THE DRAFT CHILD TRUST FUND REGULATIONS

The Chancellor in Budget 2003 announced the introduction of the Child Trust Fund (CTF) and that accounts were to be available by 2005. Children born from 1 September 2002 will be eligible for accounts if a child benefit award has been made for them and they are living in the UK.

The Child Trust Fund will:

- help people understand the benefits of savings and investing;
- encourage parents and children to develop the savings habit and engage with financial institutions;
- ensure that in future all children have a financial asset at the start of adult life to invest in their future; and
- build on financial education to help people make better financial choices.

In October 2003 the Government published the paper "Detailed proposals for the Child Trust Fund" which set out key features of the scheme.

The Child Trust Funds Bill is currently before Parliament and provides powers under which regulations on various aspects of the CTF will be made in due course.

Following a Written Statement by the Financial Secretary to the Treasury to Parliament on 2 February 2004 draft regulations have been published for the information of Parliament and others, particularly potential providers of CTF accounts. The attached Commentary provides an overview of the draft regulations and also gives some background information on some of the provisions that they make.

The CTF scheme has been based as much as possible on the ISA scheme with which many potential CTF providers will be familiar. Similarly the draft regulations which have been published today contain many regulations which replicate or are similar to existing ISA regulations. As with ISAs the Inland Revenue will also in due course publish extensive guidance for CTF managers.

There are some areas not covered by the present draft regulations – appeals and regulations relating to the tax treatment of insurance business.

The Child Trust Funds Bill provides for appeals against decisions taken by the Inland Revenue and provides powers for regulations to be made in connection with appeals. Appeals may be brought by account providers or responsible persons and will be heard by the Appeals Service which hears social security appeals including child benefit appeals. Regulations relating to appeals will be available later this year.

Draft regulations relating to the tax treatment of insurance companies and friendly societies providing CTF accounts will also be available later. The Child Trust Fund account is however modelled very closely on the ISA and the insurance business regulations will take the same approach as the Insurance Companies ISA regulations.

These regulations cover the detail of the CTF scheme anticipated in the paper 'Detailed proposals for the Child Trust Fund' and the CTF Bill. The Regulatory Impact Assessment published with the Bill addresses the impact of the details published in these draft regulations. We do nevertheless welcome any further comments on the regulatory impact of the CTF.

If there is any aspect of the draft regulations that readers wish to comment on please forward those comments to:

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COMMENTARY

Citation and Commencement

Regulation 1 gives the title by which the regulations are to be known and the date on which various of the regulations come into force.

Children born on or after 1 September 2002 will be eligible for a Child Trust Fund account but as the launch of the CTF scheme is expected to be in April 2005, there will be a large number of children born before then who will need accounts opening for them and payments processed at the start of the scheme.

In order to manage this peak of work for both providers and the Inland Revenue the commencement date of certain provisions in the regulations will be brought forward a few months to 1 January 2005. So, for example, vouchers can be issued to parents who can open a CTF account in readiness for the launch. The Government payments will not however be made into the account until shortly after the launch and parents and friends cannot subscribe to the account until then. Although providers cannot strictly be approved before 1 January 2005 when the legislation would come into effect, the process of approval will actually start on 1 October in order to give providers advance notice that they will have approval on 1 January.

Interpretation

Regulation 2 gives definitions of various terms used in the CTF regulations.

Vouchers

Regulation 3 sets out the particulars which will appear on the voucher issued to the child benefit claimant and which the responsible person uses to open a CTF account for the child. These particulars include the child's unique reference number. The unique reference number that will be used for the CTF is the Child Reference Number (the CRN) which is the forerunner of the National Insurance Number (NINO) and which is normally issued to the child at the age of 15 years 9 months. **Regulation 14 (2) (b) (vi)** prohibits the use of this number for any other purpose but the child's account.

The voucher will also contain an expiry date after which the voucher will no longer be valid. That date will normally be 12 months from the date of issue of the voucher.

However, for children in the transitional group born on or after 1 September 2002 and before the launch date, the life of the voucher will be one year from the launch date. Where the child is 17 when a child benefit award is first made for them, the expiry date will be the date the child reaches the age of 18.

The CTF provider can accept applications to open an account from a responsible person, by post, or by telephone or internet. But before the account can be opened the responsible person must give the voucher to the CTF provider.

The initial Government contribution that the voucher represents will be £250 (see regulation 7(1)).

Descriptions of Accounts

Regulation 4 provides that a CTF account must fall into one of two descriptions:

4 (a) Stakeholder account
4(b) Non- stakeholder account

Regulation 4 (1) specifies that a stakeholder account is an account that complied with the provisions of the Schedule.

