

REGULATORY IMPACT ASSESSMENT (RIA)

ISAS: SIMPLIFIED VOIDING FOR INVESTOR ERROR

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:



Ruth Kelly

Financial Secretary

16.12.02

Date

Introduction

1. The Individual Savings Account (ISA) is a type of savings account designed by the Government to encourage people to raise the level of their personal savings particularly amongst those who have little or nothing saved, and to widen access to tax free savings. ISA savers pay no tax on any of the income or gains arising from their ISA savings and investment.
2. ISAs include three components, for cash savings, stocks and shares and life insurance. Savers may opt each year to subscribe to either a Maxi ISA with a single manager for all ISA savings, or separate Mini ISAs which allow different managers to be used for each component. In addition, savers may subscribe to a TESSA only ISA if they have a maturing TESSA. Alternatively the capital from a maturing TESSA may be added to an existing cash ISA.
3. If the saver gets the ISA rules wrong, for example subscribing to a mini and a maxi ISA in the same tax year, the second ISA to be subscribed to is invalid. The error is identified by the Revenue's data matching exercise based on annual information returns from ISA managers. Where an ISA account turns out to be invalid, and following notification from the Inland

Revenue the ISA manager closes down the account (known as “voiding” the account) and returns the investments to the saver. The manager and investor must also repay to the Revenue any tax relief given in error.

Purpose and intended effect

4. The Government plans to allow ISA savers who have made certain straightforward common errors in subscribing to or transferring their ISAs, to retain their ISAs with tax relief, following a process of repair called “simplified voiding for investors”. Simplified voiding will apply to ISAs subscribed to after 6 April 2001.

5. The changes will have the effect of allowing savers to continue their repaired ISAs with the benefit of tax relief for the future from the date of repair. At the same time the ISAs concerned will lose tax relief up to the date of repair and repair may involve removal of some of the ISA subscription or investments representing the subscription. In this way savers with repaired ISAs will not gain any advantage over savers who followed the rules correctly.

Risks

6. The Inland Revenue does not foresee any significant risks associated with these changes.

Details of the Changes

7. The changes, which the Revenue consulted on, will enable ISAs to be repaired in the following three situations :

Change 1

If a saver opens an ISA and in the same tax year transfers it to another manager by closing down the first account and taking the proceeds to the second manager (self-transfer) the second ISA is technically invalid because ISA transfers should be carried out by the ISA manager. The change will allow the second ISA to be repaired. And, for ISAs subscribed to from 6 April 2003, the transfer will not invalidate the second ISA at all.

Change 2

Where a saver subscribes the capital sum from a matured TESSA to an invalid ISA, that ISA will be able to be repaired so that the TESSA capital can remain in it.

Change 3

Where a saver subscribes to an incompatible combination of mini and maxi ISAs, the first invalid ISA can be repaired to the extent that neither subscription limit for any component in a maxi ISA, nor the overall subscription limit are exceeded.

8. Eligibility for repair will be assessed in each case by the Inland Revenue and repair will take place only on the basis of instructions by the Inland Revenue to the ISA manager. The repair will take place from the “date of discovery” – which is when the Revenue give notice to the ISA manager that the ISA is invalid. The effect will be that ISA savers lose all tax relief on the investments held in the invalid ISA. But from that date the ISA manager will be able to repair the ISA so that all or part of their subscription can remain within the ISA, which will not have to be closed down. Savers will then be able to continue their repaired ISAs, with the benefit of tax relief, from the date of discovery.

Benefits

9. ISA savers who have made errors covered by these proposals will be able to retain their ISAs with tax relief, up to the permitted limits, rather than losing tax relief altogether as now.

10. ISA managers should benefit from retaining a higher volume of ISA business and improved customer satisfaction levels.

11. Detailed breakdowns of numbers of ISAs voided in earlier years as a result of errors covered by these proposals, and of the amount of tax relief lost as a result of those errors, are not available from the Inland Revenue’s compliance programme. However the Revenue estimates that up to half the number of savers whose ISAs have previously been voided each year could benefit.

Policy Costs

12. These are negligible being the tax relief for future years from allowing these ISAs to continue.

Implementation costs

13. The proposals would mean that most of the work of identifying saver error eligible for repair and the action to be taken will fall to the Inland Revenue who will provide comprehensive instructions to the manager.

14. However the Revenue's compliance process will need to ask managers for closure dates for some mini ISA accounts where subscriptions were made prior to 6 April 2003 (i.e. for ISAs reported in the 2001/2002 and 2002/2003 returns) and it appears a self-transfer may have taken place. After that date managers will have to report the date of closure of accounts in the annual information return.

15. Consultation indicates that these proposals seem unlikely to affect to any great extent managers' compliance costs for the third and fourth year of the Revenue's investor compliance programme. Most managers already record this information in their systems.

16. A change will be needed in the annual information returns submitted for the year ended 6 April 2004 to include the closure date for mini ISAs closed in the tax year. Consultation indicates that this should allow sufficient time for the change.

17. For the fifth year programme managers' compliance costs seem likely to decrease (although it is not possible at this stage to estimate the level of reduction). This is because dates of closure will be provided on information returns for the fifth year, and the Inland Revenue will be able to identify self transfer ISAs without contacting managers.

18. As part of the repair process managers will have to repay to the Inland Revenue any tax relief given to date and some of the ISA subscription or investments representing that subscription may have to be removed from the ISA. Compliance costs for most managers should be similar to the current levels - even if there was no repair programme managers would have to go through a similar process in order to void the invalid ISA. However managers' systems do differ and some managers may be faced with more significant costs, including systems costs. Managers will also have to incur some extra training costs for staff on the repair programme

19. Only a small number of those consulted on the changes responded on the question of costs, and those who did were not necessarily able to quantify the costs in detail. The indications however are that overall the additional costs from the changes are likely to be negligible.

Securing Compliance

20. Repair of invalid ISAs under the proposed changes will be undertaken by ISA managers acting in each case on detailed instructions from the Inland Revenue. In addition detailed guidance on the simplified voiding for investors process is being issued to all ISA managers.

21. ISA managers are already subject to periodic audit and financial settlement in case of non-compliance. No additional measures are proposed in respect of these changes.

Impact on Small Business

22. The costs and systems impact on small businesses is likely to be minimal as small ISA managers tend to use third party administration systems. As with larger firms small businesses will benefit from retaining ISA business.

Consultation

23. The Inland Revenue issued a consultation document on 11 September 2002 to specific interested organisations including representative bodies from the savings industry and consumer organisations. The consultation closed on 7 November 2002.

Monitoring and Evaluation

24. The impact of this measure will be monitored and reviewed in autumn 2004 following the conclusion of the ISA compliance programmes for ISAs subscribed to in 2002-2003 and 2003-2004.

Competition Assessment

25. Around 400 institutions are currently authorised by the Inland Revenue to act as ISA managers. These include banks, building societies, investment fund managers, stockbrokers and insurance companies and vary in size. Some managers design their own ISA administration systems while others buy-in third party systems. The cost of systems changes is likely to impact more on some managers than on others but is unlikely to be significant compared with the overall cost of systems implementation and maintenance. On this basis we do not consider that a detailed competition assessment is needed.

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