

Shares paid for in instalments

- 7.60 Managers must meet any instalment due after the shares are in the PEP or ISA stocks and shares component from funds within the PEP or ISA stocks and shares component, or by cash subscription to the ISA stocks and shares component in which the shares are held. The instalment payments may not be funded from cash held in any other ISA or ISA component or PEP, or from cash outside the ISA or PEP.
- 7.61 Where an investor has subscribed the maximum for the tax year in which a subsequent call is due, ISA managers will have to sell sufficient investments within the stocks and shares component to pay the call.

Changes to investments held in the PEP or the ISA stocks and shares component

- 7.62 The most common examples of a change to an investment are
- takeovers
 - demergers
 - capital reorganisations (other than a rights issue or bonus issue)
 - rights issues, and
 - bonus issues.
- 7.63 Investors may take up any offer to shareholders in respect of investments held in the PEP or the ISA stocks and shares component. Whether the resulting shares can be held in the PEP or ISA will depend on whether they are qualifying investments (paragraph 7.2).
- 7.64 Where the new investments are qualifying investments, they can remain in the PEP or ISA stocks and shares component.
- 7.65 Where the new investments are not qualifying investments, managers must either
- sell them within 30 calendar days of the date they became non-qualifying investments in which case the proceeds can remain in the PEP or ISA stocks and shares component, or
 - transfer them to the investor to be held outside the PEP or ISA.
- 7.66 Complex reorganisations often involve more than just the issue of one set of new investments. There could, for example, be a bonus issue of shares, which are replaced in turn by other shares, which are then sold, or converted to other investments. If the intermediate investments are not eligible for a PEP or ISA then, strictly, the final investments, or cash proceeds, cannot be held in the PEP or ISA even if the final investments themselves are eligible.
- 7.67 However, where ineligible investments are issued as an intermediate stage, and those investments are short-lived, or are automatically replaced by cash, SPS will consider whether it is possible to look through the intermediate stages and apply the guidance at paragraph 7.2 to the initial and final investments alone. If a reorganisation involves intermediate ineligible investments managers should submit full details to SPS Services Team 2, and if possible well before the planned reorganisation date.

Rights issues and other offers to shareholders

7.68 ISA managers may use only

- cash within the stocks and shares component, or
- further cash subscribed within the subscription limits (paragraph 6.1)

to take up rights issues and other offers for qualifying investments. An investor may give an ISA manager sufficient cash to take up the offer outside the ISA, **provided** the ISA manager immediately transfers the investments to the investor to be held outside the ISA.

7.69 PEP managers may use only cash within the PEP to take up rights issues and other offers for qualifying investments. An investor may give a PEP manager sufficient cash to take up the offer outside the PEP, **provided** the PEP manager immediately transfers the investments to the investor to be held outside the PEP.

7.70 Managers may reinvest in the PEP or ISA stocks and shares component any proceeds received from lapsed rights. The proceeds do not count as a subscription.

Bonus issues

7.71 Managers may add to a PEP or the stocks and shares component of an ISA, bonus issues of shares or units received in respect of an investment held in the PEP or ISA stocks and shares component, provided they are qualifying investments. Such bonus issues do not count towards the ISA subscription limit.

7.72 Where they are non-qualifying investments, managers should follow the guidance at paragraph 7.65.

7.73 However, where the bonus issue is derived from, and the shares are of the same type as, those transferred from an approved all-employee savings-related share option or profit sharing scheme into a PEP, or from those schemes and/or an employee share option scheme to the stocks and shares component of an ISA, these may be added to the PEP or ISA even though they are non-qualifying.

Recognised Stock Exchanges

7.74 “Recognised stock exchange” means a stock exchange recognised by the Board of Inland Revenue under Section 841 of the Income and Corporation Taxes Act 1988. The following Stock Exchanges are designated as “recognised stock exchanges” by order of the Board of Inland Revenue.

- The London Stock Exchange
- The Athens Stock Exchange
- The Australian Stock Exchange and any of its stock exchange subsidiaries
- The Colombo Stock Exchange
- The Copenhagen Stock Exchange
- The Helsinki Stock Exchange
- The Johannesburg Stock Exchange
- The Korea Stock Exchange
- The Kuala Lumpur Stock Exchange
- The Mexico Stock Exchange
- The New Zealand Stock Exchange
- The Rio De Janeiro Stock Exchange
- The Sao Paulo Stock Exchange

- The Singapore Stock Exchange
- The Stockholm Stock Exchange
- The Stock Exchange of Thailand
- The Swiss Stock Exchange
- Any stock exchange in the following countries which is a stock exchange within the meaning of the law of the particular country relating to stock exchanges (or as specified below)
 - Austria
 - Belgium
 - Canada – any stock exchange prescribed for the purposes of the Canadian Income Tax Act
 - France
 - Germany
 - Hong Kong – any stock exchange which is recognised under Section 2A(1) of the Hong Kong Companies Ordinance
 - Ireland (Republic of)
 - Italy
 - Japan
 - Luxembourg
 - Netherlands
 - Norway
 - Portugal
 - Spain
 - USA – any exchange registered with the Securities and Exchange Commission of the United States as a national securities exchange
 - USA – the NASDAQ Stock Market as maintained through the facilities of the National Association of Securities Dealers, Inc and its subsidiaries