Schedule

Definition of stakeholder account

Paragraph 1 sets out the description of a stakeholder Child Trust Fund account by reference to the characteristics and conditions set out in **paragraph 2**.

Paragraph 2(1) states that the stakeholder account must have the characteristics in 2(2), and comply with the conditions from 2(3) to 2(6).

Stakeholder characteristics

Paragraph 2(2) gives the characteristics of a stakeholder account that the account provider must adhere to, which are:

Paragraph 2(2)(a) requires that the account should be predominantly equity-based, with equities being defined in 2(7).

Paragraph 2(2)(b) requires that providers should assume that the child is a reasonably cautious investor;

Paragraph 2(2)(c) provides that the account must be adequately diversified. In practice diversification is expected to cover:

- investment across a range of different markets, sectors and securities;
- investors to not be exposed to a high proportion of high-risk bonds, whether long-dated or sub-investment grade;
- investments not to be heavily in high-risk equities; and
- derivatives to only be used for efficient portfolio management.

Paragraph 2(2)(d) specifies that the account should be "lifestyled". This is defined to mean that investments in the account should be chosen to progressively reduce the proportion of the account held in higher risk investments, with the aim of providing a cash lump sum at age 18 that has not been diminished because of the failure to do so. Such a movement towards less risk should commence before or on the child's 13th birthday (or in circumstances where the account is opened after a child's 13th birthday, when the account is opened) and continue until the child is 18. Such a reduction in risk will occur unless otherwise instructed by the registered contact.

Proportions have not been specified on particular asset classes to measure the reduction on risk. While a minimum amount of time of 5 years before the child turns 18 has been specified for the movement to begin, a maximum amount of time has not been given. However, it is envisaged that this movement cannot begin too early given the requirements of paragraphs 2(2)(a) and 2(2)(c) for the stakeholder to be equity-based and adequately diversified.

Nevertheless, such a movement towards less risky investments is not required in cases where the registered contact has chosen to opt out of this. This may be due to an intention to continue investing in another equities-based product at 18. Provided the account continues to meet the definition and other conditions of the stakeholder account, the account will remain a stakeholder account.

Stakeholder conditions

Paragraphs 2(3) to 2(6) give the conditions which the stakeholder account must meet:

Paragraph 2(3) requires that the investments specified, if they are included in the stakeholder, must be single priced. That is, the purchase and sale price must not differ from each other at any given time.

Paragraph 2(4) lists the means of payment that must be acceptable to providers for contributions to the account.

Paragraph 2(5) requires providers to accept any contributions equal to £10 or above on a single occasion. This is subject to the contribution meeting the requirements in 2(4). Providers can accept a contribution below this amount if they wish.

Paragraph 2(6) states that the account may be subject to charges, the details of which are given in paragraph 3.

Paragraphs 2(7) and 2(8) give definitions of various terms used in the CTF stakeholder regulations.

Charges

Paragraph 3 sets out the details of the charges that may be applied to the stakeholder account.

Paragraph 3(1) states that the charges applicable are contained in paragraphs 3(2) to 3(4).

Paragraph 3(2) states that the maximum level of charges that can be imposed on the account will be 1.5%. Consistent with current stakeholder pension regulations, this is measured by a maximum of 3/730% or 1.5/365% allowed per day. In a leap year, this is still calculated as 1.5/365% allowed per day.

Examples of costs included in the charge cap include costs associated with:

- Distribution and marketing
- New business processing
- Ongoing administration
- Claims administration
- Fund management excluding stamp duty and costs associated with buying or selling.

Paragraph 3(3) provides for deductions that may be made in addition to charges included under the charge cap. This includes any stamp duty or stamp duty reserve tax or other charges incurred (either directly or indirectly) in the sale or purchase of investments for the account.

Paragraphs 3(4) allows for costs incurred in relation to regulation 8(2)(d) and (e) to be deducted in addition to charges included under the charge cap. This includes costs for registered contacts to receive annual reports and other information, invitations to meetings and to vote in relation to companies in which account investments are held.

Paragraphs 3(5) and (6) detail that providers must decide whether to value a child's rights on a daily, weekly or monthly basis when calculating the charge cap.

Where the valuation is on a weekly or monthly basis, the day chosen for valuation is known as the "specified day" or "specified date" respectively. Where the specified day or date is not a working day, valuation must take place on the next working day.

The decision on valuation frequency and if applicable, specified day or date must be recorded in writing, and not modified within 12 months of an earlier decision.

Paragraph 3(7) provides for where the provider makes deductions under paragraphs 3(3) and 3(4) that the charge cap be calculated after the deductions. The effect of this requirement is that the child's rights are reduced by a smaller amount than would otherwise be the case.

