EXPLANATORY MEMORANDUM TO

THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT No. 2) REGULATIONS 2017

2017 No. [XXXX]

1. Introduction

1.1 This explanatory memorandum has been prepared by HM 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 establishes a new Individual Savings Account (ISA), the Lifetime ISA, from 6 April 2017. It sets out eligibility conditions for opening and paying into the new account; the amount and type of payments that can be made; and which investments can be held in the account. It also provides for a 25% government bonus on amounts paid to the account by the account holder; specifies circumstances in which sums may be withdrawn from an account without a government charge (withdrawal charge); and provides for the application of a 25% charge for other withdrawals. The instrument also sets out rules concerning bonus claims, and for the collection and payment of withdrawal charges and other amounts due to HMRC.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

3.2 Disregarding minor or consequential changes, the territorial application of this instrument includes Scotland and Northern Ireland and is not a financial instrument that relates exclusively to England, Wales and Northern Ireland.

4. Legislative Context

4.1 An ISA is a tax-advantaged savings product providing relief from tax to individuals. The ISA rules are set out in the Individual Savings Account Regulations 1998 (S.I. 1998/1870) (ISA Regulations), which this instrument further amends.

4.2 This instrument is made under powers in the Income Tax (Trading and Other Income) Act 2005, the Taxation of Chargeable Gains Act 1992 and the Savings (Government Contributions) Act 2017.

5. Extent and Territorial Application

5.1 The extent of this instrument is the United Kingdom.

5.2 The territorial application of this instrument is set out in Section 3 under “Other matters of interest to the House of Commons”.

6. European Convention on Human Rights

6.1 The Financial Secretary to the Treasury, has made the following statement regarding Human Rights:

"In my view the provisions of the Individual Savings Account (Amendment) Regulations 2017 are compatible with the Convention rights."

7. Policy background

What is being done and why

7.1 At Budget 2016, the government announced that it would introduce the Lifetime ISA from April 2017. Lifetime ISA is designed to help young people save flexibly for the long-term. A government bonus will be paid on amounts saved in a Lifetime ISA by an account holder, and it will be possible to make withdrawals from an account without charge in certain circumstances. These include after an account holder reaches a specified age (to be set at 60 by this instrument) or, subject to certain conditions, when an account holder is buying their first home.

7.2 The instrument amends the ISA Regulations to establish and define the Lifetime ISA (new ISA Regulation 4(1ZB)) and certain terms in relation to the new account. It also provides a £4,000 limit on 'current year payments' (detailed in new ISA Regulation 10A) that can be made to a Lifetime ISA each year. An amount held in a Help to Buy: ISA on 5 April 2017 can also be transferred to a Lifetime ISA during the tax year 2017 to 2018, without this transferred amount counting towards the £4,000 limit.

7.3 New ISA Regulation 12B sets out the conditions for opening a Lifetime ISA, including a requirement that, subject to specified exceptions, an account can only be opened by an adult younger than 40 years old. This new regulation also sets out the information, authorisations and declarations required at account opening; the process that applies where an application is made other than in writing; and arrangements for where an application is made on an individual's behalf.

7.4 New ISA Regulation 10A sets out eligibility conditions for paying into a Lifetime ISA and who is a 'Lifetime ISA qualifying individual'. This includes residency requirements and that, subject to specified exceptions, an individual can only pay into a Lifetime ISA if they are younger than 50 years old.

7.5 ISA Regulation 4 is updated to disregard, for the purposes of the ISA Regulations, any accounts where the account holder has notified closure within 30 days of the cancellation period start date set out in Financial Conduct Authority rules. ISA Regulation 4 is also amended so that during the tax year 2017 to 2018, other than in specified circumstances, a withdrawal from an account will result in that account being treated as never having been a Lifetime ISA (including for the purposes of eligibility for a government bonus or the application of withdrawal charges).

7.6 New ISA Regulation 8ZA sets out the investments that can be held in a Lifetime ISA. These are those investments which currently qualify to be held in a cash ISA or a stocks and shares ISA.

7.7 Consequential changes are made throughout the ISA Regulations to provide for the new account. These include modification of arrangements at ISA Regulation 4A for the repair of accounts and excess subscriptions (new ISA Regulation 4AA). Changes are also made to the arrangements for account transfers at ISA Regulation 21,

including to accommodate the transfer of sums from a Help to Buy: ISA to a Lifetime ISA during the tax year 2017 to 2018. The information requirements for account providers at ISA Regulation 31 are also updated for Lifetime ISA.

7.8 New ISA Regulation 37 introduces a Schedule to the ISA Regulations, making provision in relation to Lifetime ISA government bonus payments and account withdrawals.

7.9 The new Schedule defines certain terms, and sets out how a bonus due to an account holder is to be determined. The bonus is calculated at 25% of the qualifying additions (as defined in paragraph 1) made to an account.

7.10 The Schedule also sets out arrangements for claims of bonus amounts to be made to HMRC by account providers, including by specifying 'claim periods' at paragraph 1 and the due date for claims at paragraph 2. Arrangements are set out in paragraph 3 for cases in which a claim is rejected, including a right to apply to HMRC for the payment of a bonus that has been refused. Review and appeal arrangements are provided in relation to HMRC's decision on such an application.

