

**House of Lords Economic Affairs Committee – Finance Bill Sub-Committee
Call for evidence for inquiry into the draft Finance Bill 2016
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Introduction

- 1.1 We welcome the opportunity to respond to the Committee’s call for evidence for its inquiry into the draft Finance Bill 2016.

2 About Us

- 2.1 The LITRG is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT’s primary purpose is to promote education and study of the

administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Clauses 1 and 4

Personal savings allowance and ending of deduction of income tax at source from interest

- 3.1 We broadly welcome these changes. The savings allowance will offer most individuals a fairly substantial exemption in addition to ISAs. In addition, the combination of the savings allowance and the ending of deduction of income tax at source is likely to simplify the position for many individuals with modest amounts of savings income as it will produce the correct result in the majority of cases.
- 3.2 Hitherto, people on low incomes have been expected either to register with their bank for interest to be paid gross if they are not liable to tax,¹ or to reclaim any tax deducted at source for which they are not liable.² Registering to be paid gross brings with it an obligation to notify the deposit taker – and HMRC – if the individual becomes liable to pay tax, while making a claim for repayment of tax over-deducted involves working out the difference between the tax deducted at source from and the tax payable by the individual. This might mean having to undertake the difficult calculation to establish whether the individual is entitled to the starting rate for savings, and if so on how much of their income. In many cases, people simply do not know that they are entitled to a rebate, or to opt for their interest to be paid without tax deducted, and consequently routinely overpay tax on their savings. The reforms brought about by these two clauses, combined with the reduction of the starting rate for savings to zero per cent with effect from 6 April 2015 (previously 10%), should therefore bring about a worthwhile simplification for individuals on low incomes.
- 3.3 Our main concern is that the mechanism to achieve this simplification is itself highly complex. In particular, the interaction between the starting rate for savings (now 0%) and the new ‘savings nil rate’ is likely to cause confusion. The starting rate for savings is itself subject to a complex calculation and is not well understood. Superimposing another zero-rate band for savings income above the starting rate limit could be equally poorly understood and therefore result in mistakes being made. Such errors are likely to be perpetrated as much by HMRC as by taxpayers, and to involve too much tax being paid as too little.
- 3.4 We are also concerned about how well taxpayers – particularly those who are unrepresented – will be informed about these changes. Banks and building societies ought to assist in this process, particularly as they will undoubtedly receive many queries about the

¹ Using form R85

² Using form R40

changes – but they have tended in the past not to provide accurate or up-to-date information for their customers on the deduction at source scheme, how to register to receive interest gross, and how to reclaim over-deducted tax.

- 3.5 Before taxpayers can understand the changes, they need to actually be aware of them. Research last year commissioned by HMRC showed that higher rate and additional rate taxpayers had low awareness about their responsibility to notify HMRC of savings interest.³ There is arguably even less likelihood of unrepresented taxpayers on lower incomes knowing that they must now notify HMRC if their interest exceeds £1,000 in a year.
- 3.6 Information and guidance given to taxpayers on the changes must be accurate, comprehensive and comprehensible, and be readily accessible to all – not just posted on GOV.UK as a great many of the taxpayers affected will be digitally excluded.

4 CI 2 and 3

Dividend nil rate and abolition of the dividend tax credit

- 4.1 The abolition of the dividend tax credit will for the first time expose any basic rate taxpayer with dividend income of over £5,000 to a tax liability on their dividend income above that amount. There could also be unwelcome effects on low paid workers the engagers of whose labour require them to work through personal service companies – previously, no basic rate taxpayer was required to pay any further tax on a dividend to which a tax credit was attached; from April 2016, however, dividend income in excess of £5,000 a year will attract a tax liability. There is also a danger that such workers will be attracted by schemes intended to ‘avoid the new dividend tax’ which are already beginning to be mooted.
- 4.2 The same considerations will apply to the interaction between the dividend nil rate, the savings allowance and the starting rate for savings as set out in paras 3.3 to 3.6 above: there must be very clear explanations and guidance, equally accessible to those with and without access to computers or the internet.
- 4.3 There is a potential trap for donors to charity. Any donor using the gift aid scheme is required to pay during a tax year at least the amount of tax notionally attributed to the gift they are making. A dividend tax credit can count towards tax paid by the donor for this purpose. Consequently, anybody who gives to charity under gift aid, and who uses tax credits attached to their dividend income to ‘frank’ the tax attributable to their gift, must review their charitable giving when the dividend tax credit is abolished in case they are no longer eligible to use gift aid. In fact, anyone who pays less tax as a result of the changes to income taxation coming into effect in 2016/17 will be in the same position. Any donor using

³ See <https://www.gov.uk/government/publications/awareness-and-understanding-of-taxation-of-savings-interest>

the gift aid scheme whose tax bill is less than the amount of tax attributed to their gift is liable to pay HMRC the difference, and we have seen cases in which this rule has been enforced.

