

THE CHILD TRUST FUNDS (AMENDMENT) REGULATIONS 2004

In Budget 2003 the Chancellor announced the introduction of the Child Trust Fund (CTF) and that accounts would be available from April 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 saving 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.

The Child Trust Funds Act 2004 received Royal Assent on 13 May 2004. This Act gives the Treasury power to make regulations in connection with various aspects of the CTF. The main CTF regulations, The Child Trust Fund Regulations 2004 were laid on 27 May 2004.

On 6 August, draft regulations were published setting out some further changes to the main regulations and asking for comments. These included allowing early access to their CTF funds for terminally ill children, and some changes on transfers and the annual statement. At the same time as the Inland Revenue published draft amending regulations, HM Treasury launched an informal consultation concerning the list of qualifying investments for the Stakeholder. The final version of these regulations was laid before Parliament on 14 October.

The attached Commentary provides an analysis of these regulations and indicates where changes have been made since the draft regulations were published for information in August. It also gives some background information on early access for terminally ill children.

Guidance notes for potential providers of CTF accounts are available on the Inland Revenue website at www.inlandrevenue.gov.uk/ctf/htm. The guidance notes include material on the changes in the new regulations.

Regulations have also been laid relating to the tax treatment for corporation tax purposes of CTF insurance business of life companies and friendly societies.

These follow closely similar regulations for ISA insurance business. A commentary also accompanies these regulations.

COMMENTARY

EARLY ACCESS FOR TERMINALLY ILL CHILDREN

1. In a written statement published on 27 May the Financial Secretary to the Treasury announced that the Government had decided to allow early access to CTF accounts for children who meet the criteria for entitlement to Disability Living Allowance under Special Rules for the terminally ill.
2. This commentary explains the thinking behind the regulations allowing early access to CTF accounts of children who are terminally ill.

Background

3. As a general rule, no money can be withdrawn from a CTF account until the child holding the account is 18 (see section 3(4)(d) of the Child Trust Funds Act 2004 which states that the terms of a CTF account must prevent withdrawals except as permitted by regulations). Regulation 18 of the Child Trust Funds Regulations 2004 permits withdrawals from an account only in the circumstances where the child has died or where providers need to settle management charges and other incidental expenses.
4. The CTF Proposals Paper published in October 2003 did not envisage early access in any other circumstances.
5. During the passage of the Bill through parliament the Government decided that it would not be equitable to prevent access to CTF accounts where children are terminally ill. Ministers at the Department of Work and Pensions agreed that the Special Rules in Disability Living Allowance would be the main passport to early access to CTF accounts.

Disability Living Allowance

6. Disability Living Allowance (DLA) provides a contribution towards the additional costs associated with disability. It consists of two components: the care component (payable at one of 3 rates) for people who need help with personal care; and the mobility component (payable at one of 2 rates) for people who are physically unable to walk or virtually unable to walk or who need guidance or supervision when walking out of doors on unfamiliar routes.
7. Disabled people cannot become entitled to DLA until they have required the prescribed level of help with personal care, or have had the prescribed level of walking difficulties for at least three months (“the qualifying period”). Under Special Rules (introduced in 1990) this qualifying period for the care component is waived for people who are terminally ill.

“Terminally ill” is defined in section 66(2) of the Social Security Contributions and Benefits Act 1992 as follows: a person is “terminally ill” at any time if at that time he suffers from a progressive disease and his death in consequence of that disease can reasonably be expected within 6 months.

8. People awarded DLA under Special Rules are immediately entitled to the highest rate care component (they must satisfy the normal entitlement rules to get the mobility component).

Procedures for early access to CTF accounts

9. We have developed these procedures with a view to minimising any burden on parents at a very difficult time. Where Special Rules has already been awarded for the child, parents will not be required to provide any additional information and the request for early access will be processed quickly. The following paragraphs set out further details.
10. The person with parental responsibility for the child, or the child if 16 or over, will contact the CTF Office to advise that the child is terminally ill and the parent or child would like to access the CTF account. Where a Local Authority has parental responsibility for a child being looked after, that Authority is also entitled to make the claim for early access.
11. The person who contacts the CTF office will be asked whether there is a Special Rules DLA claim in place for the child. If so, the details will be confirmed with the Department of Work and Pensions and early access granted. If not, and the person wishes to make a Special Rules claim they will be given the DWP contact details to do this.
12. There are some children who cannot be passported using Special Rules DLA, namely:
 - children living abroad – i.e. children who have left the country since their CTF account was opened;
 - children being looked after in residential care by a local authority, and those who are long-term hospital patients;
 - children who qualified for highest rates of DLA under the “normal rules” before a prognosis of “terminal illness” was made, and for whom a Special Rules DLA claim has not been made because they would not gain anything from it; and
 - children whose parents do not wish to make a Special Rules DLA claim.
13. Where there is not a Special Rules award the CTF office will request written evidence that the child is terminally ill as defined for Special Rules purposes and forward this to DWP’s medical services provider for checking. As this is the body which checks all claims for Special Rules this will ensure consistency of treatment.