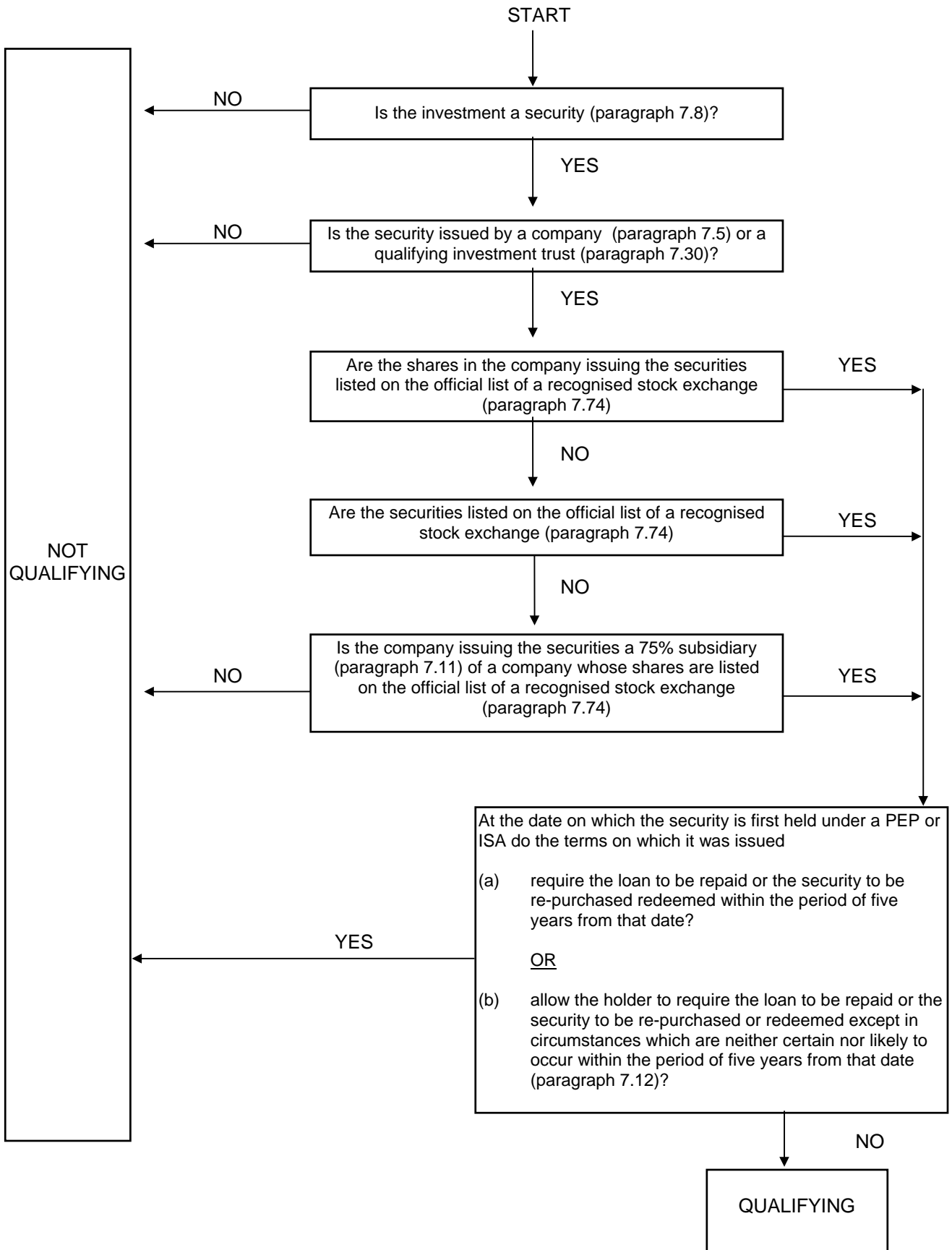
7.75 On []th November 2001 the Inland Revenue adopted a revised interpretation of the phrase 'listed on a recognised stock exchange'. Shares and securities admitted to trading on NASDAQ Europe (formerly EASDAQ), Nouveau Marché and Neue Markt Frankfurt which prior to that date were recognised as listed on a recognised stock exchange, do not count as such from []th November. Shares and securities admitted to trading on those markets (and not listed on one of the exchanges in paragraph 7.74) therefore cannot be held in a PEP or ISA.

However, shares and securities held at []th November in a PEP or ISA by virtue of their listing on NASDAQ Europe, Nouveau Marché and Neue Markt Frankfurt remain as qualifying investments for the PEP and ISA under a special rule.

If the investments change in any way, such as a change in the nature of the investments, or a change in the place of listing, managers should apply two tests

- if the change in the investments means that they no longer need the protection of the special rule, in other words if they would qualify for a ISA or PEP without the special rule, then from that point on the investments lose their protection under the special rule, and must satisfy the same rules as any other investment held in a ISA or PEP should they change again.
- if after the change the investments would not otherwise qualify for a ISA or PEP, and they still have the protection of the special rule, then they can remain in the ISA or PEP under the special rule provided they would have satisfied the ISA or PEP rules applying before []th November 2001.

QUALIFYING SECURITY CHECK



CHAPTER 2**THE PEP and ISA MANAGER**

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Who can manage PEPs & ISAs?

- 2.1 Only persons (including companies) approved by SPS can manage PEPs or ISAs. To obtain approval to manage a PEP a person must be eligible to manage a PEP and make an application to SPS. To obtain approval to manage an ISA a person must be eligible to manage at least one component of an ISA and make an application to SPS. (see paragraph 2.13)
- 2.2 Persons eligible to manage a PEP, or any or all components of an ISA are
- an authorised person within the meaning of section 31(1)(a) or (c) of, or Schedule 5 to, the Financial Services and Markets Act 2000 who has permission to carry on one or more of the activities specified in Articles 14, 21, 25, 37, 40, 45, 51 and 53 and, insofar as it applies to any of those activities, Article 64 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2000, or
 - a European institution which carries on one or more of those activities.
- 2.3 Managers must not be prevented from acting as such by
- any requirement imposed under section 43 of the Financial Services and Markets Act 2000, or
 - by any prohibition imposed by, or under any rules made by the Financial Services Authority under that Act.
- 2.4 Building societies, persons falling within section 840A(1)(b) ICTA 88 and relevant European institutions are eligible to manage cash component mini ISAs and TESSA only ISAs.
- 2.5 Persons are eligible to manage insurance component mini ISAs if they are
- an insurance company, within the meaning given by section 431(2) Income and Corporation Taxes Act 1988 (see paragraph 2.7)
 - an incorporated friendly society
 - a registered friendly society, or
 - an assurance undertaking within the meaning of Article 8 of the First Council Directive 79/267 as extended by the Agreement on the EEA signed at Oporto on 2 May 1992 (as adjusted by the protocol signed at Brussels on 17 March 1993), which does not fall within the definitions above.
- 2.6 A European institution is an EEA firm of the kind mentioned in paragraph 5(1), (b) or (c) of Schedule 3 to the Financial Services and Markets Act 2000 which is an authorised person for the purposes of that Act as a result of qualifying for authorisation under paragraph 12 of that Schedule.

