HM TREASURY

ISA qualifying investments:

consultation on including shares traded on small and medium-sized enterprise equity markets

March 2013

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Any queries regarding this publication should be sent to us at: public.enquiries@hm-treasury.gov.uk.

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Contents

1 Introduction

1.1 At Autumn Statement 2012, the Chancellor announced that the Government would consult on expanding the list of qualifying investments for stocks and shares ISAs to include shares traded on small and medium-sized enterprise (SME) equity markets.

1.2 This consultation is about implementing that announcement. This document sets out a proposal to change the ISA rules to allow company shares traded on a wider range of equity markets to be eligible for a stocks and shares ISA, including markets with a component of smaller company shares.

About ISAs and their qualifying investments

1.3 An Individual Savings Account (ISA) is a savings account within which all interest, dividends and capital gains that arise are tax-advantaged. There are two types of ISA: a cash ISA and a stocks and shares ISA.

1.4 There are limits on how much investors can subscribe to an ISA in each tax year. ISA limits for 2012-13 allow individuals to save up to £11,280 in an ISA, up to £5,640 of which can be saved in a cash ISA. These limits will rise with Consumer Price Index (CPI) inflation in 2013-14 to £11,520 and £5,760 respectively.

1.5 Not all types of asset can be held in a stocks and shares ISA. The assets that can be held in a stocks and shares ISA are specified in the Individual Savings Accounts Regulations 1998[1] (ISA Regulations). At present, this excludes many smaller company shares. The Government intends to expand the range of ISA qualifying investments to address this. More detail on ISA qualifying investments is set out in Chapter 2.

Policy objectives of the Autumn Statement 2012 announcement

1.6 Access to finance for smaller growing companies is key to promoting private investment and delivering a sustainable economic recovery. The Government wants to ensure that businesses, particularly small businesses, are able to access finance and support.

1.7 At Autumn Statement 2012, the Government announced that it would consult on expanding the range of ISA qualifying investments, to enable more shares traded on SME equity markets to be held in a stocks and shares ISA. This policy could lead to an important capital injection for SME equity markets and encourage more investment in growing businesses.

1.8 A further objective of this policy is to improve choice for ISA investors by widening the range of shares eligible to be held in an ISA. Investors will still be free to choose the investments they hold in their ISA, so do not have to invest in assets that they do not want to.

[1] (Statutory Instrument 1998/1870)

About this consultation

1.9 Since the policy announcement at Autumn Statement 2012, HM Treasury has consulted informally with stakeholders through a series of bilateral meetings. These meetings have been used to develop a proposal of how to implement this policy, which is set out in this document.

1.10 The scope of this consultation is explained below. Chapter 2 explains which shares currently qualify to be held in a stocks and shares ISA, and outlines this consultation's objectives. Chapter 3 sets out the Government's proposal for how to implement the policy, and explains how this meets the consultation objectives. Chapter 4 describes alternative approaches that have been considered. Chapter 5 explains how to respond to this consultation.

Consultation scope

1.11 This document sets out the Government's proposal for changing the ISA Regulations to expand the range of shares that are eligible to be held in a stocks and shares ISA. The aim of this consultation is to gather views on the proposed approach, so that these can be taken into account before publishing the revised regulations in draft. The consultation objectives are set out in Chapter 2.

1.12 This consultation does not ask for views on the principle of whether or not to expand the range of ISA qualifying investments. **The Government has decided to introduce this policy in order to stimulate investment in smaller companies**. The consultation asks for views on the proposed method for implementing this policy and on its potential impact, and also asks whether stakeholders think there are alternative approaches that could better meet the policy objectives.

Responding to the consultation

1.13 This consultation asks for views on the Government's proposed approach to implementing this policy, with questions highlighted in boxes throughout the document. Respondents are asked to focus their responses on these questions, although all views are welcomed within the scope of the consultation.

1.14 We would be particularly interested to hear from:

- equity markets on which shares are traded that will become eligible for stocks and shares ISAs under the Government's proposed approach;
- equity markets on which shares are traded that will continue to be ineligible for stocks and shares ISAs under the Government's proposed approach;
- non-UK equity markets and their representative bodies; and
- representatives of other affected groups, such as investors, consumers, ISA managers and financial advisers.

