is the United Kingdom.

4.2 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

### 5. European Convention on Human Rights

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

### 6. Legislative Context

6.1 An ISA is a tax-advantaged savings product providing relief from tax to individuals. A Junior ISA is a tax-advantaged savings product available to children. The ISA and Junior ISA rules, including which investments qualify for inclusion, the circumstances in which monies can be withdrawn from a Junior ISA before the age of 18 years and when monies can be returned to an ISA, are set out in the Individual Savings Account Regulations 1998 (S.I. 1998/1870) ("the ISA Regulations"), which this instrument amends.

6.2 Regulation 2 defines "dormant assets" and "recognised Undertakings for Collective Investments in Transferable Securities (UCITS)" for ISA purposes. Dormant account is defined with reference to section 39(2) of the Finance Act 2008 and recognised UCITS is defined with reference to section 236A of the Financial Services and Markets Act 2000 (FSMA).

6.3 Regulation 4ZE permits withdrawals from a Junior ISA where a child is terminally ill. Terminal illness is defined with reference to the relevant social security legislation of the individual jurisdictions.

6.4 Regulation 5C permits the payment of monies returned from the Dormant Asset Reclaim Fund to be replaced in the individual's original cash ISA outside the annual subscription limit.

6.5 Regulation 7 specifies the kind of investments which may be held in a stocks and shares ISA. Shares (including those in an Investment Trust) must be acquired via a public offer and cannot (other than in prescribed circumstances) be acquired prior to listing or admission to trading.

6.6 Regulation 8A specifies the kind of investments which may be held in an innovative finance ISA. Investments can either be an Article 36H ('peer to peer') arrangement between a borrower and lender or a debenture issued by a company or charity ('crowdfunding'). Any gain on investments in a peer to peer arrangement is defined in the context of the payment of interest, capital, or both. The rules relating to crowdfunding prevent arrangements where there is a close relationship between the individual lender and the company.

6.7 Regulations 17, 19 and 20 require ISA managers to notify HMRC and investors where their approval is withdrawn, they intend to cease acting, or no longer qualify. Managers must advise investors of their ability to either transfer their account to an ISA manager of their choosing or, by default, be included within a bulk transfer to another manager chosen by the departing manager. Regulation 18 provides a right of appeal where the Board withdraws a manager's approval.

6.8 This instrument is made under powers set out in the Income Tax (Trading and Other Income) Act 2005 and the Taxation of Chargeable Gains Act 1992.

## 7. Policy background

***What is being done and why?***

7.1 The instrument amends the ISA Regulations to accommodate developments in other legislation, clarify the position in cases of doubt, provide additional safeguards for investors and protect the integrity of the tax-free savings landscape.

7.2 This instrument will amend the definition of recognised UCITS in regulation 2 to reference section 271A of FSMA, enabling overseas collective investment schemes recognised by the FCA to be held within an ISA.

7.3 This instrument will amend regulation 4ZE to refer to the new Northern Ireland legislation and permit withdrawals where the death of the child is expected within 12 months.

7.4 The instrument will amend regulations 2 and 5C of the ISA Regulations to provide that investors in stocks and shares ISA, whose funds have been transferred to the Dormant Assets Scheme and subsequently recovered, can replace them in an ISA of their choosing. The requirement to return them to an ISA of the same type with the original provider has been removed to improve investor choice.

7.5 The instrument will amend regulation 7 to clarify the language relating to qualifying investments in an ISA, ensuring that the requirements for shares in an investment trust reflect those for shares which are not in an investment trust.

7.6 The instrument will amend regulation 8A to include a reference to "profit", enabling those who wish to invest in Alternative Finance to have access to an Innovative Finance ISA. The instrument will also amend the peer-to-peer requirements so that the investment will not qualify where there is a close relationship between lender and borrower, mirroring the approach to 'crowdfunding' rules. The amendments will not be retrospective – those who have already invested in a qualifying peer to peer arrangement can retain their investments.

7.7 The instrument will amend regulations 17, 19 and 20 to introduce additional investor protections by requiring ISA managers to draw to the investor's attention that ISAs lose their tax advantaged status if they are not transferred within 30 days of the investor receiving notice from the ISA manager. The proposed amendments will also insert a new regulation 17A which will require the departing account manager to transfer all Junior ISAs to a successor prior to HMRC's acceptance of their departure. This ensures the accounts remain under management until account maturity.

7.8 The instrument will also amend regulation 18 to provide for a right of appeal where the Board withdraws a manager's approval under regulation 17A.

*Why is it being changed?*

7.9 The Overseas Funds Regime (OFR) provides recognition for authorised overseas collective investment schemes who wish to market to retail investors in the United Kingdom. Schedule 9 of the Financial Services Act provides for the OFR by inserting relevant sections into FSMA. Section 271A sets out the requirements for becoming authorised. The existing regulations do not reflect the introduction of the OFR.