- 2.7 An insurance company within the meaning given by section 431(2) Income and Corporation Taxes Act 1988 includes
- an insurance company which is authorised by the Treasury Insurance Directorate to carry on insurance business within the UK
 - an insurance company which is incorporated in or formed under the law of an EEA member State other than the UK whose head office is in the member State, which
 - is authorised in accordance with Article 6 of the First Long Term Insurance Directive, and
 - is carrying on an insurance business in the UK through a branch or agency in the UK
- 2.8 An incorporated friendly society is a society incorporated under the Friendly Societies Act 1992.
- 2.9 A registered friendly society is a society within the meaning of the Friendly Societies Act 1992 and includes a society treated as a registered friendly society by virtue of section 96(2) of that Act.

Tax representatives

- 2.10 A manager who is approved as
- a European institution or a relevant authorised person and who does not have a branch or business establishment in the UK
 - a European institution or a relevant authorised person and who does have a branch or business establishment in the UK, but does not intend to carry out all his functions as a manager at that branch or business establishment, or
 - an assurance undertaking falling in the fourth bullet point of paragraph 2.5
- must either
- appoint a tax representative
 - make arrangements with SPS for some other person to ensure that his duties as a manager are met, or
 - make other arrangements with SPS to ensure that his duties are met.
- 2.11 A tax representative must be
- an individual who is resident in the UK or a company that has a business establishment in the UK
 - entitled to act on behalf of the manager in relation to the duties prescribed under the regulations

- responsible for ensuring that the manager meets the duties prescribed under the regulations, and
- personally liable where the manager fails to meet the prescribed duties, as if the duties imposed on the manager were jointly and severally imposed on him and the manager.

2.12 The appointment of a tax representative is treated as terminated where SPS has reason to believe that the tax representative

- has failed to ensure that the manager met his prescribed duties, or
- does not have adequate resources to ensure that the duties are met.

SPS will notify the manager of the termination, specifying the date on which the termination is effective.

Applications for approval as a PEP or ISA manager

2.13 A person who wishes to be a PEP or an ISA manager must apply to APSS Audit Unit for approval. The forms at paragraphs 2.32 and 2.33 can be used. The forms also have the address to which the application should be submitted.

2.14 The applicant must provide

- his full registered name or legal title
- his full address, including postcode, to which all communications should be sent
- the nature of his business
- the capacity in which eligibility is claimed (see paragraphs 2.2 – 2.9)
- the tax district and reference number to which he submits tax returns or accounts
- the name and telephone number of one or more individuals appointed to act as liaison officers, to provide day-to-day contact with SPS
- details of the form in which returns of information will be submitted (see paragraph 14.6, and
- for an application to be an ISA manager, details of the ISA components to be offered.
- A copy of the letter from the Financial Services Authority granting authorisation (see paragraph 2.2)

2.15

- in the case of a company, a resolution has been passed or a petition has been presented to wind it up
- in the case of a European institution, a relevant authorised person or an assurance undertaking (see paragraph 2.5), action corresponding to that in the next bullet point has been taken by or in relation to the institution, person or undertaking under the law of an EEA State, or
- in the case of a building society, person falling within section 840A(1)(b) ICTA 88, or a relevant European institution
 - it ceases to be a building society or to be a person falling within section 840A(1)(b) ICTA 88, or to be a relevant European institution, as the case may be
 - its directors have made a proposal under Part 1 of the Insolvency Act 1986 for a composition in satisfaction of its debts or a scheme of arrangement of its affairs
 - an Administration Order is made in relation to it, or
 - a receiver or manager of its property has been appointed.

2.29 A manager who has ceased to qualify must inform SPS and each investor within 30 calendar days of the date he ceased to qualify. The notice to investors must inform them of their right to transfer their PEPs or ISAs to another manager (see paragraphs 11.1 and 11.23).

Returns required on cessation as a manager

2.30 A manager who has ceased to manage PEPs or ISAs must submit

- an annual return and claim form (see paragraph 13.25)
- a return of information (see paragraph 14.1)
- an annual return of statistical information (see paragraph 15.1), and
- for ISA managers, a quarterly return of statistical information (see paragraph 16.1)

to the date of cessation.

2.31 In the case of involuntary cessation or withdrawal of approval the person appointed to terminate the scheme should perform these duties.



APPLICATION FOR APPROVAL AS PEP MANAGER

Full registered name
or legal title

Full address to which
all communication should
be sent

Postcode

Tax District and reference number where
business tax returns and accounts are
submitted

I apply for approval to manage personal equity plans

And I certify that I am approved to manage these plans by virtue of my being (*tick as appropriate*)

- an authorised person within the meaning of section 31(1)(a) or (c) of, or Schedule 5 to, the Financial Services and Markets Act 2000 who has permission to carry on one or more of the activities specified in Articles 14, 21, 25, 37, 40, 45, 51 and 53 and, insofar as it applies to any of those activities, Article 64 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2000
- a European institution which may carry on home-regulated investment business in the United Kingdom in accordance with the Banking Co-ordination (Second Council Directive) Regulations 1992

I will submit annual returns of information by (*tick as appropriate*)

Magnetic media tape	<input type="checkbox"/>
Floppy disc	<input type="checkbox"/>
Paper	<input type="checkbox"/>

Name and telephone number of one or more individuals approved to act for PEP manager as liaison officer to provide day to day contact with SPS.

<i>Name</i>	
<i>Number</i>	
<i>Name</i>	
<i>Number</i>	
<i>Name</i>	
<i>Number</i>	

Please return this application form (and any supporting documentation - see paragraph 2.15 – 2.16 of Guidance Notes for PEP & ISA managers) to

Inland Revenue
APSS Audit Unit
St John's House
Merton Road
Bootle
Merseyside
L69 9BB

If you wish to receive information and notices by electronic mail, please notify us of your address below.

