THE CHILD TRUST FUND REGULATIONS 2004

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. This was followed by the consideration of the Child Trust Funds Bill by Parliament during the period from November 2003 to May 2004. The Child Trust Funds Bill received Royal Assent on 13 May and became the Child Trust Funds Act 2004.

The Child Trust Funds Act 2004 gives power for regulations to be made in connection with various aspects of the CTF. Following a Written Statement by the Financial Secretary to the Treasury to Parliament on 2 February draft regulations were published for the information of Parliament and others, particularly potential providers of CTF accounts.

The final version of those regulations were laid on 27 May. The regulations will, subject to Parliamentary procedures, come into force on 1 January 2005 for some introductory provisions but mainly on the day the Child Trust Funds Act 2004 is brought into force (expected to be 6 April 2005).

The attached Commentary provides an overview of these regulations and indicates where changes have been made since the draft regulations were published for information in February.

Draft guidance notes for potential providers of CTF accounts will be available on the Inland Revenue website shortly after 1 June 2004 at www.inlandrevenue.gov.uk/ctf/index.htm . The guidance notes provide details

of how the regulations will apply to CTF providers. The guidance notes will be expanded and amended as further regulations are laid, and in response to comments made by potential providers.

There are some areas not covered by the CTF regulations at this stage:-

- The Government has decided to make early access to CTF accounts available to children under 18 years of age who meet the criteria for entitlement to Disability Living Allowance under the special rules arrangements for terminally ill people. Inland Revenue and DWP officials are taking forward work on the operational details and regulations will be laid once that work is completed

- Regulations will also be made providing for the Official Solicitor in England, Wales and Northern Ireland and the Accountant of Court in Scotland to instruct on the management of CTF accounts for looked after children for whom there is no-one with parental responsibility.

- The Child Trust Funds Act also 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.

- Regulations relating to the corporation tax treatment of CTF insurance business will be also be issued later.

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. The launch of the CTF scheme is expected to be on 6 April 2005; there will therefore be a large number of children born after 1 September 2002 and before the launch date who will be entitled to CTF accounts at the launch, and we will want them to receive their Government contribution 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. To further manage the peak of work the vouchers for this group will be issued in stages over the three months from 1 January.

The Government contributions 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. Providers will be able to test that their systems can communicate with the Inland Revenue systems from October so that they can solve any initial problems before the launch date.

Interpretation

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

Vouchers

Regulation 3 relates to the voucher issued to the person who is entitled to child benefit for the child. This voucher will be sent to that person by post shortly after they have been sent an information pack. The voucher is used by a 'responsible person', or the child themselves if aged 16 or more, to open a CTF account for the child. Section 3 (8) of the Child Trust Funds Act 2004 defines a 'responsible person' as a person with parental responsibility by reference to the Children Act 1989 and its Northern Irish and Scottish equivalents.

Regulation 3 (1) sets out the particulars which will appear on the voucher and these 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) (vii)** prohibits the use of this number for any other purpose but the child's account.

The voucher will also contain a space on the back for the contact details of the responsible person. This is in response to a request by some potential providers of the CTF who have pointed out that there will be cases where the voucher is posted to a provider with no other information. Providing a space for the responsible person to insert their details will make the process more convenient. This provision for contact details does not need to be specified in the regulations.

The voucher will also contain an expiry date after which the voucher will no longer be valid. **Regulation 3 (3)** provides that that expiry date will normally be 12 months from the date of issue of the voucher. If that voucher is not used within the 12 month period the Inland Revenue will open a Revenue allocated account for the child – see Regulation 6 below.

For children in the transitional group (those born on or after 1 September 2002 and before the launch date in April 2005) vouchers will be issued earlier – from January 2005 onwards. So, for example, if their voucher is issued in February 2005 it will expire in February 2006. In the original regulations the life of the voucher for the transitional group was going to be 12 months from the date of the launch in April 2005. This, however, would lead to all vouchers expiring on the same day. The change will spread the administrative burden on providers and the Revenue, when unpresented vouchers expire and Revenue allocated accounts are set up, over a period of 3 months

The CTF provider can accept applications to open an account by post, or by telephone or internet. But before the account can be opened the voucher must be given or sent to the CTF provider.

