EXPLANATORY MEMORANDUM TO

THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT NO. 2)

REGULATIONS 2016

2016 No. 364

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 This instrument introduces a new type of Individual Savings Account (ISA) – "the innovative finance ISA" - and enables interest and gains from certain peer-to-peer (P2P) loans to be tax-advantaged within this account. It also updates the rules for "flexible accounts" (ISAs that allow savers to replace withdrawn cash without this counting towards the annual ISA subscription limit) to allow replacement subscriptions using certain types of shares. In addition, the instrument makes minor amendments to the ISA rules concerning other subscriptions that do not count towards this annual subscription limit.

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 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

4.1 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).

4.2 The ISA Regulations currently establish two types of ISA (cash ISA and stocks and shares ISA) and specify the investments which can be held in each of these accounts. They also set out which financial institutions can offer ISAs and other account features and requirements.

4.3 These ISA Regulations were amended most recently by the Individual Savings Account (Amendment) Regulations 2016 (S.I. 2016/16). Among other matters, these amending regulations established flexible accounts.

4.4 Financial institutions are regulated by the Financial Conduct Authority (FCA) when they carry out activities in article 36H (operating an electronic system in relation to lending) or article 39G (debt administration) of the Financial Services and Markets

Act 2000 (Regulated Activities) Order 2001 (S.I. 2001/544) (Regulated Activities Order). Some institutions currently have interim (rather than full) permissions to carry out these activities, under the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2013 (S.I. 2013/1881).

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 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 The changes in this instrument are designed to increase choice for ISA investors. The instrument introduces a new type of tax-advantaged account – the innovative finance ISA (defined at new ISA Regulation 4(1ZA), inserted by regulation 5(b)) – and specifies (at new ISA Regulation 8A, inserted by regulation 12) the investments which qualify for this account. These include payments made under certain P2P loan agreements (article 36H agreements), as well as payments for the assignment or novation of these agreements or made by way of compensation.

7.2 The instrument also makes provision (at regulation 15) for financial institutions to qualify for approval from HMRC as an ISA provider if they have full permission to carry out activities detailed in article 36H or article 39G of the Regulated Activities Order.

7.3 Investors wishing to subscribe to an innovative finance ISA can do so by paying cash to an ISA provider, subject to the annual ISA subscription limit (currently £15,240). This cash can be used to make loans to borrowers under article 36H agreements.

7.4 The instrument also makes provision for various matters in relation to the innovative finance ISA, including: eligibility for an account (regulation 13); the general conditions for an account, including transfers and withdrawals (regulation 5); and the information that ISA providers must supply to HMRC about the accounts they manage (regulation 17). Minor and consequential amendments are also made to other ISA Regulations.

7.5 Regulation 9 of this instrument amends ISA Regulation 5DDB (concerning flexible accounts), so that the terms and conditions of these accounts can allow investors to use certain types of employee shares (rather than cash) to replace sums they withdrew from their account earlier in the year, without these shares counting towards the ISA subscription limit for the year.

7.6 Amendments made by regulations 13 and 14 of this instrument concern other subscriptions that are disregarded for the purposes of the annual ISA subscription limit. They amend the rules at current ISA Regulations 10 (qualifying individuals) and 12 (conditions for application to open an account) for cases in which it is possible for an investor to subscribe to more than one cash, stocks and shares and innovative finance ISA in a tax year.

7.7 Finally, the instrument makes a number of minor typographical corrections to the Individual Savings Account (Amendment) Regulations 2016.

Consolidation

7.8 There are no plans to consolidate the ISA Regulations.

8. Consultation outcome

8.1 HM Treasury issued a consultation on its proposed approach to making P2P loans eligible for ISA on 17 October 2014. This consultation closed on 12 December 2014 and received 81 formal responses, comprising 39 responses from individuals and 42 responses from organisations. Most respondents were broadly supportive of the proposal, but some called for modification in certain areas. HM Treasury's response was published on 8 July 2015, and set out the intention to create the innovative finance ISA as well as some of the design features of this new account.

8.2 HMRC undertook a technical consultation on draft regulations for the innovative finance ISA between 8 December 2015 and 1 February 2016. 8 responses were received from P2P operators, industry representatives and other businesses. Most welcomed the detail of the draft legislation, but some called for technical changes – for example, concerning which institutions could offer innovative finance ISAs and which payments would qualify to be held in these accounts. Following this consultation, a number of changes have been made, with the aim of providing greater clarity and flexibility within the rules, while also taking account of technical changes to the general regulatory rules for P2P lending.

8.3 The changes in relation to flexible accounts and subscriptions that are disregarded for the purposes of the annual ISA subscription limit are minor in their potential impact. Consultation on these changes was not therefore considered necessary.

9. Guidance

9.1 HMRC's Guidance Notes for ISA providers 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 business is expected to be mainly for financial institutions who choose to offer innovative finance ISAs or flexible accounts. These businesses will face one-off and ongoing costs from complying with the ISA Regulations. However, it is anticipated the overall costs for businesses will be negligible.

10.2 There is no impact on charities or voluntary bodies.

10.3 The impact on the public sector is expected to be negligible.

10.4 Tax Information and Impact Notes covering this instrument have been published on the HM Government website at—

https://www.gov.uk/government/publications/income-tax-innovative-finance-individual-savings-account-and-peer-to-peer-loans and https://www.gov.uk/government/publications/individual-savings-accounts-increasing-flexibility-for-savers/individual-savings-accounts-increasing-flexibility-for-savers

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 businesses is that no business will be required to make any changes as result of this instrument. Whether or not a business chooses to offer innovative finance ISAs or flexible accounts will be a commercial decision.

12. Monitoring & review

12.1 The instrument is designed to increase the choice available to ISA investors by introducing a new account – the innovative finance ISA, and updating the rules in relation to flexible accounts. HMRC will monitor take up of these accounts on an ongoing basis using the information provided annually by ISA providers.

13. Contact

13.1 Simon Turner at HMRC Telephone: 03000 546588 or email: savings.audit@hmrc.gsi.gov.uk can answer any queries regarding the instrument.