<i>e mail address</i>	
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APPLICATION FOR APPROVAL AS ISA MANAGER

Full registered name
or legal title

Full address to which
all communication should
be sent

Postcode

Tax District and reference number where
business tax returns and accounts are
submitted

I apply for approval to manage individual savings accounts offering (*tick as appropriate*)

Stocks and Shares Component

Cash Component

Insurance Component

And I certify that I am approved to manage these components by virtue of my being (*tick as appropriate*)

- an authorised person within the meaning of section 31(1)(a) or (c) of, or Schedule 5 to, the Financial Services and Markets Act 2000 who has permission to carry on one or more of the activities specified in Articles 14, 21, 25, 37, 40, 45, 51 and 53 and, insofar as it applies to any of those activities, Article 64 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2000

- a European institution which may carry on home-regulated investment business in the United Kingdom in accordance with the Banking Co-ordination (Second Council Directive) Regulations 1992

- a building society/ person falling within section 840A(1)(b) ICTA 88 /a relevant European institution*

(cash component only)

- an insurance company, within the meaning given by Section 431(2) of the Taxes Act/an incorporated friendly society/a registered friendly society*

(insurance component only)

- an assurance undertaking other than an insurance company within the meaning of Section 431(2) of the Taxes Act, an incorporated friendly society or registered friendly society

(insurance component only)

* delete as appropriate

CHAPTER 7**PEPs AND ISA STOCKS AND SHARES COMPONENT**

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Qualifying investments for the PEP and the stocks and shares component of an ISA

7.1 From 6th April 2001 the rules for eligible PEP and ISA investments were aligned. For the rules applying to PEP investments before that date please refer to Guidance Notes for Plan Managers.

7.2 The investments that managers may purchase, make or hold in a PEP or the stocks and shares component of an ISA ('qualifying investments') are

- qualifying shares (paragraph 7.4)
- qualifying securities (paragraph 7.8)
- government securities (paragraph 7.17)
- units or shares in qualifying authorised funds (paragraph 7.19)
- shares in qualifying investment trusts (paragraph 7.30)
- units or shares in a relevant UCITS (paragraph 7.35)
- shares transferred directly into the ISA stocks and shares component (paragraph 7.41)
- depositary interests (paragraph 7.42), and
- cash (paragraph 7.47).

All other kinds of investments are not qualifying investments and may not be held in a PEP or the stocks and shares component of an ISA.

7.3 Investments validly held in a PEP on 5th April 2001 that would not otherwise qualify under the rules applying from 6th April can continue to be held in the PEP from 6th April under a special rule. But if the investments change in any way, such as a change in the nature of the investments, or a change in the place of listing, PEP managers should apply two tests

- if the change in the investments means that they no longer need the protection of the special rule, in other words if they would qualify for a PEP without the special rule, then from that point on the investments lose their protection under the special rule, and must satisfy the same rules as any other investment held in a PEP should they change again.
- if after the change the investments would not otherwise qualify for a PEP, and they still have the protection of the special rule, then they can remain in the PEP under the special rule provided they would have satisfied the PEP rules applying before 6th April 2001.

Qualifying shares

7.4 Qualifying shares are shares, not being shares in an investment trust, issued by a company (paragraph 7.5) which is incorporated anywhere in the world, and which are officially listed on a recognised stock exchange (paragraph 7.74).

- 7.5 "Company" means any body corporate having a share capital other than
- an open-ended investment company within the meaning of section 236 of the Financial and Services and Markets Act 2000
 - a UCITS (paragraph 7.35)
 - an industrial and provident society registered under the Industrial and Provident Societies Act 1965, and
 - a body corporate which is a 51 per cent. subsidiary (paragraph 7.6) of an industrial and provident society.

- 7.6 "51 per cent. Subsidiary" has the meaning given by section 838 of the Income and Corporation Taxes Act 1988.

- 7.7 Qualifying shares do not include, for example,

- shares dealt in on the Alternative Investment Market (AIM)
- shares in unquoted companies
- shares traded on Ofex
- nil paid rights (purchased in the market by the manager)
- warrants to subscribe for shares (but see paragraph 7.33), or
- futures and/or options.

These investments are not qualifying investments and may not be held in a PEP or the ISA stocks and shares component (but see paragraphs 6.19 and 7.3)

Qualifying securities

- 7.8 Qualifying securities are securities (paragraph 7.13), which have been issued by a company (paragraph 7.5) which is incorporated anywhere in the world and which satisfy **at least one** of the three conditions in paragraph 7.10 **and** the condition in paragraph 7.12.

- 7.9 Securities in an investment trust (paragraph 7.30) are qualifying investments provided

- the security meets the condition at paragraph 7.12, and
- the investment trust meets the requirement for investments (paragraph 7.31).

- 7.10 The three conditions of which **at least one** must be satisfied are that

- the securities
- the shares in the company issuing the securities, or
- the company issuing the securities is a 75 per cent subsidiary (paragraph 7.11) of a company whose shares

are listed on the official list of a recognised stock exchange (paragraph 7.74)

- 7.11 “75 per cent subsidiary” has the meaning given by Section 838 of the Income and Corporation Taxes Act 1988.
- 7.12 The condition which must be satisfied is that at the date when each security is first held in the PEP or ISA, the terms on which it was issued do not
- require the loan to be repaid or the security to be re-purchased or redeemed, or
 - allow the holder to require the loan to be repaid or the security to be re-purchased or redeemed except in circumstances which are neither certain nor likely to occur
- within the period of five years from that date (paragraph 7.14).
- 7.13 “Security” means any loan stock or similar security of a company whether secured or unsecured. Qualifying securities may therefore include
- loans
 - loan stocks (whether secured or not)
 - debentures, and
 - Eurobonds.
- Managers may hold securities in registered or bearer form.
- 7.14 Securities must have a minimum residual term of five years when first held in a PEP or ISA. There is no objection to
- terms which allow **borrowers** (that is, the companies issuing the securities) to redeem the loan, whether to re-finance advantageously or in response to changes to withholding or other taxes, or the actual re-purchase of securities by borrowers or an associate in the market
 - terms which allow **borrowers**, or associates to repurchase the securities in the market
 - call options, typically exercisable, in the case of Euro-convertible bonds, at the five year point by **borrowers**, giving them the right to redeem subject to the holder’s prior right to convert into the underlying ordinary equity
 - other similar terms which allow **borrowers** to force conversion by serving a notice of intended redemption when a particular percentage of other holders have converted (to tidy up the issue) or the share price has reached a specified price for a specified interval (to cut the borrowing cost), or
 - terms which allow **holders** to redeem where the borrower defaults, or appears close to insolvency, breaches covenants or other terms written into the bond, changes the nature of its business or exceeds pre-set borrowing limits.
- 7.15 There is no requirement for investors to **hold** qualifying securities for five years.
- 7.16 Managers may find the flowchart at paragraph 7.76 useful in order to determine whether a security is a qualifying security. The flowchart relates solely to securities and not other investments which may or may not be qualifying investments.