Some providers have asked for the paper voucher to be dispensed with on the grounds that many parents will prefer to apply for their child's CTF account electronically by phone or on the internet. These providers are concerned that some parents will also forget to send in the voucher, resulting in further administration.

The main reason for requiring the voucher to be handed over is the efficient transfer of data encoded in the microline on the voucher to the Inland Revenue. Using the microline will reduce the kind of keying-in mistakes that could lead to delays in payments to children's CTF accounts being made or even

payments being made to the wrong accounts. It costs money for both the Revenue and providers to correct data matching failures so it will save money to prevent this happening in the first place. Vouchers can do this in a way that internet or phone applications cannot. Providers will not have the burden of checking the details they have been provided with – they simply relay the data on the voucher.

The voucher will also have a role in reducing fraud. It is important that Government contributions should be paid into CTF accounts as quickly as possible for children and should not fall into the hands of those not entitled to them. Whilst sophisticated fraudsters can produce a copy of any document, the voucher will be designed in a way to make copying difficult for the less sophisticated so CTF providers will have a degree of confidence that the voucher accompanying the application to open the CTF is genuine.

The Government however acknowledges the concerns of some providers about the voucher. The Child Trust Funds Bill was amended to remove the requirement from primary legislation to obtain the voucher, and to put that requirement into regulations instead. This change will give flexibility to change the system in the future if practical experience with the CTF, once it is up and running, demonstrates that would be appropriate.

The initial Government contribution that the voucher represents will be £250 (see regulation 7(4)). A higher sum will be given to children in the transitional group – see regulation 7(2).

Descriptions of Accounts

Regulation 4(1) provides that a CTF account must fall into one of two descriptions:

- Stakeholder account
- Non-stakeholder account

A stakeholder account is an account that complies with the provisions of the Schedule attached to the regulations. Details of the schedule are given at the end of this Commentary.

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. The draft regulation has been amended to reflect the change made to the Child Trust Funds Bill allowing children aged 16 or over to manage their own accounts. If the child therefore is 16 or over when their CTF account is to be opened only they will be able to open the account, and only they can manage it.

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 applicant (which must be the child if they are aged 16 or over) must enter into an agreement with the account provider for the management of the account. That agreement must include the application and declaration required by Regulation 13(3) – see later;
- If the application is not in writing, the applicant has agreed to the management of the account;
- Where the management agreement is a distance contract the agreement must be an initial service agreement for the purposes of the Distance Marketing Directive and in any case where there is a right to cancel, that the cancellation period has expired.

New regulation 5 (2) has now been added in. **Regulation 5(2) (a)** makes it clear that until the four conditions have been satisfied and the account has been opened, no subscriptions to the child's account can be accepted by the provider.

Accounts can be set up for children in the transitional group born between September 2002 and the launch date in April 2005 in advance of the launch date. This will help stagger applications to providers (and the setting up of Revenue allocated accounts when vouchers expire). **Regulation 5(2) (b)** provides that subscriptions cannot be accepted for these accounts until the launch date. Providers can of course make other arrangements outside of the scope of the CTF to accept subscriptions in advance.

Where a person (which can include a child if they are 16 or over) 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. These are the accounts that the Revenue opens because a CTF account has not been opened in the 12 month period 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. This measure has been revised to exclude from those particulars an expiry date for the voucher since this is not necessary in this context.

The Inland Revenue will give the provider the address of the Child Benefit claimant so that they can forward the annual statement for the child. Once the account has been opened the Revenue will send a letter to the Child Benefit claimant informing them that an account has been opened and giving contact details for the provider.

Regulation 6 (2) requires the account provider to open immediately a stakeholder account for that child as if a responsible person (the child if 16 or over) 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 contributions that will be made to a child's CTF account.

Regulation 7 (1) has been expanded since the draft regulations to specify which of the following provisions relates to the initial contributions, the supplementary contributions and the contributions paid to children in the care of a local authority ('looked after children') – the latter contributions are now termed "special contributions".