1.15 Responses to this consultation should be sent to HM Treasury by Wednesday 8 May 2013.

Please email enquires and consultation responses to:
ISASharesConsultation@hmtreasury.gsi.gov.uk specifying in the subject line whether your email is an enquiry or a formal consultation response.

Alternatively, address responses to:
ISA Shares Consultation, Pensions and Savings Team, 1 Horse Guards Road, London, SW1A 2HQ

1.16 Chapter 5 has further details on responding to this consultation.

Next steps

1.17 Once this consultation has closed on 8 May 2013, the Government will consider all responses and publish a 'summary of responses' document. This will review the responses received, and explain how they will be taken into account when drawing up draft regulations.

1.18 The Government expects to publish draft regulations to lay before Parliament in the summer.

2 Qualifying shares in ISAs

2.1 The categories of assets that can be held in a stocks and shares ISA are set out in the ISA Regulations. To be a qualifying investment for a stocks and shares ISA under the current regulations, shares in a company must be officially listed on a recognised stock exchange, in addition to meeting certain other criteria.

Box 2.A: Definitions of recognised stock exchange terminology

Recognised stock exchange is defined at section 1005(1) of the Income Tax Act 2007 as:

- any market of a recognised investment exchange which is for the time being designated as a recognised stock exchange... by an order made by the Commissioners for Her Majesty's Revenue and Customs; and
- any market outside the United Kingdom which is for the time being so designated. (Section 1005, Income Tax Act (ITA) 2007).

A list of recognised stock exchanges can be found on the HM Revenue and Customs website at http://www.hmrc.gov.uk/fid/rse.htm

Listed on a recognised stock exchange: Under section 1005(3) of the Income Tax Act 2007, references to shares that are listed on a recognised stock exchange are to shares that are:

- admitted to trading on that exchange; and
- included in the official UK list (maintained by the Financial Services Authority as the UK Listing Authority), or officially listed in a qualifying country outside the UK in accordance with provisions corresponding to those generally applicable in EEA states.

2.2 Many smaller company shares are not listed on the Financial Services Authority's Official List, or are not listed in a qualifying country outside the UK. These shares are therefore ineligible to be held directly in a stocks and shares ISA because they do not meet the HM Revenue and Customs (HMRC) definition of "listed on a recognised stock exchange".

2.3 Some shares are dual-listed, meaning that they are listed on at least one recognised stock exchange as well as being traded on another market. Such shares are already eligible to be held in a stocks and shares ISA. In addition, unlisted shares may be held indirectly in a stocks and shares ISA through a fund, such as an Open Ended Investment Company (OEIC), if the fund itself is an ISA qualifying investment.

Consultation objectives

2.4 There are three objectives that set the parameters for this consultation, within which an expansion to the ISA qualifying investments is to be defined:

1. **Bring company shares on SME equity markets from across the European Economic Area (EEA) into the scope of ISA qualifying investments.**
   This is the core objective of the policy. The policy should apply across the EEA, in accordance with European law;

2. **New ISA qualifying investments must comply with the other existing ISA rules.**
   The ISA rules underlie its success as a popular and trusted savings product. They include requirements that the time taken for transfers and withdrawals must not exceed 30 days; and that ISA investors who hold shares in a company should have access to certain information about that company, and be entitled to attend and vote at investors' meetings; and

3. **Any new criteria for eligibility as ISA qualifying investments must be simple to apply, should provide certainty, and should not impose disproportionate assessment or monitoring requirements on HMRC.**
   The new qualifying criteria for company shares in ISAs should give clarity about what is included and what is not included under the criteria, and should minimise the need to monitor the qualifying investments on an ongoing basis. The new qualifying criteria should apply to equity markets, rather than individual shares, to provide certainty for ISA managers and investors as well as HMRC.

Qualifying investments for Child Trust Fund and Junior ISA

2.5 The Government's tax-advantaged savings accounts for children, Child Trust Fund (CTF) and Junior ISA, also have rules about which investments can be held in a stocks and shares account. These are broadly aligned with the investments that qualify to be held in 'adult' ISAs. When the range of ISA qualifying investments is expanded to include shares traded on SME equity markets, the Government intends to apply the same extension to CTFs and Junior ISAs.