Government securities

- 7.17 Government securities are qualifying investments provided they are
- gilt-edged securities (“gilts”)
 - gilt strips
 - securities issued by or on behalf of a government of any EEA State, and
 - strips of securities issued by or on behalf of a government of any EEA State

Which have at least 5 years to run to maturity when purchased by the manager (paragraph 7.14).

- 7.18 Managers must apply the 5 year test to each purchase, even where, for example, the gilt purchased is of the same type of gilts already held in a PEP or ISA stocks and shares component.

Qualifying authorised funds

- 7.19 An “authorised fund” is
- an authorised unit trust, or
 - an open-ended investment company (OEIC) incorporated in the UK where authorisation from the FSA under regulation 14 of the Open-Ended Investment Companies Regulations 2001 is in force.

An “authorised unit trust” is a unit trust scheme where an order under Section 243 of the Financial Services and Market Act 2000 is in force.

- 7.20 Units or shares in an authorised fund are qualifying investments provided
- the units or shares are in
 - a securities scheme (paragraph 7.21)
 - a warrant scheme (paragraph 7.22), or
 - a qualifying fund of funds scheme (paragraph 7.23), and
 - the authorised fund meets the requirement for investments (paragraphs 7.26 - 7.27)

- 7.21 A “securities scheme” is either –
- (i) an authorised fund which according to the terms of the scheme is a securities scheme belonging to the category under that name established by the Financial Services Authority, or
 - (ii) a sub-fund of an umbrella scheme which the terms of the scheme identify as a sub-fund that would belong to that category if the sub-fund were itself an authorised fund.

- 7.22 A "warrant scheme" is
- (i) an authorised fund which according to the terms of the scheme is a warrant scheme belonging to the category under that name established by the Financial Services Authority, and
 - (ii) a sub-fund of an umbrella scheme which the terms of the scheme identify as a sub-fund that would belong to that category if the sub-fund were itself an authorised fund.

7.23 A "fund of funds scheme" for the purposes of a PEP or an ISA stocks and shares component only, is

- (i) an authorised fund which according to the terms of the scheme is a fund of funds scheme belonging to the category under that name established by the Financial Services Authority, and
- (ii) a sub-fund of an umbrella scheme which the terms of the scheme identify as a sub-fund that would belong to that category if the sub-fund were itself an authorised fund,

where, in either case, the terms of the scheme do not permit any of the investments of the scheme, or subject to the trusts of the scheme, to consist of

- units in or shares of authorised funds which are not securities schemes or warrant schemes
- units in or shares of sub-funds of umbrella schemes which are not securities schemes or warrant schemes
- units or shares in collective investment schemes which are "recognised schemes" by virtue of section 270 or 272 of the Financial Services and Markets Act 2000 unless the schemes are equivalent to securities schemes or warrant schemes, or
- units or shares in sub-funds of umbrella schemes which are "recognised schemes" by virtue of section 270 or 272 of the Financial Services and Markets Act 2000 unless the schemes are equivalent to securities schemes or warrant schemes.

7.24 Units in a sub-fund of an umbrella scheme are qualifying investments provided the sub-fund falls within one of the categories at paragraph 7.20.

An "umbrella scheme" is an authorised fund which under the terms of the scheme belongs to the category under that name established by the FSA.

If the umbrella scheme is an authorised unit trust, references to part of the scheme shall be construed in accordance with section 468(8) ITCA 88, and reference to investments subject to the trusts of that part shall be construed in accordance with section 468(9) ITCA 88.

If the umbrella scheme is an open-ended investment company, references to part of the scheme shall be construed in accordance with section 468(18) ITCA 88 as that subsection is added in relation to open-ended investment companies by regulation 10(4) of the Open-ended Investment Companies (Tax) Regulations 1997, and reference to investments of the company shall be construed in accordance with section 468(12) ITCA 88 as so added.

7.25 Examples of investments in unit trusts which are **not** qualifying are

- units in unauthorised unit trusts
- units in authorised unit trusts, such as
 - money market schemes
 - futures and options schemes
 - geared futures and options schemes
 - property schemes, and
 - feeder funds, and
- units in funds of funds schemes which invest in any of the following
 - money market schemes
 - futures and options schemes
 - geared futures and options schemes
 - property schemes, and
 - feeder funds.

7.26 An authorised fund, other than a fund of funds scheme, meets the requirement for investments if the investments of the fund satisfy the 50% test (see paragraph 7.39)

7.27 An authorised fund which is a fund of funds scheme meets the requirement for investments if not more than 50% in value of investments of the scheme are units or shares in securities schemes or warrant schemes, or units or shares in a relevant UCITS (paragraph 7.35) where the fund, company or UCITS does not meet the requirement in paragraph 7.39.

Qualifying open-ended investment companies (OEICs)

7.28 An “open-ended investment company” has the meaning given by Section 468(10) of the Income and Corporation Taxes Act 1988 as that subsection is added in relation to open-ended investment companies by Regulation 10(4) of the Open-ended Investment Companies (Tax) Regulations 1997.