7.10 The change is consequential on the Social Security (Terminal Illness) Act (Northern Ireland) 2022 which has amended the definition of terminal illness from one where death is expected within six months to one where death is expected within 12 months. However, the Northern Ireland Assembly cannot alter legislation outside its competence.

7.11 The change is consequential on the Dormant Asset Act 2022 (the Act) which extended the ambit of the Dormant Assets scheme to encompass certain investments, including those held in a stocks and shares ISA. Regulation 5C is currently restricted to cash ISAs and cannot accommodate monies arising from a dormant stocks and shares ISA. The Act could not alter the ISA Regulations.

7.12 Successive changes to the ISA Regulations, and regulation 7 in particular, have led to a lack of clarity regarding the requirement for shares in an Investment Trust to be acquired prior to listing or admission to trading.

7.13 Changes are required to regulation 8A as a result of the Alternative Finance (Income Tax, Capital Gains Tax and Corporation Tax) Order 2022 ("the Order") which widened the scope of tax legislation to treat returns from alternative finance (such as sharia-compliant arrangements) as though they were interest for tax purposes. While this included arrangements facilitated through Financial Conduct Authority regulated peer-to-peer platforms, such arrangements require finance to be provided without the payment of interest. The Innovative Finance ISA Regulations refer to interest and, as such, cannot encompass alternative finance arrangements. Cash ISAs and stocks and shares ISAs have no such restriction. The Order could not amend the ISA Regulations.

7.14 Industry comment has highlighted the lack of consistency between the current peer-to-peer and crowdfunding rules. The former allows directors, shareholders, and employees to make loans to, and receive interest from, loans to a company with which they are connected. The regulations governing crowdfunding explicitly prohibit such arrangements.

7.15 An ISA manager who has its approval withdrawn, ceases to act, or to qualify, is required to advise investors of their options. Where an account has not been transferred to another ISA manager the investor risks the ISA losing its tax advantage. In the context of work elsewhere, consideration has been given to whether existing regulations provide sufficient consumer protection and aid consumer understanding.

## 8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

## 9. Consolidation

9.1 There are no plans to consolidate the ISA regulations.

## 10. Consultation outcome

10.1 Regular discussions take place with Industry representatives and ISA managers on the operational design of ISA, potential improvements, and to clarify misapprehensions. A technical consultation on the operational consequences of the changes took place between 21 November and 11 December 2022. These discussions have informed the proposed changes to the process design and reporting timescales, which will better accommodate the practical operation of ISAs.

## 11. Guidance

11.1 HMRC's Guidance Notes for ISA providers will be amended to reflect the changes to the ISA rules. These are available at www.gov.uk/government/collections/isa-managers-guidance.

11.2 Guidance on Junior ISAs is available at www.gov.uk/junior-individual-savings-accounts.

## 12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies. The change to Innovative Finance ISA will have a negligible impact on a small number of ISA managers, who will be unable to offer Directors' Loans arrangements to new investors. Allowing sharia-compliant peer to peer arrangements in an ISA may benefit ISA managers who wish to engage in this market.

12.2 There will be a positive impact on children, their families and friends. The changes to notice requirements will ensure the continuation of the tax advantaged status of accounts where account providers change or cease to act. The measure relating to terminally ill children in Northern Ireland will ensure that such children continue to be able to withdraw their funds when needed.

12.3 There is no, or no significant, impact on the public sector.

12.4 A Tax Information and Impact Note covering this instrument will be published on the website at www.gov.uk/government/collections/tax-information-and-impact-notes-tiins.

## 13. Regulating small business

13.1 The legislation applies to activities that are undertaken by small businesses.

13.2 No specific action is proposed to minimise regulatory burdens on small businesses (employing up to 50 people). HMRC will continue to monitor the impact of this instrument, as well as the cumulative effect of the ISA Regulations, on small businesses through its regular engagement with the ISA industry and representative bodies.

13.3 The basis for the final decision on what action to take to assist small businesses is that no action is required because the changes to the notice requirements are anticipated to have a negligible administrative impact on ISA and CTF managers. Allowing sharia-compliant peer to peer arrangements in an ISA may benefit a number of smaller ISA managers who wish to engage in this market.

## 14. Monitoring & review

14.1 The approach to monitoring of this legislation is that HMRC will continue to review compliance with the ISA Regulations using information provided annually and through regular contact with ISA providers and other groups.

14.2 The instrument does not include a statutory review clause in accordance with section 28(3)(a) of The Small Business, Enterprise and Employment Act 2015 because it amends a provision to vary tax.

## 15. Contact

15.1 Helen Williams at HMRC can be contacted on telephone 03000 512336 or by email: savings.audit@hmrc.gsi.gov.uk with any queries regarding this instrument.

15.2 Andrew Edwards, Deputy Director for Pensions, Savings and Charities at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.3 Andrew Griffith MP, Economic Secretary to the Treasury can confirm that this Explanatory Memorandum meets the required standard.