Question 1: Do respondents agree that the set of investments that can be held in Child Trust Funds and Junior ISAs should be expanded in line with 'adult' ISAs, to include shares traded on SME equity markets? If not, why not?

3 Proposed qualifying criteria

3.1 This chapter sets out the Government's proposal for how the scope of stocks and shares ISA qualifying investments could be expanded to include shares traded on SME equity markets, in a way that is consistent with the consultation scope and objectives set out in Chapters 1 and 2.

Expanding the shares eligible for ISAs under recognised stock exchanges

3.2 Chapter 2 explained the current requirements for company shares to be ISA qualifying investments; namely, that they are "listed on a recognised stock exchange". The Government's proposed approach is to broaden the range of shares traded on a recognised stock exchange that are eligible to be held in an ISA.

3.3 **The Government proposes to expand the range of ISA qualifying investments to include company shares admitted to trading on a recognised stock exchange in the European Economic Area.** This will remove the requirement that company shares must be listed on the Official List of the UK Listing Authority (or listed by an equivalent overseas listing authority), while maintaining the requirement that the shares must be traded on a recognised stock exchange.

3.4 The Government believes that this proposed approach is the best way to implement the policy, for the following reasons:

- it meets this consultation's main objective, allowing company shares on SME equity markets from across the EEA into the scope of ISA qualifying investments;
- by limiting the newly eligible company shares to those on EEA recognised stock exchanges, the expanded criteria ensure that investors will continue to benefit from the protections of European market regulation, thereby meeting this consultation's second objective; and
- it meets this consultation's third objective – it simplifies compliance by using terminology with precedent in tax legislation; provides certainty by using the list of recognised stock exchanges maintained by HMRC; and minimises operating requirements for ISA managers, participating markets and HMRC.

3.5 The Government recognises that there are some drawbacks to this approach:

- it is not perfectly targeted at smaller companies, potentially capturing larger firms and non-SME equity markets; and
- equity markets that are not recognised stock exchanges would be ineligible. Nevertheless, there are advantages to basing the criteria on recognised stock exchanges, and markets can apply to HMRC to be considered for recognised stock exchange status.

Question 2: Are there any EEA SME equity markets that would not qualify under the proposed criteria, and if so, which markets? Is there a case for including these markets? If so, how could this policy be implemented differently to include these markets?

Question 3: What risks, if any, does the proposed approach have for ISA investors? What alternative method of implementing this policy would reduce such risks?

Question 4: Which non-SME equity markets would also qualify for ISAs under the proposed expanded criteria?

Compliance of newly eligible shares with general ISA rules

3.6 This consultation's second objective is that any new ISA qualifying investments must comply with other existing ISA rules – for example, the requirement that the time taken for transfers and withdrawals must not exceed 30 days. Specifically, this requirement is that ISA transfer instructions or withdrawal instructions shall be subject to any reasonable business period of the account manager required for the practical implementation of the instructions, but such period must not exceed 30 days (Regulation 4(7) in the ISA Regulations). This requirement is an important part of the ISA rules because it ensures that investors can rely upon ISA as an accessible savings product.

3.7 ISA rules also require that ISA investors who hold shares in a company should have access to certain information about that company, and be entitled to attend and vote at investors' meetings. It is important that these requirements are maintained to ensure that ISA remains a trusted savings vehicle.

3.8 There are no plans to change any aspect of these ISA rules to accommodate the expansion of ISA qualifying investments. It will remain, as at present, the responsibility of the ISA manager to ensure that the relevant ISA rules are met.

Question 5: Consultation objective 2 requires that all new ISA qualifying investments comply with the ISA rules. Would any of these rules disproportionately restrict the eligibility of smaller company shares for ISAs if the range of ISA qualifying investments were expanded as proposed in this consultation?

Question 6: Are any other safeguards required to provide investors with additional reassurance, without compromising the main objective of this policy?