7.29

Qualifying investment trusts

- 7.30 An “investment trust” has the same meaning as in Section 842 of the Income and Corporation Taxes Act 1988. Shares in an investment trust are qualifying investments for the PEP or ISA stocks and shares component provided the investment trust meets the requirements for investments.
- 7.31 An investment trust must will meet the requirement for investments if
- it has no eligible rental income (defined at S508A Income and Corporation Taxes Act 1988), and
 - meets the 50% test (see paragraph 7.39)
- 7.32 Only shares and securities in an investment trust are qualifying investments unless, exceptionally, shares with warrants attached are purchased by the manager in the course of a public offer.
- 7.33 Where managers apply for shares in an investment trust using cash within a PEP or the stocks and shares component of an ISA, they may retain in the PEP or ISA any warrants attached to the shares acquired in the course of the public offer (paragraph 7.32). Any warrants received subsequently must either be sold or re-registered into the investor’s own name (paragraph 7.65).
- 7.34 New issues of warrants offered to existing shareholders only cannot be held in the PEP or the ISA stocks and shares component (paragraph 7.65).

Relevant UCITS

- 7.35 Units in or shares of a UCITS (paragraph 7.36) or a sub-fund of a UCITS are qualifying investments provided the UCITS or sub-fund of the UCITS
- is situated in a EU member State other than the UK (Appendix C)
 - has been authorised by the competent authorities of the state in which it is situated
 - is a “recognised scheme” within the meaning of Section 264 of the Financial Services and Markets Act 2000
 - meets the requirement for investments (paragraph 7.38), and
 - the terms of the UCITS or sub-fund of the UCITS identify that it would belong to one of the categories of securities scheme or warrant scheme if it were subject to an authorisation order made by the FSA.
- 7.36 A "UCITS" means an undertaking for collective investment in transferable securities within the meaning of Article 1 of Council Directive 85/611("the UCITS Directive"), and is an undertaking

- the sole object of which is the collective investment in transferable securities of capital raised from the public and which operate on the basis of risk-spreading, and
- the units or shares of which are, at the request of holders, re-purchased or redeemed directly or indirectly, out of those undertakings' assets.

References to -

- (i) "the member state in which a UCITS is situated", and
- (ii) a UCITS which has been "authorised by the competent authorities of the member state in which it is situated"

have the same meanings as in Articles 3 and 4 respectively of that Directive.

Article 3 states that a UCITS is deemed to be situated in the member state in which the investment company or, in the case of a unit trust, the management company, has its registered office.

Article 4 provides that a UCITS is authorised only if the competent authorities have approved the management company and the fund rules, or the instrument of incorporation and the choice of depository. Member states designate their own competent authority (in the case of the UK, that is the FSA).

- 7.37 A 'recognised scheme' is a scheme constituted and authorised in a member state, other than the UK, and which meets the conditions of the UCITS Directive. The scheme must also meet the requirements of local marketing laws. The Financial Services Authority 'recognises' such schemes and they are listed in the Financial press.

- 7.38 The investments held by a UCITS or sub-fund of a UCITS must satisfy the 50% test (paragraph 7.39). Where the investment for a PEP or stocks and shares component of an ISA is a sub-fund of a UCITS, managers must apply the 50% tests to each sub-fund.

The 50% test

- 7.39 The 50% test is satisfied if not more than 50% in value of the investments held are securities (paragraph 7.13) which when purchased

- require the loan to be repaid or the security to be re-purchased or redeemed, or
- allow the holder to require the loan to be repaid or the security to be re-purchased or redeemed except in circumstances which are neither certain nor likely to occur

within the period of five years from that date.

- 7.40 There is no requirement that any securities held be otherwise eligible for a PEP or ISA. For example, the 50% test would not prevent a fund from holding 100% stocks and shares listed on non-recognised stock exchanges, or long dated government securities issued by non-EEA states.

Shares transferred directly into the ISA stocks and shares component

- 7.41 Shares acquired by employees, which have emerged from an all-employee savings-related share option, profit-sharing scheme or employee share ownership plan may be transferred directly into the stocks and shares component of an ISA, and are qualifying investments for the stocks and shares component (paragraph 7.2). This applies even where the shares would not otherwise be qualifying investments (for example, because they are not listed on a recognised Stock Exchange).

Depositary interests

- 7.42 Depositary interests, (DIs) are investments where one person holds relevant investments, or rights to those investments, on behalf of the investor. The first person effectively acts as the investor's nominee. Relevant investments are qualifying investments other than cash or depositary interests.
- 7.43 One common form of DI is a CREST Depositary Interest or CDI, where an investor deposits his overseas shares with a nominee company in exchange for a CDI. This allows the shares to be dealt on the CREST system. Other forms of DI, such as American Depositary Receipts, will be eligible providing the regulations are met.
- 7.44 A practical test that managers can apply to DIs is to look through the DI to the investment that the DI represents. This might require looking through intermediaries. For example, if an investor held a DI in overseas shares which was then exchanged for a CDI, then the underlying investment is not the CDI, but the shares represented by the DI. If **all** the underlying investments (other than cash) would qualify for an ISA if held directly by the investor, then the DI will qualify. In some cases the investor cannot hold shares directly, such as when the shares are issued in the form of a Global Note. The test should then be applied as if the investor were capable of holding the shares.

Purchasing investments

- 10.8 The open market price of investments, other than units or shares in qualifying authorised funds, is the price for which those investments might reasonably be expected to be purchased in the open market.
- 10.9 Where an authorised fund is a dual priced unit trust, the open market price for purchases of units is the manager's price for the sale of the relevant class of units within the meaning of, and complying with the requirements of, rule 15.4.4 of the Collective Investment Schemes Sourcebook.
- 10.10 Where an authorised fund is a single priced unit trust or an open-ended investment company, the open market price is the price of a unit or share within the meaning of, and complying with the requirements of, rule 4.3.11 of the Collective Investment Schemes Sourcebook.
- 10.11 Managers may purchase units and shares in tranches to meet the aggregate requirements of investors. Where the rules of the FSA require him to attribute a uniform price by calculating a weighted average of the prices paid for all transactions in the same allocation period, then that uniform price may be treated as the open market price.
- 10.12 In any other case, where managers make a series of purchases, each PEP or ISA involved must reflect its share of each purchase price. An "average" price may not be used.