Regulation 4 (2) provides that all accounts opened by the Inland Revenue are stakeholder accounts.

Opening of account by responsible person

Regulation 5 sets out the conditions and procedures for when the responsible person - who is usually the parent – opens a CTF account for their child. There are four conditions, all of which must be satisfied before the account can be opened. Those conditions are:

- The voucher must be handed over to the provider;
- The responsible person must enter into an agreement with the account manager for the management of the account. That agreement must include the application and declaration required by Regulation 13 – see later;
- If the application is not in writing, the responsible person has agreed to the management of the account;
- Any cooling off period or cancellation period must have expired.

Where a responsible person opens a CTF account they then become known as the "registered contact". There can only be one registered contact at any time, so the provider will not receive conflicting advice. **Regulation 13 (10)** allows the registered contact to change under specified circumstances.

Opening of account by the Inland Revenue – (Revenue allocated accounts)

Regulation 6 relates to Revenue allocated accounts which are the accounts that the Revenue opens where a responsible person has not opened an account for the child before the voucher expires.

Regulation 6 (1) provides that the Revenue will forward to the provider the particulars of the child for whom a Revenue allocated account will be opened.

Regulation 6 (2) requires the account provider to open immediately a stakeholder account for that child as if a responsible person had entered into the account provider's standard management agreement for the stakeholder account in question.

Regulation 6 (3) provides for the Revenue to maintain and update the list of providers who are prepared to offer Revenue allocated accounts. Providers can agree to be providers of Revenue allocated accounts when they apply for approval as a CTF account provider or at any date afterwards. They can also withdraw from this agreement provided they give the Revenue 30 days notice (see regulation 19(2)).

A provider for an individual child's Revenue allocated account will be chosen in strict rotation from the list maintained by the Revenue. **Regulation 6 (4)** provides that where the provider offers two or more stakeholder accounts they will be expected to allocate between these accounts in rotation.

Government contributions

Regulation 7 sets out the amounts of Government payments (endowments) that will be made to a child's CTF account.

Regulation 7 (2) specifies the amount of the initial Government endowment for children born between 1 September 2002 and 5 April 2005.

Regulations 7 (3) specifies the amount of the Government endowment for children in the care of a local authority ('looked after children'). The amount is the equivalent of both the initial endowment paid to all children and the higher rate paid to poorer children.

Regulation 7 (4) specifies the amount of the initial endowment for children born from 6 April 2005.

Regulation 7 (6) specifies the amount of the supplementary Government endowment for children born between 1 September 2002 and 5 April 2005.

Regulation 7 (7) specifies the amount of the supplementary endowment for children born from 6 April 2005.

Regulation 7 (8) defines what is meant by the term "commencement date" in this regulation.

Regulation 7 does not however include the further payment to be made when the child reaches the age of 7. As the first children to reach the age of 7 will not do so until September 2009, the amount of that payment will be decided nearer that time, when the appropriate regulations will also be made.

PART 2

Other requirements to be satisfied in relation to accounts

General requirements for accounts

Regulation 8 sets out the general requirements for a CTF account with **Regulation 8 (1)** specifying that the account must be in the child's name, that a child can have only one account, and that at any one time only a single responsible person (the "registered contact") can give instructions to the account provider. It also specifies that the account must be managed in accordance with the management agreement between the provider and the registered contact.

Regulation 8 (2) sets out that the terms of the account must include certain conditions including that the investments in the account are beneficially owned by the child but with the title to those investments vesting in the account provider or his nominee, or the registered contact depending on the nature of the investment. However where the investments include life insurance policies, **regulation 8(2)** provides that the title to the policies must be vested in the registered contact and the policy documents must also be held by the registered contact. This is to avoid the problem which would otherwise arise if the account provider is also the insurer, since an insurer cannot hold a contract with itself.

The terms also include arrangements for registered contracts to receive annual reports and other information, invitations to meetings and to vote in relation to companies in which account investments are made.

Regulation 8 (2) (h) and (i) provide for the free transfer of CTF accounts save for "incidental expenses" (which are defined by **Regulation 8 (4)).**

Regulation 8 (3) requires that the terms include the requirement that transfer of a CTF account is to take place within any reasonable business period not exceeding 30 days.

Annual Limit on Subscriptions

Regulation 9 deals with subscriptions - these are contributions into a child's account other than Government payments and will commonly be made by family members and friends and the child themselves (for example, from money from employment or a Saturday job). Subscriptions can only be made in cash but this includes cheques, credit cards, debit cards, standing order and direct debit.

Regulation 9 (1) allows anyone to make a subscription into a child's account so in addition to family and friends subscriptions can also be made by any institutions or organisation, for example, businesses, community groups, charities and local authorities.