14. Once the Special Rules award or other evidence has been checked with DWP and their medical services provider the CTF office will advise the CTF provider to grant early access to the registered contact. This will be done in the fortnightly schedule sent by CTF office to providers.
15. The CTF office will also write to the person who requested access to the account informing them that this has been granted.

The role of providers

16. In developing these procedures we have tried to minimise any administrative burden on providers. The provider of the child's CTF account will not be involved in the decision-making process as this will be the responsibility of DWP and its medical services provider. Material on how to handle early access cases will be added to the guidance notes for providers.
17. Parents, or children if 16 or over, may approach providers in the first instance, rather than the CTF office or helpline. In that case the provider should advise that early access can be granted where a child is terminally ill as defined for the purposes of the Special Rules and advise the claimant to contact the CTF office.
18. Parents whose child has a Revenue allocated account and have not themselves become the registered contact may also request early access to their child's account. If these parents approach the provider, they should be advised that they need to become the registered contact to be able to make withdrawals but should contact the CTF office to request early access.
19. Once the CTF office has agreed that early access can be granted, they will write to person who requested access and inform the provider electronically on the next fortnightly schedule
20. The CTF Office will give providers a phone number to contact if the registered contact requests a withdrawal before the provider has received confirmation from the CTF office.

STAKEHOLDER CHILD TRUST FUND – DIRECT HOLDINGS IN EQUITIES

1. In August 2004, when the Inland Revenue published draft amending regulations concerning terminally ill children and other rules, HM Treasury launched an informal consultation concerning the list of qualifying investments for the Stakeholder CTF.
2. Following representations from participants in the CTF roadshows and consultations with providers it was proposed that the list of qualifying investments be confined to collective investment schemes, certain life vehicles and cash held for the purpose of investing in the above. However, in response to the comments received as part of this informal consultation, we further amended our policy.
3. Instead of limiting the qualifying investments in the way we had suggested, we decided to leave the original list of qualifying investments unchanged save for specific exclusions to remove the following potentially volatile investments from the Stakeholder CTF account:
 - direct holdings in equities;
 - direct holding in securities, other than gilts and Securities issued by European Economic Area governments, unless the securities guarantee 80% of an investors starting capital.
4. Cash deposit accounts will also remain part of the Stakeholder CTF but, to prevent the possibility of hidden charging by providers an additional rule has been added. The rule states that the maximum difference between the Bank of England base rate and the interest rate on the cash deposit account element of the Stakeholder CTF is –1%.

COMMENTARY ON INDIVIDUAL REGULATIONS

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 when it commences in April 2005. There will therefore be a large number of children born from 1 September 2002 and before the launch date who will be entitled to CTF accounts at the launch. The Government wants 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 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 until before 1 January 2005 when the legislation would come into effect, the process of approval started on 1 October in order to give providers advance notice that they will have approval on 1 January.

Amendments to the Child Trust Fund Regulations 2004

Regulation 2 provides that the main CTF regulations shall be amended.

Regulation 3 – adds a definition of “assurance undertaking” to the main regulation definition section.

Regulation 4 adds a new paragraph to the end of main CTF regulation 6 to put in the requirement that where a Revenue allocated account has been opened the Inland Revenue will write to the person entitled to child benefit to inform them of this and the particulars of the account.

Regulation 5(a) amends regulation 7(4) of the main CTF regulations so that the words “becomes an eligible child” replace the words “is born”. This change, which did not appear in the draft regulations issued in August, is to ensure that children born before 6 April 2005 who do not become eligible for a

CTF account until after that date receive the correct Government starting payment.

Regulation 5(b) adds a further and new paragraph at the end of main CTF regulation 7 to provide that the Inland Revenue, following final determination of entitlement to Child Tax Credit, will write to the person entitled to child benefit to tell that the supplementary contributions is being paid into the child's account.

Regulation 6 amends regulation 8(2) of the main CTF regulations which relates to the terms and conditions applying to CTF accounts. The requirement to allow transfers in without charge has been added to the list of terms and conditions at regulation 8(2). This change has been made as it became apparent that although regulation 8 (2) (h) of the main CTF regulations prevents providers levying a charge for the external transfer of a CTF account, there was no express analogous restriction on transfers in.

Regulation 7 makes various amendments to regulation 10 of the main CTF regulations, which deals with annual statements

Regulation 7(a) substitutes in regulation 10(2) (a) "61" for "60". Regulation 10(2) of the main CTF regulations sets the time limits within which the provider must issue the annual statement for a CTF account. The period has been amended from not more than 60 days before or after the named child's birthday to not more than 61 days before or after the birthday.