7.11 Paragraph 12 sets out arrangements for the recoupment by HMRC of wrongly paid bonus amounts, including who is liable to repay such amounts.

7.12 The charge that will apply to certain withdrawals from a Lifetime ISA on or after 6 April 2018 is specified at 25% of the withdrawn amount (paragraph 5). Paragraph 17 requires account providers to give certain information to account holders on request, after a withdrawal charge has been made.

7.13 Paragraph 4 provides that withdrawals can be made without a withdrawal charge once an account holder reaches 60, and sets out conditions for charge-free withdrawals in relation to the terminal illness of an account holder or on transfer of an account.

7.14 Paragraphs 6 to 8 set out the conditions that must be satisfied for a withdrawal in relation to a first time residential purchase not to be subject to a withdrawal charge, including relevant definitions. These paragraphs also set out the process and information requirements that must be satisfied by an account holder and their conveyancer in relation to the withdrawal.

7.15 Paragraph 10 provides that withdrawn funds must be returned to a Lifetime ISA if a first time residential purchase has not been completed within 90 days of the receipt of these funds by the conveyancer. Any such funds not returned will be treated as a withdrawal from a Lifetime ISA, and may be subject to a withdrawal charge. However, this 90 day period, as well as other time periods set out in the Schedule, may be extended by HMRC under paragraph 18.

7.16 The Schedule also specifies (at paragraph 11) other circumstances in which removal of sums from a Lifetime ISA will not be considered to be a withdrawal for the purposes of a withdrawal charge.

7.17 Arrangements are also set out (at paragraph 14) for the collection and payment of withdrawal charges by account providers, as well as the information that account providers must give to HMRC (paragraph 13). Paragraph 14 also provides for an account holder to apply to HMRC for the repayment of a wrongly made withdrawal charge, and for review and appeal arrangements in relation to HMRC's decision on such an application.

7.18 Paragraph 15 concerns the application of late payment and repayment interest on amounts payable to, or by, HMRC. Paragraph 16 sets out rules for appeals in relation to certain matters.

Consolidation

7.19 There are no plans to consolidate the ISA Regulations.

8. Consultation outcome

8.1 A draft version of these regulations was published for consultation between 27 October 2016 and 6 January 2017. There were 14 respondents to this consultation, mainly potential account providers and representative groups for ISA providers or conveyancers. Responses included a number of technical points and suggestions in relation to the draft, including on the transfer process, the relevant time limits and the rules concerning a first time residential purchase. Many of these points have been reflected within this instrument.

8.2 A number of respondents also raised points concerning the design of Lifetime ISA, including the payment limit for the account and the eligibility rules, or suggested other circumstances in which a withdrawal might be made without a withdrawal charge being applied. Other respondents suggested additional features that could be added to Lifetime ISA. These points will be considered further for future development of the Lifetime ISA rules.

9. Guidance

9.1 HMRC Guidance Notes for ISA providers will be amended 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 business, charities or voluntary bodies is mainly on financial institutions who choose to offer Lifetime ISA accounts. It will be a commercial decision for each ISA provider whether they offer the account, and the Lifetime ISA is expected to increase business for institutions that offer it. Lifetime ISA providers will face one-off and ongoing costs, including those associated with training staff, establishing new systems for the account, policing the eligibility and other rules, calculating and claiming government bonus amounts due, deducting and paying withdrawal charges from 6 April 2018, and providing information to HMRC. There will also be one-off and ongoing costs from 6 April 2018 for conveyancers acting for Lifetime ISA holders purchasing their first home. These include costs associated with conveyancers familiarising themselves with and applying the relevant rules and processes, and providing information to the account provider from whom a Lifetime ISA withdrawal has been made. Detailed evidence necessary to enable an assessment of the total impact across all businesses is not currently available. However, HMRC will continue to work with businesses and their representatives to fully quantify the impacts.

10.2 The impact upon the public sector is that Exchequer costs for the Lifetime ISA are estimated to reach £830m in the tax year 2020 to 2021. HMRC will face additional costs associated with the payment of government bonuses and collection of

withdrawal charges. Total additional costs to HMRC are currently estimated to be around £3 to £3.5 million.

10.3 The Lifetime ISA rules include rights of appeal against certain HMRC decisions, and this could increase demand for tribunal hearings. However, it is anticipated that appeals will be rare, given the clarity of the Lifetime ISA rules.

10.4 A Tax Information and Impact Note has been prepared and is available on gov.uk. An earlier Impact Assessment in relation to Lifetime ISA was published alongside the Savings (Government Contributions) Bill, and can be found at https://www.gov.uk/government/collections/the-savings-government-contributions-bill.

11. Regulating small business

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

11.2 No action is proposed to minimise regulatory burdens on small businesses.

11.3 The basis for the final decision on what action to take to assist small business is that no business will be required to make any changes as result of the Lifetime ISA. Whether or not a business chooses to offer Lifetime ISA or process Lifetime ISA withdrawals for a first time residential purchase will be a commercial decision.

12. Monitoring & review

12.1 HMRC will monitor the impact of these changes on an ongoing basis using the information provided by Lifetime ISA providers.

13. Contact

13.1 Helen Williams at HM Revenue and Customs - Telephone: 03000 512336 or email: savings.audit@hmrc.gsi.gov.uk can answer any queries regarding the instrument.