EXPLANATORY MEMORANDUM TO

THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT) (NO. 2) REGULATIONS 2024

2024 No. 1022

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. 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 Individual Savings Account Regulations 1998 (the ISA Regulations) to bring into effect an Autumn Statement 2023 announcement to allow fractional interests in an ISA, clarify the position in cases of doubt around transfers of ISAs and provide additional safeguards for investors and ISA managers.

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 An Individual Savings Account (ISA) is a tax-advantaged savings product providing relief from tax to individuals. The ISA rules, including which investments qualify for

inclusion, the basis on which accounts must operate and the requirements individuals must meet to open an account, are set out in the ISA Regulations.

5.2 This instrument amends the ISA Regulations to: provide that fractional interests (also known as 'fractional shares') in certain defined investments qualify for inclusion in an ISA; clarify the position regarding the transfer of accounts between ISA managers; and protect the integrity of the tax-free savings landscape by requiring National Insurance numbers to be provided when opening an account.

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 ISA Regulations define a 'fractional interest' in a share for the purposes of the ISA legislation and set the conditions with which a fractional interest must comply.

5.4 To ensure equivalence with the treatment of whole shares, the ISA Regulations require that ISA 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 stocks & shares ISA 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 ISA Regulations do not extend to investment in a fraction of a share. Shares, as described in the ISA Regulations, apply to whole shares only. Fractional shares are a relatively new investment type and did not exist when the ISA Regulations were introduced.

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

5.8 The Regulations require, amongst other things, that certain information is provided by an investor to enable an account to be opened. They do not mandate the provision of a National Insurance number. The change will require a National Insurance number to be provided unless the investor is not entitled to one.

5.9 The Regulations set out the basis on which accounts must operate, including the information which must be passed between ISA managers in relation to the transfer of an account. The changes will clarify the rules relating to the transfer of subscriptions made in the current year.

6. Legislative and Legal Context

How has the law changed?

6.1 Regulation 4 of the ISA 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 6 of the ISA Regulations specifies the requirements as to the price at which ISA transactions, by purchase, sale or otherwise, are made. Regulation 7 of the ISA Regulations specifies the kind of investments which may be held in a stocks and shares ISA and includes shares (including those in an Investment Trust) and shares in Funds.

6.2 This instrument will amend Regulations 4, 6, and 7 to provide that certain defined fractional interests are qualifying investments for ISA 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 6 to require that any transaction by purchase, sale or otherwise in a fractional interest is proportionate to that of the whole share and be at the open market price. It will also require ISA managers 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.

6.3 Regulation 4ZA of the ISA Regulations requires certain information to be provided to open a Junior ISA and Regulation 12 of the ISA Regulations requires similar information to be provided to open an ISA.

6.4 To protect the integrity of the tax-free savings landscape, address a lacuna and mirror the approach with Lifetime ISAs, this instrument will amend Regulations 4ZA and 12 to require the provision of a National Insurance number where the investor is entitled to one.

6.5 Regulation 21 of the ISA Regulations specifies the process for transfers of accounts and funds between ISA managers and Regulation 21A of the ISA Regulations specifies the information to be provided by an ISA manager in relation to a transfer between cash accounts.

6.6 This instrument will amend Regulations 21 and 21A to clarify the rules relating to the transfer of current year subscriptions from one ISA manager to another.

Why was this approach taken to change the law?

6.7 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 ISA managers on the operational design of ISA, potential improvements, and to clarify application of the ISA 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 ISA managers available on the gov.uk website[1] will be amended to reflect the changes to the ISA 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 an ISA may benefit ISA managers who wish to engage in this market. Changes to the requirement for the individual to provide a National Insurance number when opening an ISA will require some ISA managers to make changes to their ISA application process.

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 an ISA.

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 ISA Regulations using information provided annually and through regular contact with ISA Managers 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").

[1] Guidance Notes for ISA managers: http://www.gov.uk/government/collections/isa-managers-guidance
[2] Tax Information and Impact Note: https://www.gov.uk/government/publications/individual-savings-account-and-child-trust-funds-amendment-no-2-regulations-2024