This is because by extending the period to 61 days, providers can choose to send statements to all children holding accounts with them three rather than four times a year (twice 61 is 122 and three times 122 is 366). This will give providers greater flexibility without affecting the amount of information about the CTF account given to parents and children.

Regulation 7(b) substitutes in main regulation 10 (4) (i) the words "(see regulation 7) received by the account provider" for the words "claimed by the account provider under regulation 30". The wording of 10 (4) (i) has been amended so that the statement must include the amount of the government contributions "received" rather than "claimed". The reason for this is that where a claim had not yet been paid into the account the original wording could have been misleading. Regulation 10 (4) (i) has therefore been amended accordingly.

Regulation 7 (c) adds a further paragraph to the end of main regulation 10. Regulation 10 (4) (k) requires that each annual statement include the total amount of deductions (including actual figures for management charges) made from the CTF. This has been amended to give providers flexibility to express

management charges as a percentage if this is preferred to expressing them as actual figures.

Regulation 8 amends main regulation 12 (9) (b) (iii) to relax slightly the requirement that life policies held within a valid CTF must have a term in the policy preventing the payments of proceeds to the child before he or she reached the age of 18. This relaxation is to enable payments to be made to the child where they are terminally ill. Further information is in the material on terminally ill children at new Regulation 18A below in this Commentary.

Regulation 9 (a) adds to paragraph (3) (b) (i) of main CTF regulation a phrase relating to Scotland. This is a new change.

Regulation 9 (b) adds to main CTF regulation 13 (5) (c) a further requirement. This is a new change which was not in the draft regulations issued on 9 August. Regulation 15(5) sets out the items that an application by a responsible person must contain. This does not include the date of birth of the child. However in many cases the application form will come in separately from the voucher and the child's date of birth is important in ensuring that the correct application is linked up to the correct voucher. We have already drawn providers' attention to this in the draft CTF Providers Guidance: the child's date of birth should be entered on the application form (or in the case of non-written applications, to provide that detail).

Regulation 9 (c) adds a paragraph at the end of regulation 13 to require the Official Solicitor or the Accountant of Court to make the necessary declarations required by regulation 13 where he is the registered contact.

Regulation 10 amends main regulation 14(3) by substituting the words "before commencement of completion of" for the words "prior to discussing". Regulation 14(3) applies where a CTF provider does not offer a stakeholder account. The provider is required to inform a potential applicant of the stakeholder account, and facilitate an application to another CTF provider who does offer the stakeholder account. The change allows providers to satisfy this requirement alongside FSA key features and minimum information rules, without the need to introduce a separate procedure. This is a change which was not in the August draft regulations. It is not a relaxation of the need to disclose the stakeholder account to all customers prior to them opening an account – it simply ensures that the stakeholder is discussed as well as a non-stakeholder account and does not have to be discussed beforehand.

Regulation 11 inserts a new subparagraph (ab) in main regulation 18. The latter is the regulation which sets out the very limited occasions in which withdrawals may be made from a child's CTF account. To these are being added early access for terminally ill children.

Regulation 12 inserts a new regulation - regulation 18A - setting out the procedures for early access for terminally ill children.

New Regulation 18A

Paragraph 1: a person with parental responsibility for the child who owns the CTF account (including a Local Authority) may make a claim to withdraw money from the CTF account. In most cases that responsible person will be the child's father or mother but there are other people who can have parental responsibility such as adoptive parents or guardians. "Parental responsibility" is defined in the Children Act 1989 as all the rights, duties, powers, responsibilities and authority which by law a parent of a child has in relation to the child and his property.

Where the child owning the account is over 16, either the child or a person with parental responsibility for the child can make the request for early access.

Paragraph 2: where DLA under Special Rules has been awarded for the child (Case 1), the responsible person will be asked to give consent for the CTF office to contact DWP to confirm this award. Where there is no Special Rules award, the responsible person will be sent a form for completion by a medical practitioner confirming that the child is terminally ill as defined for Special Rules (Case 2). This form will be checked by the medical services provider used by DWP.

Paragraph 3: Once the claim has been agreed, the CTF office will write to the claimant giving the registered contact authority to make withdrawals from the account. This letter will point out that it is possible they will receive this information in advance of the provider and that they may wish to take the letter with them when going to make a withdrawal in case the provider is not aware that the claim has been agreed. The CTF office will inform the provider on the next fortnightly schedule that access has been agreed to a particular account.

Where the claimant is not the registered contact, he or she will need to advise the registered contact that authority has been given and should pass a copy of the CTF office letter of authority to the registered contact.