Regulation 7 (2) specifies the amount of the initial Government contribution for children born between 1 September 2002 and 5 April 2005. The figures vary depending on when the child was born – those born earlier will received a higher figure than those born later to reflect the extra time that they have had to wait for an account.

Regulation 7 (3) specifies the amount of the special contribution for children in the care of a local authority ('looked after children') and who are in the transitional group. The amount is the equivalent of both the initial contributions paid to all children and the supplementary contribution paid to poorer children. The figure of £553 which appeared in the draft regulations has been rounded up to £554.

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

Regulation 7 (4) (b) sets out the amount of the special contribution for looked after children born from 6 April 2005.

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

Regulation 7 (7) specifies the amount of the supplementary contribution 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, the child must be an eligible child, that a child can have only one account, and that at any one time only a single "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. This regulation has been amended to take account of the change allowing a child aged 16 or over to instruct on the management of their own CTF account.

Regulation 8(1) (f) has also been added to provide that the management agreement must include instructions to the provider as to the manner in which the Government contributions and any subscriptions made are to be invested under the account.

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)(f)** 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)(e)**

Regulation 8 (2) (h) and (i) provide for the free transfer of CTF accounts save for "incidental expenses" (which are defined by **Regulation 8 (5)).**

Regulation 8 (3) adds in an additional provision in relation to distance contracts which stipulates that any transfer or internal transfer will only take effect once the contract satisfies Condition 4 in regulation 5.

Regulation 8(4) provides that any 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 contributions and will commonly be made by family members and friends and also the child (for example, from money from employment or a Saturday job). For non-stakeholder accounts the provider can determine in which form they will accept subscription. For stakeholders providers are required to accept subscriptions by cheque, direct debit, standing order and direct credit (other than standing order).

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 grandparent lives abroad whilst the grandchild is resident in the UK. Under this regulation the grandparent will be able to subscribe to their grandchild's CTF account just as a grandparent 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 the child is no longer in the country. (Government payments, however, 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 child's CTF 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 each 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 around the time of 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.

This regulation has also been amended to provide that for transitional group children for whom accounts can be opened from January 2005, the first year runs from when those accounts can accept subscriptions under regulation 5(2).

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

The draft regulations issued in February originally provided that the statement date for the annual statement should be as at the child's birthday and should be sent within 60 days of the statement date. Some providers, however, have argued that they should be able to send statements in advance of the child's birthday. This is in order to remind parents and families of unused subscription limits for the year which will be lost after the child's birthday.

The Government considers that the proposal will help encourage further saving. **Regulation 10(2)** has therefore been amended to provide that the statement must be created at any date not more than 60 days before or after the child's birthday and not more than 12 months from the previous statement date.

Regulation 10 (3) provides that the statement shall be sent to the child care of the registered contact and where the named child is the registered contact (because they are aged 16 or over) to the child. In the draft regulations this regulation specified that the statement should be sent to the child. The regulation has been changed because the registered contact will need to see the statement to help them make the appropriate investment decisions. The statement must be sent with 30 days of the date the statement is created.

Originally the draft regulations specified that the statement should be sent by post. However the reference to 'post' has been removed since it is recognised that some children and registered contacts will prefer to receive statements electronically.

Regulation 10 (4) 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.

Additional items since the original list in regulation 10(3) of the draft regulations are the number or amount, description and market value of each investment, the basis of calculation and the exchange rate used where any investment is in a currency other than sterling.

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 into ISAs under the ISA rules, will not be able to be made into CTF 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.

The list of investments does not include the new schemes introduced by the FSA in The New Collective Investment Schemes Sourcebook. We will consider to what extent units or shares in those schemes will be eligible for a CTF and will amend the regulations as necessary prior to the launch of the CTF.

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 to open a CTF account. This has been amended to take account of the reduction from 18 to 16

of the age at which a young person can instruct on the management of 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 applicant that he or she is aged over 16 and that they are either the responsible person for a child under 16 or that they are the child themselves being over 16. They will also declare that they are to be the "registered contact" for the child.

