

DRAFT EXPLANATORY MEMORANDUM TO
THE INDIVIDUAL SAVINGS ACCOUNT (AMENDMENT NO.2)
REGULATIONS 2016

2016 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 This instrument introduces a new type of Individual Savings Account (ISA) - the innovative finance ISA - and makes it possible for interest and gains from peer-to-peer (P2P) loans to be tax-advantaged within this account. The instrument also sets out various conditions and rules for this new type of ISA, including those concerning the eligibility of P2P loans.

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 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 ISA and certain other account features and requirements.
- 4.3 Financial institutions are regulated by the Financial Conduct Authority (FCA) where they carry out activities detailed 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). 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 by introducing a new form of tax-advantaged account – the innovative finance ISA. Under this new account, interest paid on P2P loan agreements (Article 36H agreements), and gains from the assignment or sale of rights under these agreements, can qualify for ISA tax advantages, subject to certain conditions.
- 7.2 The instrument will establish the innovative finance ISA (defined at new ISA Regulation 4(1ZA)) and specify (at new ISA Regulation 8A) the kinds of investments which qualify for this account.
- 7.3 In line with these changes, the instrument will update the ISA Regulations so that providers with full permissions to carry out activities detailed in Article 36H or Article 39G of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 can also obtain approval from HMRC to be an ISA provider.
- 7.4 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 provide a loan to a borrower under an Article 36H agreement. ISA tax advantages mean that income tax will not be chargeable on any interest paid on this loan.
- 7.5 The instrument will also set out rules within the ISA Regulations on various matters concerning the innovative finance ISA, such as: eligibility for an account (which will be restricted to individuals aged 18 or over); the general conditions for an account; an investor's rights to transfer or withdraw cash held in their account and the information that account providers must supply to HMRC concerning the accounts that they manage. Minor consequential amendments will also be made to other ISA Regulations.
- 7.6 ISA Regulation 5DD will be updated to provide that certain compensation sums received in respect of innovative finance ISA investments can be disregarded for the purpose of the annual ISA subscription limit. The rules concerning the additional permitted subscription available to the spouse or civil partner of a deceased ISA saver will also be updated to include innovative finance ISA assets.

Consolidation

- 7.7 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.

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 regulated P2P operators who choose to offer innovative finance ISA. 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 A Tax Information and Impact Note is submitted with this memorandum and is available on gov.uk.

11. Regulating small business

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 No specific 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 this instrument. Whether or not a business chooses to offer innovative finance ISA 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. HMRC will monitor take up of this account 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.