5 CI 71

Simple assessment

- 5.1 We generally welcome this facility to assess individual taxpayers with straightforward affairs without putting them into self-assessment, particularly pensioners whose only taxable income is the state retirement pension (on which DWP will not operate PAYE), and others with insufficient PAYE income to enable collection of tax they owe.
- 5.2 We are however concerned that figures provided by HMRC might be erroneous, particularly if relying on third party information, and yet there is a strong risk that an unrepresented taxpayer might accept without question whatever emanates from HMRC and disregard their own records even if accurate.
- 5.3 In particular, an unrepresented taxpayer may not be able to identify reliefs, allowances or claims they are entitled to make that will reduce their liability. We suggest that such simple assessments should identify the main reliefs and claims that might be considered – for example claims for mileage allowance, professional subscriptions and the marriage allowance (take-up of this last relief has hitherto been low). In addition, taxpayers need to be made aware where any claims might be made in relation to employer error or HMRC error.
- 5.4 When a simple assessment is issued, the taxpayer does not have to complete a tax return unless there are other income and gains not included in the assessment. In order to do this, taxpayers will need to be given detailed information. For example, providing a composite figure for interest received would require the taxpayer to undertake considerable work to substantiate the figure if they held more than one interest-bearing account. HMRC will be furnished with that information by the relevant banks and other financial institutions and it makes sense, therefore, for the assessment to contain details both of the institution(s) involved and the relevant account number(s) as well as interest paid.
- 5.5 It is not clear how these simple assessments will interact with the new digital tax accounts. It is crucial that taxpayers understand this and that non-digital options remain. According to HMRC's own research,⁴ 15% of the UK population are digitally excluded, equivalent to over 7 million adults, while almost 2 in 5 of the population are 'assisted digital' (ie require help with using computers and accessing the internet). That is a very substantial minority, and Government would be failing in its duty if it did not ensure that those people had equal

⁴ Digital exclusion and assisted digital research, September 2015: see <https://www.gov.uk/government/publications/digital-exclusion-and-assisted-digital-research>.

access to information about their legal obligations and entitlements as those who are digitally competent.

6 CI 83-87

Office of Tax Simplification

- 6.1 We very much welcome making the OTS permanent and putting it on a statutory footing. Simplification generally benefits the unrepresented population as a simplified part of the tax code is *ipso facto* easier to understand for those without access to professional advice.
- 6.2 That said, the OTS can only realise its full potential if the Government does what it recommends. Clause 8 of the Finance Bill (trivial benefits provided by employers) and provisions in last year's Finance Act which enacted OTS recommendations about taxation of employees are and were particularly welcome because they did what the OTS recommended.
- 6.3 It has not always been so. For example, the OTS devised and recommended a simplified cash accounting method for the smallest businesses on a low turnover of £30,000 a year. The OTS recommendations were indeed simple and very much in line with what businesses of that size tended to do anyway. The Government, however, decided that the simplified method should be made available to businesses with a much higher turnover – twice the VAT threshold in some cases – which necessitated a set of complicated rules about allowable, non-allowable and partly allowable deductions, computation of loss relief, who may and may not elect for the cash basis to apply to them and when, treatment of capital receipts, anti-avoidance provisions, and so forth – 20 pages of complex new law. It is not thought that many businesses have found the new set of rules sufficiently simple or attractive to opt for them.
- 6.4 Similarly, the OTS's very useful reports on the taxation of pensioners were practically disregarded except for one idea taken in isolation – the abolition of the age-related allowance – which meant that a golden opportunity to simplify the tax system for a great many taxpayers in retirement was missed.
- 6.5 We hope that the OTS's new permanent, statutory status will bring with it sufficient standing to encourage the Government to take its recommendations more seriously than on some occasions in the past, and that it will be sufficiently well funded by the Treasury to carry on its useful work over a greater part of the UK's tax code – which has never stood in greater need of real simplification than now.

LITRG

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