In addition a subscriber does not have to be resident in the UK to subscribe to a child's CTF account. A common instance would be where a grandmother lives abroad whilst her grandson is resident in the UK. Under this regulation she will be able to subscribe to her grandson's CTF account just as a grandmother who lives in the UK would be able to do so.

Subscriptions will also be able to be made to a child's account even though they are no longer in the country (although Government payments will not be able to be made into an account during the period when the child is out of the country). There are quite a few children who are sent abroad for educational or other reasons, but whose parents continue to reside and work in the UK. Those parents will therefore be able to contribute to their children's account whilst that child is outside the country.

Regulation 9 (2) sets out the amount that can be subscribed each year to a child's CTF account - the annual limit is £1,200 in total between all contributors. So if a child's parents had already put £800 into their child's account in a particular year, the child's aunt or anyone else could subscribe no more than £400 in that year.

Each child has their own annual limit so if for example parents had two children, both of whom had a CTF account, up to £1,200 could be subscribed into each child's account in a year.

Regulation 9 (2) also reiterates the requirement in the primary legislation that for the purpose of subscriptions a year runs from the date the account was first opened until the day before the child's next birthday and then after that any succeeding period of 12 months. The date of the child's birthday has been chosen for the beginning and end of the subscription year. Using the tax year instead would disadvantage some children compared to others and apportionment – which could be messy – would be needed to level the playing field. Most subscriptions are expected to be made on the child's birthday which is a date familiar to relatives who may not be so at ease with the concept of a tax year. The child can also relate well to a birthday year as well.

Regulation 9 (3) provides that where the subscription limit in one year is not used up it will not be possible for that unused subscription to be carried forward to the next year.

Statements for an Account

Regulation 10 requires the account provider to issue a statement for the account.

Regulation 10 (1) (a) specifies that the statement must be issued at the child's birthday and **Regulation 10 (1) (b)** specifies that where an account is transferred, a statement must be issued as at the transfer date.

Regulation 10 (2) says that the statement should be sent to the child, within 60 days of the statement date.

Regulation 10 (3) lists the items of information that statements must contain. As well as personal details the statement includes items such as the description of the account, the total market value of the account at the previous statement date and as at the present statement date, the amount of any Government contributions, the total amount of deductions and the aggregate amount of the subscriptions.

General Investment Rules

Regulation 11 sets out the general investment rules for CTF investments. These require all sales and purchases of investments into and out of the CTF account to be made at a fair market price and also provides rules governing the way in which cash can be held.

Qualifying investments for an account

Regulation 12 lists the investments which will qualify for a CTF account. These essentially mirror the list of investments which qualify for ISAs. However transfers of shares from an employee shares scheme which can be made under the ISA rules will not be able to be made into Child Trust fund accounts. Valuation of quoted and unquoted shares would increase administration and add to costs. Unlisted shares cannot be valued immediately. If their value is higher than expected or if other contributions are made into the account whilst they are being valued, the annual limit could be breached and excess contributions would have to be returned possibly to more than one contributor. Investment in a block of single company shares also risks unbalancing the diversification of investment required for the stakeholder account.

Regulation 12 (2) lists qualifying investments. They include shares in listed companies, securities, collective investment schemes and insurance policies.

Regulation 12(3) allows providers to apply for shares that are not at the time of application listed on a recognised stock exchange, provided the shares are due to be listed within 30 days of the allocation or allotment of the shares.

Regulation 12(4) prevents providers from applying for shares under regulation 12(3) where the allocation or allotment is linked to other allocations or allotments – otherwise the tax relief available to investments in the CTF could be artificially and unfairly increased.

Regulation 12(5) is the equivalent for securities of the listing on a recognised exchange for shares.

Regulation 12(6) restricts investment in investment trusts to those which invest in shares and securities, by disallowing investment in those with eligible rental income.

Regulation 12(8) prevents providers from offering high returns on cash accounts which are linked to the holding of other investments - otherwise the tax relief available to investments in the CTF could be artificially and unfairly increased.

Regulations 12(9) & (10) set out the conditions for a life insurance policy to be held in a CTF. They are very similar to the conditions for a life policy to be held within an ISA. A requirement is that the insurance is on the life of the child. Another requirement is that the policy will automatically terminate if the event specified in **Regulation 12(11)** occurs. That is, if it comes to the notice of the provider that there has been a breach of the conditions for holding a life policy in a CTF which either cannot be remedied or is not remedied within a reasonable time. An example might be where an insurance policy is held in a CTF which was opened incorrectly for a child born before 1 September 2002.

Regulation 12(11) allows that where an insurance policy is found to have breached the CTF rules (and therefore not be eligible for the CTF) it is treated as if it were eligible provided that whatever caused the breach in the rules is put right within a reasonable time after the breach is found.