Selling investments

- 10.13 Managers must sell PEP or ISA investments at the price they might reasonably be expected to be sold in the open-market.
- 10.14 Policies of life insurance in the insurance component of an ISA cannot be sold.

Withdrawals from a PEP or ISA

- 10.15 Investors must have the right to withdraw all or part of their investments by request to the manager, subject to the terms and conditions of the PEP or ISA. The request need not be in writing.
- 10.16 Withdrawals do not affect ISA subscription limits. An investor who has subscribed the maximum permitted may make no further subscriptions, regardless of withdrawals.
- 10.17 Except where more than £180 interest is withdrawn from a PEP in a tax year, or where a flat rate charge is due on interest in ISA stocks and shares and insurance components, (paragraph 10.29), investments, and the income and proceeds from investments held in a PEP or ISA may be paid to the investor without any deduction for tax. The withdrawal does not give rise to a tax liability for the investor.
- 10.18 The treatment of interest withdrawn where
- an investor dies is explained in paragraph 12.7
 - an ISA or PEP is made void is explained in paragraph 12.23, and
 - a policy of life insurance has been paid late is explained in paragraph 12.17.

Withdrawal of investments from a PEP or ISA stocks and shares component

- 10.19 On the transfer to an investor of an investment, the manager must provide the investor with details in writing of the market value (paragraphs 10.20 to 10.22) of the investment as at the date of withdrawal.
- 10.20 For shares or qualifying securities listed in The Stock Exchange Daily Official List, managers should take the value computed by reference to Section 272 Taxation of Chargeable Gains Act 1992. That is, normally, either
- (a) the lower of the two prices shown in the quotations for the shares in The Stock Exchange Daily Official List on the relevant date plus one-quarter of the difference between those two figures (commonly referred to as the “quarter up rule”), **or**
 - (b) halfway between the highest and the lowest prices (commonly referred to as the “middle market” quotation) at which bargains, other than bargains done at special prices, were recorded in the shares for the relevant date.

Managers should take the amount at (a) if

- it is smaller than the amount at (b), or
- there were no such bargains as at (b).

Otherwise they should take the amount at (b).

If the London trading floor was closed on the relevant date, managers should determine the market value by reference to the previous date or earliest subsequent date on which it is open, whichever affords the lower market value.

- 10.21 The market value of units is the price at which unit trust managers are prepared to buy units from unit holders, known as the “bid” price. Unit trust managers publish this price on a daily basis. Where the bid price was not published at the date for which the valuation is required, managers should use the bid price on the latest day before. Managers should note that the market value is not reduced by exit, redemption or withdrawal fees.
- 10.22 The market value of shares in open-ended investment companies is the price at which the company is prepared to buy shares from shareholders. Open-ended investment companies publish this price on a daily basis. Where the price was not published at the date for which the valuation is required, managers should use the price on the latest day before.

Withdrawal of investments from an ISA insurance component

- 10.23 Life insurance policies cannot be withdrawn from the ISA component by the investor. The proceeds from termination of the policy, or partial surrender of the rights in the policy may be withdrawn.

CHAPTER 8

ISA CASH COMPONENT

Qualifying investments for the ISA cash component	8.1 to 8.5
Connected accounts	8.6 to 8.9

Qualifying investments for the ISA cash component

8.1 Qualifying investments for the ISA cash component are

- cash deposited in
 - a deposit account or share account with a building society
 - a deposit account with a person falling within section 840A(1)(b) ICTA 88, or
 - a deposit account with a relevant European institutionwhich is designated as an ISA account
- units or shares in a money market scheme (paragraph 8.4)
- units in a qualifying fund of funds scheme, for a cash component (paragraph 8.5), and
- securities, other than National Savings certificates, premium savings bonds, National Savings stamps and National gift tokens, issued under the National Loans Act 1968 or the National Savings Bank Act 1971, on terms which provide for them to be held in the cash component of an ISA.

8.2 In practice managers can operate a single account for PEP and ISA cash provided

- the account is designated as a PEP and/or ISA account
- the monies relating to the PEP and/or each ISA component and underlying investor are recorded and can be accounted for separately.

That account can also hold other savings products, such as feeder funds and current account balances.

8.3 The Tax Deduction Scheme for Interest does not apply to income arising on investments held in the cash component.

8.4 A “money market scheme” is

- (i) an authorised fund which according to the terms of the scheme is a money market scheme belonging to the category under that name established by the Financial Services Authority, and
- (ii) a sub-fund of an umbrella scheme which the terms of the scheme identify as a sub-fund that would belong to that category if the sub-fund were itself an authorised fund.

- 8.5 A “fund of funds scheme” for the purposes of the cash component only, is
- (i) an authorised fund which according to the terms of the scheme is a fund of funds scheme belonging to the category under that name established by the Financial Services Authority, and
 - (ii) a sub-fund of an umbrella scheme which the terms of the scheme identify as a sub-fund that would belong to that category if the sub-fund were itself an authorised fund,
- where, in either case, the terms of the scheme permit the investments of the scheme, or subject to the trusts of the scheme to consist only of units in, or shares of, money market schemes.

Connected Accounts

- 8.6 Where at any time, an ISA cash component is connected with another savings account it will cease to be a qualifying investment and where appropriate, income tax at the lower rate should be deducted from any interest paid or credited to the account from that date.
- 8.7 An ISA cash component is connected with another account if either was opened with reference to the other, or with a view to
- enabling the other to be opened on particular terms, or
 - facilitating the opening of the other on particular terms
- and the terms on which the ISA cash component was opened would have been significantly less favourable to the investor if the other had not been opened.
- 8.8 The Inland Revenue will accept that an account is not a connected account if it is a “feeder” account opened to enable investors to fund future deposits into an ISA, provided that the interest on the feeder account is in line with the interest paid on the ISA manager's other savings accounts. Such feeder accounts should not be included on ISA managers returns of information.
- 8.9 The Inland Revenue will not use the ‘connected accounts’ rule in cases where the terms of the connected accounts are the same. For example where an ISA manager offers an instant access ISA cash component paying interest at $x\%$ on condition that the investor invests £10,000 in an instant access deposit account paying interest at $x\%$ the ‘connected accounts’ rule would not be applied. But where an ISA manager offers a cash component paying interest at $(x + 5)\%$ on condition that the investor invests £10,000 in a deposit account paying interest at $(x - 5)\%$ the ‘connected accounts’ rule would be applied

CHAPTER 9**ISA INSURANCE COMPONENT**

Qualifying investments for the ISA insurance component	9.1
Policies of life insurance	9.2 to 9.13
Connected policies	9.14 to 9.17
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Qualifying investments for the ISA insurance component

9.1 The investments that ISA managers may purchase, make or hold in the insurance component are

- certain policies of life insurance (paragraph 9.2), and
- cash (paragraph 9.21).