The applicant, 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. An addition to the draft regulations is that that authority must continue until a further declaration and authorisation is made in accordance with paragraph 13(10).

Regulation 13(5) also lists the items of information that the application must contain. **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. **Regulation 13(6)** states that there may be only one declaration and authorisation in force for a CTF account at any time.

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, for example a person presenting themselves as the registered contact for a Revenue-allocated account, must provide full details and make the same declaration as required on opening the account. Again the regulation has been amended to take account of the reduction to age 16 of the right to manage 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) (a) provides that a person who wishes to be a CTF account provider must make an application in a form prescribed by the Inland Revenue. **Regulation 14(2) (b)** sets out the specific undertakings that a potential provider must make. The draft regulations for the CTF required providers to offer the stakeholder account. The final regulations will allow firms to provide the CTF, where they are not in a position to offer the stakeholder account, by means of an alternative rule, where they provide details of a stakeholder account offered by another provider**. Regulation 14(3)** provides that they will however have a duty to ensure that all potential applicants for a CTF are made aware of the availability of the stakeholder account and its feature and put in a position to apply for that stakeholder account should they wish to do so.

Providers must accept all vouchers subject to 13(8) and must also demonstrate that they can satisfactorily operate the fortnightly claims and returns procedures set out in **Regulation 30.**

Regulation 14 (2) (b) (vii) 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 a person 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.

Withdrawal from a CTF account before the age of 18 has been reached will also be allowed where the child has become terminally ill. Regulations setting out the procedures and requirements in that circumstance will be issued later.

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 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. To the draft regulations has been added the requirement to inform the registered contact of his rights under **Regulation 20(3)** below.

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. Should any situations arise they will be dealt with on a case by case basis.

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 18th 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.

Transfers must take place within the time stipulated by the registered contact, but subject to a reasonable business period for (not exceeding 30 days) (see regulations 8(4) and subject to the expiry of any cancellation period (see regulation 10(3)).

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(2) has been amended to take account of the situation where the registered contact specifies a transfer of an account to an account of a different description.

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 a notice containing 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 a dividend was 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(1)** 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) provides for the recovery of any supplementary contribution (see regulation 7(6)) where the relevant tax credit or benefit determination is overturned.

Regulation 22 (3) lists the persons from whom recoupment may be made and states that they will be jointly and severally liable. **Regulation 22 (4)** 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 is such a breach that the child's account should be closed down, unless the child was not eligible for the account in the first place.

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 contributions.

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) applies section 349B of the Taxes Act which will allow interest payments to CTF providers to be made gross.

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

Regulation 24 (f) 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(1) and (2) provide that claims can only be made for a tax month or months (not exceeding six) and that the Revenue will be under no obligation to pay a claim earlier than the end of the month following that in which it is received. A tax month runs from 6th of one month to the 5th of the next.

Regulation 26 (3) provides that a claim may not be made for a tax month ending 5 October, or later, where an annual claim (regulation 27) is outstanding for the previous tax year.

Regulation 26(4) provides that where, on the occasion of a claim, there is an amount due to the Revenue, it is recoverable as if it were tax charged by an assessment.

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 providers to make annual claims for repayment of tax and sets out the conditions and timing for these claims. The requirement to make an annual return has been removed to smooth the administration for CTF providers.

Regulation 27(1) requires that an annual claim must be for a tax year ending on 5 April and cannot be made more than six years after the end of a tax year.

Regulation 27(2) requires a provider to make an annual claim only where
- Interim claims (regulation 26) have been made for the year

- There is an amount due to the Revenue, or
- The provider wishes to make a claim.

Regulation 27(3) requires providers to repay any excessive amounts claimed on interim returns and where an annual claim is not made on time, **regulations 27(4) and (5)** make provision for the Revenue to recover any amounts paid on interim claims which are considered to be excessive.

Regulation 27(6) allows providers to make a supplementary claim where they discover an error or mistake in the original.