Regulation 12(12) applies where there has been such a breach. The policy is nevertheless treated as satisfying the CTF conditions up to the date the breach comes to the notice of the account provider (or the date the policy ended if that date is earlier) except for certain specified regulations. The intention of regulation 12(12) is to ensure that there are no practical difficulties which may otherwise arise because the CTF has become invalid before the account provider has become aware that there has been a breach of the rules. The exceptions to regulation 12(12) are to ensure that any gains on policies which have breached the CTF rules are properly reported and taxed.

Conditions for application by responsible person to open an account (and changes to an account)

Regulation 13 sets out the conditions for an application by a responsible person to open a CTF account.

Regulation 13 (2) provides that the application must specify the description of the account – whether stakeholder or non stakeholder.

Regulation 13 (3) specifies that the application must include a declaration by the responsible person that he or she is aged over 18, or in Scotland is over 16, that he or she is the responsible person for the child and that they will be what is termed the "registered contact" for the child.

The responsible person, under **Regulation 13(4)** must also authorise the account provider to hold all the investments on behalf of the child and also make any claims to tax for them.

Regulation 13(5) also lists the items of information that the application must contain and **Regulation 13 (7)** provides that apart from the circumstances listed in that sub Regulation, any change in the identity of the registered contact will require the confirmation of the current registered contact that his or her declaration is cancelled. This is to avoid placing CTF providers in the position where they might receive conflicting instructions from two people who are responsible persons for the child.

Although providers must not decline to accept a voucher when presented to them, **Regulation 13 (8)** allows them to do so where they have reason to believe the voucher has expired or might not be genuine or where the applicant has given untrue information in their application.

Regulation 13 (9) requires that if the application is not in writing (for example if it is made over the phone or the internet) then the provider shall make a written copy of the declaration and obtain the applicant's agreement that the copy is correct. The agreement can be obtained by, for example, reading back the declaration over the phone or sending it by post or internet. If the applicant does not reply within 30 days then they are treated as having agreed that the declaration is correct.

Regulation 13 (10) requires that on occasions other than the opening of the account, a new registered contact must provide full details and make the same declaration as required on opening the account.

Account provider – qualifications and Board's approval

Regulation 14 sets out the circumstances in which a person may be approved by the Inland Revenue as a CTF provider.

Regulation 14 (2) sets out the specific undertakings that a potential provider must make and contains important items such as the commitment to offer a stakeholder account and to accept all vouchers subject to 13(8). Providers must also demonstrate that they can satisfactorily operate the fortnightly claims and returns procedures set out in **Regulation 30.**

Regulation 14 (2) (b) (vi) provides that the child's unique reference number may only be used by the account provider for the purposes of the child's CTF account and for fulfilling the requirements of the CTF regulations.

Regulation 14 (2) (d) to (f) sets out who a CTF provider can be.

Account Provider – appointment of tax representative

Regulation 15 sets out the requirements referred to **in Regulation 14 (2) (f).** A provider who does not carry on business in the UK must appoint an individual who is resident in the UK, or a company that has a business establishment in the UK who will be responsible for ensuring that all duties required of the provider are carried out. Exceptionally the Revenue will enter into other arrangements to ensure that the duties are carried out.

Account provider – withdrawal by Board of approval

Regulation 16 sets out the circumstances in which the Inland Revenue may withdraw their approval of a provider as a CTF provider. **Regulation 16 (3)** specifies the contents of the notice that the Inland Revenue must give to a provider from whom they intend to withdraw approval.

Account provider – appeal against non-approval or withdrawal of Board's approval

Regulation 17 provides for a provider whose application to be a CTF provider has been turned down, or to whom notice of withdrawal has been given by the Inland Revenue, to appeal against that decision within 30 days.

Permitted Withdrawals from an account

A fundamental feature of a CTF account is that the funds in the account are locked into the account until the child reaches the age of 18 and there cannot be access to those funds by anyone before then. This is to ensure that the child has a stock of assets at 18. **Regulation 18** however allows access to the funds in the sad circumstances where the child has died before reaching the age of 18. This Regulation also permits providers to recoup their charges and other incidental charges from the funds in the child's account, as otherwise they could not be paid for the services they provide for the child's account.

Account provider ceasing to act (or ceasing to accept Revenue allocated accounts

Regulation 19 sets out the procedures where a CTF provider ceases to act as a CTF provider, or where the provider no longer wishes to accept or manage Revenue allocated accounts. In these circumstances the provider is required to give not less than 30 days notice of this intention to the Inland Revenue and the registered contact.

