EXPLANATORY MEMORANDUM TO

THE CHILD TRUST FUNDS (AMENDMENT) (NO. 2) REGULATIONS 2024

2024 No. 1023

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 Parliament by Command of His Majesty.

2. Declaration

2.1 Tulip Siddiq MP, Economic Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Helen Page, Deputy Director for Pensions, Savings and Charities at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Claire Cornell Johnson at HMRC: 03000 200 3300 or email: savings.audit@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 This instrument amends the Child Trust Funds Regulations 2004 (the CTF Regulations) to bring into effect an Autumn Statement 2023 announcement to allow certain fractional interests in a CTF.

4.2 Fractional interests (also referred to as 'fractional shares') entitle investors to an interest in a portion of a share that is owned by a firm (usually a stockbroker), rather than a full share owned by themselves. Fractional interests enable savers to invest in a portion of a high value share which may otherwise be unaffordable to them.

Where does the legislation extend to, and apply?

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

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

5. Policy Context

What is being done and why?

5.1 A Child Trust Fund (CTF) is a tax-advantaged savings product providing relief from tax to children. The CTF rules, including which investments qualify for inclusion and the basis on which accounts must operate, are set out in the CTF Regulations

5.2 This instrument amends the CTF Regulations to provide that fractional interests (also known as 'fractional shares') in certain defined investments qualify for inclusion in a CTF.

5.3 Fractional shares are not included as specified investments for the purposes of regulated activity in the UK (as defined in The Financial Services and Markets Act 2000 (Regulated Activities) Order 2001), nor is there a generally accepted definition of a fractional share. This reduces the protections offered to customers under UK Regulations. To minimise the risk of investor detriment in the face of a new investment type, the amendments to the CTF Regulations define a 'fractional interest' in a share for the purposes of the CTF legislation and set the conditions with which a fractional interest must comply.

5.4 To ensure equivalence with the treatment of whole shares, the CTF Regulations require that CTF providers own the underlying whole share and that transactions in any fractional interest are at a price proportionate to that of the whole share in the open market. Voting and other shareholder rights are disapplied in respect of fractional interests totalling less than one whole share as they cannot be passed on proportionately.

5.5 Extending the range of qualifying investments for the CTF to accommodate certain fractional interests will allow investors at all income levels to save and invest in ways which best meet their needs.

What was the previous policy, how is this different?

5.6 The existing CTF Regulations do not extend to investment in a fraction of a share. Shares, as described in the CTF Regulations, apply to whole shares only. Fractional shares are a relatively new investment type and did not exist when the CTF Regulations were introduced.

5.7 At Autumn Statement 2023 the Government announced that it intended to permit certain fractional interests to be eligible CTF investments, extending choice for investors, their children and CTF providers.

6. Legislative and Legal Context

How has the law changed?

6.1 Regulation 8 of the CTF Regulations provides the general conditions with which an account must comply if it is to qualify for relief from tax, including the treatment of custody and beneficial ownership of account investments, and the treatment of beneficial shareholder rights. Regulation 11 of the CTF Regulations specifies the requirements as to the price at which CTF transactions, by purchase, sale or otherwise, are made. Regulation 12 of the CTF Regulations specifies the kind of investments which may be held in a CTF and includes shares (including those in an Investment Trust) and shares in Funds. Regulation 2 of the Schedule Stakeholder Accounts of the CTF Regulations specifies the characteristics of stakeholder accounts and includes investments which cannot directly be held.

6.2 This instrument will amend Regulations 8, 11, 12 and Regulation 2 of Schedule Stakeholder Accounts to provide that certain defined fractional interests are qualifying investments for CTF purposes. It will limit eligibility to the fractional interests of otherwise qualifying shares which are listed or traded on a recognised stock exchange, including shares issued by a fund which are listed or traded on a recognised stock exchange. The instrument will amend Regulation 11 to require that any transaction by

purchase, sale or otherwise in a fractional interest is proportionate to that of the whole share. It will also require CTF providers to have contractual arrangements with their investors and will disapply the requirement relating to voting rights and shareholder meeting attendance in relation to fractional interests. This is necessary as while 'fractional shares' entitle investors to an interest in a portion of a share, they are not the owner of the full share and voting and other shareholder rights are not therefore guaranteed. It will also require that fractional interests of an investment trust may not be directly held in a stakeholder account to ensure consistency with the approach to whole shares in an investment trust, which cannot be directly held in a stakeholder account.

Why was this approach taken to change the law?

6.3 This is the only possible approach to make the necessary changes.

7. Consultation

Summary of consultation outcome and methodology

7.1 Regular discussions take place with industry representatives and CTF providers on the operational design of CTFs, potential improvements, and to clarify application of the CTF rules. These discussions have informed the proposed changes, Additionally, a technical consultation on the operational consequences of the changes, and the draft legislation, took place between 2 August and 16 August 2024. Technical comments received in relation to the operation and management of fractional interests have informed the drafting of the amending legislation.

8. Applicable Guidance

8.1 HMRC's Guidance Notes for CTF providers available on the gov.uk website[1] will be amended to reflect the changes to the CTF rules.

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note covering this instrument will be published on the gov.uk website[2].

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies. Allowing defined fractional interests to be eligible for a CTF may benefit CTF providers who wish to engage in this market.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector because the changes do not affect how businesses interact with HMRC.

9.5 There is no, or no significant impact on the flow or allocation of funds to a CTF.

[1] Guidance Notes for CTF providers: https://www.gov.uk/government/publications/child-trust-fund-guidance-notes-for-providers

[2] Tax Information and Impact Note: https://www.gov.uk/government/publications/individual-savings-account-and-child-trust-funds-amendment-no-2-regulations-2024

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

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

10.2 The instrument does not include a statutory review clause, in line with the requirements of the Small Business, Enterprise and Employment Act 2015, because it amends a provision to vary tax.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 None.

12. European Convention on Human Rights

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

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 (“relevant European Union Acts.