Eligibility for other tax reliefs

3.9 Many of the smaller company shares being targeted by this policy are eligible for tax reliefs for unlisted shares, such as the Enterprise Investment Scheme (EIS), Venture Capital Trust (VCT), and Inheritance Tax Business Property Relief. One of the eligibility requirements for these reliefs is that the shares are <u>not</u> "listed on a recognised stock exchange".

3.10 This means that the company shares that would newly qualify to be held in a stocks and shares ISA under the proposed expanded criteria would not lose their eligibility for these tax reliefs, so long as the shares remained unlisted. However, any shares that are already ineligible for these reliefs would remain ineligible.

4 Alternative qualifying criteria considered

4.1 In the process of deciding on the proposed new ISA qualifying criteria set out in Chapter 3, a number of alternative options were considered. All the options have advantages and disadvantages, but the Government believes that the proposed approach set out in Chapter 3 best meets the consultation objectives.

4.2 This chapter sets out the other options that were considered. Each option has an explanation of the reasons why it is not the Government's proposed implementation approach.

Specifying individual markets

4.3 This approach would involve selecting individual markets and allowing the shares quoted on them to be eligible for inclusion in ISAs. This would be straightforward to implement and potentially well-targeted at SME equity markets.

4.4 However, without specified conditions for why some markets were eligible and others were not, picking markets would create a risk of unfairness and potential legal challenge. It could also lead to uncertainty for markets and investors.

Applying a test to determine eligible markets

4.5 Another possible approach would be to apply a new bespoke test to equity markets to determine whether or not the shares quoted on them are eligible for ISAs. The advantage of this option is that the test could target SME equity markets. A test could be based on other relevant market classifications, for example the "SME Growth Market" classification that has been proposed in the review of the Markets in Financial Instruments Directive (MiFID). In this case, the test might, for example, specify that a certain proportion of the companies admitted to trading on a market were SMEs, i.e. had a market capitalisation of less than a specified value.

4.6 However, such a test would create significant monitoring burdens for markets and HMRC. If the test was based on the eligibility criteria of the proposed "SME Growth Market" MiFID classification, there would be a risk that the "SME Growth Market" criteria would have changed by the time the classification came into force. This could cause confusion and uncertainty for markets and investors.

Multilateral Trading Facilities (MTFs)

4.7 Under this approach, the ISA qualifying criteria could be expanded to include company shares admitted to trading on a Multilateral Trading Facility. The advantage of this option is that it is based on existing terminology under MiFID, and therefore covers markets across the EEA.

4.8 The drawbacks of this option are that it does not target SME equity markets, and it uses concepts and definitions that are not widely established in UK tax law.

Recognised Investment Exchanges (RIEs), Recognised Overseas Investment Exchanges (ROIEs) or Prescribed Markets

4.9 RIEs, ROIEs, and Prescribed Markets already exist in legislation, so would be simple to refer to, and would capture some SME equity markets.

4.10 However, RIEs and Prescribed Markets are primarily UK terms, so would only capture SME equity markets that are based in the UK. ROIEs cover the 'rest of the world' but not the EEA, because in financial services legislation EEA markets are captured by the MTF classification. Therefore, each of these criteria would fail the objective to bring in company shares on SME equity markets from across the EEA.

Question 7: Is there another approach for implementing this policy that has not been considered above? What would be the benefits and drawbacks of such an approach?

Question 8: When the "SME Growth Market" classification is introduced as part of MiFID Review, should the Government revisit the ISA Regulations for qualifying SME equity markets to bring them into line with the new classification? What would be the advantages to doing so? What would be the disadvantages?

Question 9: Are there any other points that respondents would like to raise about the Government's proposed approach and alternative approaches?