Account Provider ceasing to qualify

Regulation 20 sets out the procedures where a CTF provider ceases to qualify as a CTF provider. **Regulation 20 (1) and (2)** set out the circumstances where the provider ceases to qualify and provides that he shall give notice to the Inland Revenue and to the registered contact. This regulation (and Regulation 19 above) are similar to the corresponding ISA regulations and the Revenue's experience is that no ISA provider has gone into liquidation. However, as the CTF involves the interests of children, consideration is being given as to whether further procedures should be put in place to safeguard their interests.

Transfer of accounts to other account providers

Regulation 21 sets out the rules which will apply to transfers of CTF accounts. Transfers of a CTF account may be made to a different provider or to a different type of account, for example, from non-stakeholder account to a stakeholder account or vice versa.

There is no restriction on the number of transfers of a child's CTF account that can be made in the course of the life of the account, up to the child's 18^{th} birthday. Parents will want to monitor the investment strategy and performance of their child's account and to make changes where appropriate if they wish.

All transfers must be free except that providers will be permitted to charge the CTF account with the costs of any share dealings which are necessary as part of the process of transferring the account from the old provider to the new provider.

Regulation 21(1) and (2) set out the circumstances in which a transfer will be treated as a transfer of the CTF account.

Regulation 21 (3) provides that where a transfer takes place between providers the registered contact has to complete a new application and declaration for the new provider.

Regulation 21(4) provides that the old provider will give to the new provider the information specified in **Regulation 21(5)** and the declaration required by **Regulation 21 (6).** The information includes a description of the account and the total amount subscribed to the account during the period from the beginning of the subscription year in which the transfer takes place to the date of the transfer.

The declaration in **Regulation 21 (6)** states that the old provider has fulfilled all his obligations to the child, the Revenue or otherwise, that all the account investments have been transferred to the new provider and that he will forward on receipt of the payment any further payment received from the account investments. So for example if dividend received by the old provider after the CTF account was transferred to the new provider, the old provider must pass that dividend on to the new provider so that the new provider can place it in the child's account. This provision safeguards the child's interest by explicitly requiring the old provider to forward sums received. Failure to comply with Regulation 21(6) is a breach of the CTF rules and would attract the appropriate penalty.

Recoupment of Inland Revenue contributions to void accounts

In circumstances where a child was not eligible to have a CTF account, or where more than one account was opened for them, **Regulation 22** provides that the CTF account is void and that any Government payments to the account, together with any income and gains which have arisen on these payments and tax relief must be returned to the Inland Revenue. The balance of any amounts remaining in the account would be returned to the child.

Regulation 22 (2) lists the persons from whom recoupment may be made and states that they will be jointly and severally liable. **Regulation 21 (2)** states that any amount due will be treated as if it were tax charged in an assessment on that person.

'Repair' of invalid accounts

There are many circumstances where there could be a breach in the CTF rules – for example where there is an unsigned application form or the provider has invested the funds in ineligible investments. However the Government consider that it would not be appropriate where there could be such a breach that the child's account should be closed down, unless the child was not eligible for the account.

Regulation 23 requires the CTF provider and registered contact to fix the breach in the rules. If they do, the account is treated as if it had always been valid. In the examples above, the failure to sign the application form might be fixed by the registered contact signing the form, or completing a new application form. The breach due to the ineligible investments could be fixed by the provider selling the investments and buying eligible investments. The repaired account suffers no loss of tax relief or Government endowments.

Part 3

Tax and Administration of accounts

Exemption from tax of account income and gains

Regulation 24 makes various provisions in connection with the exemption from tax of income and gains arising on investments within a CTF account. This means that the child will not pay any tax on the income from the CTF savings and investments, including dividends, interest and bonuses.

The child will also not pay any capital gains tax on capital gains arising on disposals of CTF investments.

Regulation 24 (b) provides that as with ISAs, capital losses on disposals of CTF investments cannot be taken into account for capital gains tax purposes. This means that losses on CTF investments cannot be set off against capital gains made by the child on disposals of assets outside their CTF account.

Regulation 24 (c) provides that corresponding deficiency relief is not available to the child on a policy held within a CTF.

Regulation 24 (e) provides that the income tax settlements legislation will not apply to parental contributions made to their child's CTF account. The settlements legislation prevents parents getting a tax advantage by giving sums of money or other assets to their children. Where gifts from a parent give rise to gross income of more than £100 in a year, the settlements legislation provide that the parent is taxed on all that income at his or her own income tax rate. The £100 rule applies separately to each parent, and continues to apply until the young person reaches 18 or marries. However, exceptionally, parental contributions to a CTF account will not count towards this £100 limit. Even relatively modest contributions will build up over the long-term and would have triggered the settlements legislation in the later years of the account. This would have complicated the administration of the account and counteracted the incentive to save into the account and maximise the fund by the time the child is 18.