Paragraph 4: There is no restriction on the number of withdrawals that can be made once access has been granted subject to sufficient balance being maintained in the account so that it is not closed. The CTF account will remain open to receive any further Government contributions for which the child is eligible. It will also be possible for subscriptions (i.e. savings by family and friends) to be made to accounts up to the annual limit.

It will not be necessary to sell the assets held in a CTF account before withdrawal. Account managers will be able to transfer assets from the account to the child rather than be required to sell investments and transfer the proceeds. All tax exemptions given to those assets under the CTF will cease on withdrawal.

There is one exception to this rule: it will not be possible to transfer life insurance products from CTF accounts. This is because the income and gains on assets in the underlying funds of the insurer that back up the policies in CTF accounts will roll up tax-free. If the policy were to cease being in the CTF but continue in existence then a related proportion of the insurer's funds would have to be transferred to the insurer's basic life assurance and general annuity business fund where income and gains are taxed. This would add unnecessary tax and administrative complexity.

However, it will be possible to withdraw the proceeds of a life insurance product from the CTF if the policy is wholly or partly surrendered or matures within the CTF. As mentioned above, regulation 12(9)(b)(iii) of the main Regulations is being amended to relax slightly the requirement that life policies held within a valid CTF must have a term in the policy preventing the payment of proceeds to the child before he or she reaches the age of 18. Payments to the child will now be allowed if the child is terminally ill.

Once early access has been given to a CTF it will remain in place for the life of the account. In all other respects the CTF is to be treated as any other CTF.

Paragraph 5: Where withdrawals are made by the transfer of assets to the child, the child is treated for capital gains tax (CGT) purposes as having disposed of the investments immediately prior to the withdrawal and having immediately reacquired them outside the CTF at their market value. This ensures that any gains or losses within the CTF are not subject to CGT and that when the investments are subsequently disposed any gains or losses relating to the period since the withdrawal from the CTF fall within the normal CGT rules.

Paragraph 6: the definition of "terminally ill" in section 66(2) of the Social Security Contributions and Benefits Act 1992 is: a person is "terminally ill" at any time if at that time he suffers from a progressive disease and his death in consequence of that disease can reasonably be expected within 6 months.

Regulation 13 amends regulation 21 of the main CTF regulations to ensure that the only grounds on which providers will be entitled to refuse to accept transfers into stakeholder CTFs will be that:

- a. the information in the application is not accurate;
- b. accepting the transfer could jeopardise the provider's ability to carry out CTF business; or

- c. the provider from whom the account is being transferred has not given the notice required.

This will prevent CTF providers restricting transfers in of stakeholder accounts to the more financially attractive accounts, such as those with large balances or regular subscriptions. All children with stakeholder accounts must have access to the full range of stakeholder accounts.

Regulation 14 amends main regulation 33. 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.

As part of these arrangements regulation 33 (2) sets out the details of when local authorities shall send an information return to the Inland Revenue about looked after children on the date that the CTF is launched who are born after 31 August 2002 – known as the transitional group of children.

Regulation 14 (b) adds an additional paragraph (7) to regulation 33 allowing this particular information return to be sent by registered post or by electronic means.

Regulation 14 (a) also adds an additional paragraph (6) to regulation 33 in connection with the monthly returns of information from local authorities required by regulation 33(4). Where a child becomes looked after for the first time by a local authority but then dies before the monthly return has been sent to the Revenue, local authorities have to let the Revenue know this and provide the name and address of the child's personal representative. The additional paragraph (6) specifies that they must also send the Revenue a copy of the death certificate (or other documentary evidence of death) to the Board by post.

Both these changes to paragraph 33 are new changes not in the draft regulations.

Regulation 15 makes amendments to the Schedule attached to the main CTF regulations, that deals with the stakeholder account.

Regulation 15(a) and (c) introduce further restrictions on the type of investment that can be held in the stakeholder account.

Regulation 15 (a) adds a direct holding in shares in listed companies to the list of investments that are excluded from the stakeholder account. Such shares held indirectly in a collective investment scheme can be held in the stakeholder account.

Regulation 15 (c) places restrictions on cash and securities held in the stakeholder account. Cash held in a deposit account or in a share account with a building society remains as a qualifying investment for a stakeholder account, but only where the interest is earned on that account on a daily basis, and the maximum difference between the Bank of England base rate and the interest on the account is less than 1% per year.

A direct holding in securities remains as a qualifying investment for a stakeholder account (aside from securities in an investment trust) but only if the securities are gilts, or securities issued on behalf of an EEA government, or where the securities are effectively held under a guarantee that the child will not lose more than 20% of the price paid for the securities. Securities held indirectly in a collective investment scheme are not affected by these conditions.

The remaining amendments to Regulation 15 are for clarification and do not introduce substantive changes.