5 How to respond

Summary of views requested

5.1 The Government welcomes views on the following questions, although all views are welcomed within the scope of the consultation:

- Question 1: Do respondents agree that the set of investments that can be held in Child Trust Funds and Junior ISAs should be expanded in line with 'adult' ISAs, to include shares traded on SME equity markets? If not, why not?
- Question 2: Are there any EEA SME equity markets that would not qualify under the proposed criteria, and if so, which markets? Is there a case for including these markets? If so, how could this policy be implemented differently to include these markets?
- Question 3: What risks, if any, does the proposed approach have for ISA investors? What alternative method of implementing this policy would reduce such risks?
- Question 4: Which non-SME equity markets would also qualify for ISAs under the proposed expanded criteria?
- Question 5: Consultation objective 2 requires that all new ISA qualifying investments comply with the ISA rules. Would any of these rules disproportionately restrict the eligibility of smaller company shares for ISAs if the range of ISA qualifying investments were expanded as proposed in this consultation?
- Question 6: Are any other safeguards required to provide investors with additional reassurance, without compromising the main objective of this policy?
- Question 7: Is there another approach for implementing this policy that has not been considered above? What would be the benefits and drawbacks of such an approach?
- Question 8: When the "SME Growth Market" classification is introduced as part of MiFID Review, should the Government revisit the ISA Regulations for qualifying SME equity markets to bring them into line with the new classification? What would be the advantages to doing so? What would be the disadvantages?
- Question 9: Are there any other points that respondents would like to raise about the Government's proposed approach and alternative approaches?

Submitting responses

5.2 Responses to this consultation should be sent to HM Treasury by Wednesday 8 May 2013.

Please email enquires and consultation responses to:
ISASharesConsultation@hmtreasury.gsi.gov.uk
specifying in the subject line whether your email is an enquiry or a formal consultation response.

Alternatively, address responses to:
ISA Shares Consultation, Pensions and Savings Team, 1 Horse Guards Road, London, SW1A 2HQ

5.3 The Government will also be meeting with stakeholders during the consultation period to discuss their views on the questions set out in this document.

5.4 When responding please say if you are a business, private individual or representative body. In the case of representative bodies please provide information on the number and nature of people or businesses you represent.

5.5 Please be aware that all responses may be shared with HM Revenue & Customs and the Financial Services Authority.

Confidentiality

5.6 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

5.7 If you want the information that you provide to be treated as confidential, please be aware that, under FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

5.8 HM Treasury will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

5.9 This consultation is being run in accordance with the Government's Consultation Principles. The Consultation Principles are available on the government website:
https://www.gov.uk/government/publications/consultation-principles-guidance

5.10 The Government's Consultation Principles state that "timeframes for consultation should be proportionate and realistic". This consultation will run for eight weeks, which should be sufficient time for stakeholders to consider and respond. A longer consultation is considered unnecessary because this document consults on policy implementation rather than principle, and the policy will involve a secondary, rather than primary, legislation change.

5.11 If you have any comments or complaints about the consultation process please contact:

Amy Burgess, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.

A Summary of impacts

A.1 This annex provides a summary of the expected impacts of this policy. A full Tax Impact and Information Note (TIIN) will be published alongside draft regulations following the completion of this consultation.

Table A.1: Summary of impacts

Exchequer impact	Negligible (assumes that any increased investment in newly eligible company shares takes place in substitution of investment in existing qualifying investments through ISAs).
Economic impact	No evidence of an impact that would affect OBR forecasts.
Impact on individuals and households	Increased flexibility for ISA investors through wider range of stocks and shares ISA qualifying investments. It is likely that a minority of ISA investors will take advantage of this increased flexibility. Any impact is dependent on investors choosing to hold the newly eligible shares in their ISA.
Equalities impacts	No significant impact. It is likely that the additional ISA flexibility will be of most interest to more experienced investors with higher value ISA funds.
Impact on business including civil society organisations	The policy is expected to lead to an inflow of investment into smaller companies with shares traded on SME equity markets. It is not expected that the proposed approach for implementing this policy will have a significant impact on ISA managers, beyond broadening the range of investments they can offer in an ISA.
Operational impact	The proposed approach for implementing this policy should not substantially complicate the compliance system; therefore, the operational impact is expected to be low.
Other impacts	The policy is not expected to have any other significant impacts.

Source: HM Treasury/HM Revenue and Customs assessment

HM Treasury contacts

This document can be found in full on our website: http://www.hm-treasury.gov.uk

If you require this information in another language, format or have general enquiries about HM Treasury and its work, contact:

Correspondence Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 5000

E-mail: public.enquiries@hm-treasury.gov.uk

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