Tax liabilities and reliefs – account provider to act on behalf of the named child

Regulation 25 allows the account provider to act as the child's representative in relation of the tax reliefs and liabilities of a CTF account. This relates to making tax claims and appeals and sets out the treatment and adjustments to be made where excessive reliefs or exemptions have been given.

Repayments in respect of tax to account providers – interim tax claims

Regulation 26 sets out the conditions and timing in which an interim claim to the Inland Revenue for repayment of tax may be made by a provider.

Regulation 26(5) provides that this regulation and regulation 27 to which it refers will not apply to any repayment in respect of tax on insurance investments.

Repayments in respect of tax to account provider – annual tax returns and tax claims

Regulation 27 provides for CTF managers to make annual claims for repayment of tax and sets out the conditions and timing for these claims.

Account provider's tax returns and tax claims – supplementary provisions

Regulation 28 provides a number of supplementary provisions on returns, appeals and the like.

Assessments for withdrawing relief and recovering tax

Regulation 29 make provisions for the withdrawal of tax relief or any exemption from tax and recovery of tax overclaimed and details of the assessment that will be raised.

Fortnightly claim and financial returns

Regulation 30 sets out details of the fortnightly information returns which providers will have to provide to the Inland Revenue. In this return the provider notifies the Revenue of CTF accounts which have been opened, closed and transferred by that provider since the last fortnightly return. This is to enable the Revenue to identify where Revenue allocated accounts need to be set up (because the child's parents have not opened an account for a child within a year of receiving the voucher).

The return will also enable the Revenue to identify where duplicate accounts have been opened.

The frequency of the fortnightly return is to ensure that there is as little delay as possible in paying the Government endowments into an account so that the funds can begin earning as soon as possible. The return will also enable the Revenue to identify where duplicate accounts have been opened and to nip potential fraud in the bud. For all these reasons a nil return will be required and failure to provide the return will be regarded as a breach of the CTF rules.

In addition the fortnightly return will also act as a claim for payment to the provider by the Revenue of the Government endowments for an individual child's account. Once account details have been reconciled with Inland Revenue data the payments will be made.

The Revenue will also on a fortnightly basis send providers a schedule which will ask them to open Revenue allocated accounts for particular children. The schedule will in addition inform providers of payment of the initial and any supplementary or further Government payments to be claimed..

Records to be kept by the account provider

Regulation 31 obliges account providers to keep sufficient records on a child's CTF account to satisfy the requirements of the CTF regulations. In particular **Regulation 31(2)** specifies that applications to open CTF accounts, including where a responsible person assumes responsibility for a Revenue allocated account, must be retained, as must the voucher used to open accounts. These items have to be retained for a period of 3 years, even if in the meantime the account is transferred to another provider. Both the voucher and the application can be stored in electronic form, for example by storing an image of the documents.

Returns of information by account provider

As well as the fortnightly returns referred to in **Regulation 30** providers must send an annual return to the Inland Revenue. **Regulation 32(1**) requires the annual return to be made within 60 days of the end of each tax year, and also where a provider ceases to act or qualify as a CTF provider.

Regulation 32 (2) sets out the items of information which must appear in the return which include personal details of each individual child, whether an account is a stakeholder account, the amount of cash subscribed and the aggregate market value of the account investments. **Regulation 32 (3)** provides that the market value of an insurance policy should be taken to be its surrender value**.** Finally **Regulation 32(4)** provides that providers cannot make claims for repayments of tax if they have not sent the appropriate return to the Inland Revenue.

Information about "looked after children' from Local Authorities

Regulation 33 sets out when and what information is required by the Inland Revenue from local authorities (and their equivalents in Scotland and Northern Ireland) to ensure that looked after children do not miss out on a CTF account. Special arrangements are needed as some looked after children will never have had a child benefit claim made for them and so will not have a CTF account. Guidance for local authorities will be available at a later stage.

Regulation 33 (1) gives definitions of various terms used in this particular regulation.

Regulation 33 (2) sets out the details of when local authorities shall send information to the Inland Revenue about looked after children on launch date, who are born after 31 August 2002.

Regulation 33 (3) explains what information local authorities have to send to the Inland Revenue.

Regulation 33 (4) sets out that local authorities send the relevant information to the Inland Revenue on a monthly basis and for which children information should be supplied.

Regulation 33 (5) explains more about what should be included in the information returned to the Inland Revenue for each child.

Information to be provided to the Board

Regulation 34 requires any relevant person to provide information to the Inland Revenue following the issue of a notice and in the time specified in that notice (which must not be less than 14 days).