Policies of life insurance

9.2 A policy of life insurance (as determined under general law) is eligible to be included in the insurance component if it is a policy

- on the life of the ISA investor (paragraph 9.4)
- the terms and conditions of which must include that
 - the policy may be owned or held only as a qualifying investment for an insurance component of an ISA
 - the policy shall terminate automatically if it ceases to be owned or held in the insurance component of an ISA (paragraph 9.5)
 - the policy, or the rights conferred by the policy or any share or interest in the policy or rights respectively, other than the cash proceeds from termination or part surrender of the rights conferred, cannot be transferred to the investor, and
 - the policy, the rights conferred by the policy and any share or interest in the policy or rights respectively, are not capable of assignment or assignation (other than that the policy may be transferred within the insurance component of one ISA manager to another) *, and the rights may vest in the personal representatives of a deceased investor (paragraph 3.22)
- which evidences or secures a contract of insurance which either falls within paragraph I or III of Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, or would fall within either of those paragraphs if the insurer was a company with permission under Part 4 of the Financial Services and Markets Act 2000 to effect or carry out contracts of insurance (for example, if the body is an EU insurer providing insurance on a services basis and subject to home state authorisation in accordance with Article 6 of the First Council Directive 79/267/EEC) (paragraph 9.8)
- the policy is not
 - a contract to pay an annuity on human life
 - a personal portfolio bond within the meaning of regulation 2(1) of the Personal Portfolio Bonds (Tax) Regulations 1999, or
 - a contract, the effecting and carrying out of which constitutes "pension business" within the meaning of Section 431B(1) of the Taxes Act, and

- after the first payment in respect of a premium in relation to the policy has been made, there is no contractual obligation on any person to make any other such payment (paragraph 9.10).

* Where the new ISA manager is an insurer manager, title to the policy and any policy documents should be transferred to the investor as part of the transfer arrangements.

9.3 Where an ISA policy fails any of the conditions at paragraph 9.2, the policy must be removed from the ISA (paragraph 9.27).

9.4 A policy of life insurance for the insurance component must be on the life of the ISA investor alone. Joint life, multiple life and life of another policies are not permissible as a qualifying investment for the insurance component.

9.5 Where

- the conditions relating to policy loans (paragraph 9.18) or connected policies (paragraph 9.14) have been fouled, or
- any of the qualifying conditions including those applicable to the investor or the ISA manager are not satisfied, for example where an investor was not eligible to subscribe to the ISA (paragraph 3.4)

the policy is a "void policy" and should automatically terminate (paragraph 9.30).

9.6 ISA managers may set a minimum limit for subscriptions, which if not reached would allow the insurer to terminate the policy (for example, a minimum limit of £500 premiums to be paid within 3 years).

9.7 ISA policies may give higher returns where

- a certain limit has been reached, or
- further or regular subscriptions (premiums) are paid.

9.8 An ISA policy may satisfy the requirement that it falls within paragraph I or III of Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (paragraph 9.2) if it includes subsidiary benefits such as a sickness, critical illness, accident or waiver of premium benefit. Payment of subsidiary benefits would not require a policy to terminate.

9.9 Subject to the connected policy rules (paragraph 9.14), an ISA policy may incorporate an option to take out another policy, whether an ISA policy or a non-ISA policy, without the need for further medical evidence.

9.10 Where ISA subscriptions are applied as premiums under an ISA policy, and the subscriptions are payable in instalments, there must be no obligation to pay any instalment (or any premium) other than the first one. But this does not prevent subscriptions being made by direct debit or standing order arrangements. Regular premium policies including 'qualifying policies' (Schedule 15 ICTA 1988 defines a 'qualifying policy') are not permissible investments.

- 9.11 The insurance component of an ISA may comprise a number of policies of life insurance. A cluster of policies may be issued in respect of a single subscription. Separate policies may be issued each year. This may have advantages if any invalid subscriptions are made and policies have to be terminated or if an investor wants to transfer part of a component to a new ISA manager. The policies should be genuinely independent and free-standing. Guidance on cluster and connected policies has been given on a number of occasions to insurers and the insurance industry. That guidance applies to ISA policies. If further guidance as to what constitutes a separate free-standing policy is needed write to

Business Tax (Insurance Group)
Room 5W5 5th Floor
22 Kingsway
London WC2B 6NR or telephone 020 7438 6460.

- 9.12 The rights conferred by an ISA policy must be in the beneficial ownership of the investor. They cannot be put into trust.
- 9.13 Where a policy is surrendered or has paid benefits on maturity, ISA managers may use the proceeds to take out one or more new policies. Proceeds used in this way will not count towards the subscription limit.

Connected policies

- 9.14 An ISA policy must not be connected with any other policy or contract of insurance. An ISA policy is connected with another policy or contract of insurance if either was made with reference to the other, or with a view to

- enabling the other to be made on particular terms, or
- facilitating the making of the other on particular terms, and

the terms on which the ISA policy was issued would have been significantly less favourable to the investor if the other insurance had not been issued.

- 9.15 The Inland Revenue will accept that an ISA policy is not connected with another policy if
- a "feeder" insurance is used to enable investors to fund future ISA policy premiums and the initial charges that would otherwise apply to the ISA policy are waived, or
 - an existing insurance is surrendered and an ISA policy is substituted and the initial charges that would otherwise apply to the ISA policy are waived.
- 9.16 There is no requirement to apply discontinuation penalties or a Market Value Adjustment.