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 an account has not been opened for a child within a year of issue of the voucher), to identify where duplicate accounts have been opened, and to instruct providers to claim further Government contributions.

The frequency of the fortnightly return is to ensure that there is as little delay as possible in paying the Government contributions 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 contributions 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.

Regulation 30(1) specifies the duration of the fortnightly return and the initial return period. In the period from January to March 2005 when the CTF is being phased in providers will be asked to make returns on two dates only – the 28 of February and the 31 March.

Regulation 3(3) provides the time limits in which the return must be made, **Regulation 3(4)** that a declaration and a claim must be made as part of the return. **Regulation 3(5)** lists the information that the return must contain.

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. To this list in the draft regulations has been added the annual statement.

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, however, 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. The draft regulations have been amended to state that the return will be made by electronic communication. Because the return will be made electronically the previous requirement for a signed certificate as to the contents of the return has been removed from the regulations.

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. The regulations now provide that even where there are no relevant children to report on the local authority shall still submit a return – in this case a 'nil' return.

Regulation 33 (3) explains what information local authorities have to send to the Inland Revenue. The sex of the child has been added to this list.

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. The regulations now provide that even where there are no relevant children to report on that month the local authority should still submit a return – in this case a 'nil' return.

Regulation 33(5) sets out the additional information that will be required from local authorities after 31 August 2009 so that looked after children will be paid the correct amount into their accounts on their 7th birthday.

Regulation 33 (6) 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 CTFs – Supplementary Provisions

Regulation 37 provides requirements in connection with various administrative matters.

This includes **Regulation 37(5)** 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(6) 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. **Regulation 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.

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(5).

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) specifies what types of investments can be held in the account. Investments that qualify under regulation 12 apart from the exceptions listed in paragraph 2(2)(a) are allowable. Paragraph 2(2)(a)(v) and (vi) 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(2)(b) requires that the account have an equity component, either directly or indirectly, subject to the other requirements in paragraph 2 (such as unless lifestyling has commenced, see paragraph 2(2)(d) below);

Paragraph 2(2)(c) provides that the account must be adequately diversified and puts a general duty of care on the provider. 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;
- derivatives to only be used for efficient portfolio management;
- investors to not be exposed to a high level of currency risk; and
- investments not to be heavily in highly-geared firms/funds.

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 minimise the variation in capital value of the account which could be caused by market conditions. Such a movement towards less volatility 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 volatility will occur unless otherwise instructed by the registered contact.

Proportions have not been specified on particular asset classes to measure the reduction in volatility. 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 paragraph 2(2)(c) for the stakeholder to be adequately diversified.

Nevertheless, such a movement towards less volatile 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(5) give the conditions which the stakeholder account must meet:

Paragraph 2(3) lists the means of payment that must be acceptable to providers for contributions to the account.

Paragraph 2(4) 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(3) or being another mean of payment acceptable to the provider. Providers can accept a contribution below this amount if they wish.

Paragraph 2(5) states that the account may be subject to charges, the details of which are given in paragraph 3.

Paragraphs 2(6) and 2(7) give definitions of various terms used in paragraph 2.

Charges

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

Paragraph 3(1) states that only charges detailed in paragraph 3 may be applied to the account.

Paragraph 3(2) states that the maximum level of charges that can be imposed on the account will be 1.5%, subject to the exemptions given in paragraph 3(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, stamp duty reserve tax, dilution levy and costs associated with buying or selling.

Paragraph 3(3) details that providers must decide whether to value a child's rights on a daily, weekly or monthly basis when calculating the charge cap. The decision on valuation frequency and if applicable, specified day or date (see paragraph 3(4) below) must be recorded in writing to the registered contact, and not modified within 12 months of an earlier decision.

Paragraph 3(4) states that 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.

Paragraph 3(5) provides for deductions that may be made in addition to charges included under the charge cap. This includes any stamp duty, stamp duty reserve tax or other charges incurred (such as any dilution levy), either directly or indirectly, in the sale or purchase of investments for the account.

It also allows for legal costs and 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.

Paragraph 3(6) provides for where the provider makes deductions under paragraph 3(5) 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.