Inspection of records by officers of the Board

Similarly under **Regulation 35** the Inland Revenue may by notice of not less than 14 days require any relevant person to make records (including records kept on computer) available for inspection by the Revenue. This is the basis of audits by the Revenue.

Capital gains tax – adaptation of enactments

Regulation 36 makes changes to the normal capital gains tax (CGT) rules. These changes are designed to ensure that capital gains and losses arising on investments in a CTF account are kept out of the scope of the tax, and are effectively ring-fenced for CGT purposes from any investments the child holds outside the account.

Paragraph (a) of regulation 36(1) provides that account investments are regarded for CGT purposes as held separately from any other assets which a child holds. One effect of this will be that, where a child holds identical shares both outside and inside the CTF account, those holdings are kept apart and gains and losses on disposals out of each holding are worked out independently.

Paragraph (b) of **regulation 36(1)** deals with the situation where a child reaches the age of 18 and the CTF account comes to an end. The child is treated for CGT purposes as having disposed of all the CTF investments immediately before that time, and having immediately reacquired them outside the CTF at their market value. The first effect of this treatment is to ensure that all the gains and losses on those investments which are attributable to the period during which they have been held in the account are not subject to CGT. The second effect is to ensure that the amount of any capital gain or loss which arises when the investments are subsequently disposed of represents the increase (or decrease) in value after the account came to an end.

Regulation 36(2) deals with the case where shares or securities are held in a CTF account and the company in question makes a rights issue. The normal CGT rules treat shares, etc. which are acquired via a rights issue as though they were acquired as the original shares or securities were acquired, and as though they belong to the same holding as those shares or securities. This treatment is not feasible where some or all of the cash paid to take up the rights issue comes from outside the CTF account because some or all the shares etc. which are acquired will not be account investments. Regulation 36(2) has effect to provide that shares etc. acquired under a rights issue in *any* case where the rights that were exercised were rights carried by account investments are treated as a separate acquisition for CGT purposes. This does not, however, prevent such of those rights issue shares etc which are subscribed for using cash held on the account being account investments.

Administration of Tax in Relation to ISAs – Supplementary Provisions

Regulation 37 provides requirements in connection with various administrative matters.

This includes **Regulation 37(6)** which removes the obligation for insurers to report gains to the policyholder and the Revenue on policies held within a valid CTF, which would otherwise exist. This is because the gains are not taxable. However, the obligation to report gains is not removed when regulation 38 applies i.e. when gains arise on a policy where the CTF rules are breached.

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Regulation 37(7) applies where the account provider is different to the insurer and it has come to the account provider's notice that the event specified in regulation 12(11) has occurred, as described above. Then the account provider must inform the insurer within 30 days of this event coming to his notice that this is the case. This is so the insurer can terminate the policy as required by the terms of the policy.

Application of the provisions of Chapter 2 of Part 13 of the Taxes Act to policies

Regulation 38(1) applies regulation 38 to cases where there has been breach of the conditions for a life insurance policy to be validly held in a CTF and that breach either cannot be remedied, or is not remedied within a reasonable time. **Regulation 38** ensures that the policy comes within the tax and reporting rules, suitably modified, which apply to life insurance policies generally.

Regulations 38(2) removes the entitlement to tax relief under the CTF rules on chargeable event gains on the policy.

Regulations 38(3) and (4) provide a mechanism for taxing the gains on the policy when it is terminated, as required by the terms of the policy. Such a termination is treated as a surrender of the policy. **Regulation 38(3)** also ensures that any earlier gains on the policy are taxable.

Regulation 38(5) provides that gains from the policy are taxed under Case 6 of Schedule D and modifies the normal rules which govern taxation of life policies to ensure that those gains are not treated as having had tax paid at the lower rate. This is because the insurer does not pay tax on the income and gains from assets in its child trust fund business.

Regulation 38(6) provides that for the purposes of computing top-slicing relief only, gains from policies in CTFs are treated as having had tax paid at the lower rate. This is to ensure that top-slicing relief is computed correctly.

Regulations 38(7) and (8) modify the rules which set out the requirements for insurers to report gains on life insurance policies to the policyholder and the Inland Revenue so that those rules apply properly to gains on policies which breach the CTF rules.

Regulation 38(9) requires the account provider to pay tax at the lower rate to the Revenue on gains on policies which breach the CTF rules and this is payable without the Revenue needing to make an assessment.

However, **Regulation 38(10)(a)** gives the Revenue the power to make an assessment on the account provider or the registered contact (on behalf of the child) if necessary, to recover income tax on the gains at the lower rate. The Revenue also has the power under **regulation 38 (10)(b)** to assess the registered contact of the child for income tax at the higher rate on the gains.