Savings allowance, and savings nil rate etc.; deduction of Income Tax at source
Consultation on draft clauses for Finance Bill 2016
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 We welcome the opportunity to comment on the draft legislation to introduce a new nil rate of tax for savings income within an individual's savings allowance and to remove the requirement on deposit-takers and other institutions to deduct income tax from the interest they pay on certain savings and investments.

1.2 We note that 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.[1]

1.3 We are concerned, however, that the mechanism to achieve this simplification is overly complex. In particular, the fact that there are two different levels of savings allowance (three, if one includes the zero level for additional rate taxpayers), depending on the marginal rate of tax, may not only cause confusion, but also leads to arbitrary and arguably unfair results. We strongly recommend that the operation of the savings allowance is rethought. One option would be for the savings allowance to operate along similar lines to the dividend allowance. This would be far simpler for taxpayers to understand.

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[1] http://www.litrg.org.uk/latest-news/news/150930-press-release-pay-savings-income-without-deducting-tax-say-campaigners

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1.4 We are also very concerned by the additional complexity and consequent burdens that low income individuals with savings and dividend income may face, as they will now have to deal with not only the savings allowance, but also the starting rate for savings and the dividend allowance – all three of which are essentially nil rate bands of tax that operate differently from one another.

1.5 We therefore call on HM Revenue & Customs (HMRC) to ensure that very clear guidance is made available and also that there is sufficient publicity and a proactive communications strategy to draw people's attention to the changes. This is crucial to ensure that individuals understand the savings allowance and the fact that they need to notify HMRC should their savings income exceed their savings allowance. Guidance should also include examples that deal with the interactions between the savings allowance, the starting rate for savings and the dividend allowance. Guidance should be available in hard copy format as well as online, as many of the people who will benefit from the measures will almost certainly be digitally excluded.

2 About Us

2.1 The Low Incomes Tax Reform Group (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 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 General comments

3.1 We have broadly welcomed the introduction of the savings allowance and the cessation of deduction of income tax at source from savings interest. This will provide simplification for the majority of taxpayers and produce the correct result in the majority of cases. We note however, that for some unrepresented individuals with modest incomes there will be increased complexity and burdens, as they will face a new requirement to notify HMRC about their untaxed, taxable savings interest.[2] Others will find that they have to change their arrangements for charitable giving, as they will no longer pay sufficient tax to allow them to donate under Gift Aid.

3.2 We are concerned, that the mechanism to achieve this simplification is overly complex. In particular, the fact that there are two different levels of savings allowance (three, if one includes the zero level for additional rate taxpayers), depending on the marginal rate of tax, may cause confusion and appear unfair, because of the cliff-edge effect it creates. By way of example:

John has total income of £43,001 in 2016/17. Of this, £1,000 is savings interest. Since his total income means that he is a higher rate taxpayer, he is entitled to a savings allowance of £500. His savings income is taxed as follows:

£500 @ 0% = £0
£499 @ 20% = £99.80
£1 @ 40% = £0.40
Total tax on savings interest of £100.20

John has total income of £43,000 in 2016/17. Of this, £1,000 is savings interest. Since his total income means that he is a basic rate taxpayer, he is entitled to a savings allowance of £1,000. His savings income is taxed as follows:

£1,000 @ 0% = £0
Total tax on savings interest of £0

Thus, a £1 increase in income produces an additional tax liability of £100.20. This may prove problematic for individuals with income levels that fluctuate from year to year, or those who find themselves within higher rate tax for the first time, following a pay rise or other change in circumstances (see paragraph 3.9 below).

3.3 Given the complications noted at paragraph 3.2, we recommend that the operation of the savings allowance is rethought. One option would be for the savings allowance to operate along similar lines to the dividend allowance.[3] This would be far simpler for taxpayers to understand, as the operation of the dividend allowance is itself simpler than that of the savings allowance. In addition, both allowances would operate in the same way – this would be simpler for taxpayers and would be less likely to result in errors. Further, the operation of

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[2] According to HMRC's Policy Paper, published on 9 December 2015, around 1.4 million individuals are expected to still have some tax to pay on their savings income following the introduction of the savings allowance. There is no indication as to how many will face a new reporting obligation as a result of the changes. https://www.gov.uk/government/publications/income-tax-personal-savings-allowance/income-tax-personal-savings-allowance

[3] One allowance amount, and then different rates of tax on amounts of savings income exceeding that allowance, according to the tax band.

the dividend allowance does not produce the arbitrary and arguably unfair results produced by the savings allowance. Alternatively, there could be a taper, which could operate along the lines of that for the removal of the personal allowance for those with income in excess of £100,000.[4] This would be less satisfactory, as it would introduce additional complexity.

3.4 The difference between the savings allowance and the dividend allowance is likely to cause confusion. While we are pleased that low income individuals may be eligible for both of these allowances, the fact that they operate in such different ways is extremely unhelpful. It will be essential for guidance to include examples that show the operation and interaction of the savings allowance and the dividend allowance.

3.5 While we are pleased that low income individuals may be eligible for both the starting rate for savings and the personal savings allowance, their co-existence is nevertheless another source of complexity. Taxpayers will likely struggle to understand the order of priority of the different nil rates, and in addition, the fact that they operate in different ways will lead to further confusion. Therefore we call on HMRC to include examples in their guidance that show the interaction and operation of both the starting rate for savings and the savings allowance.

3.6 It appears that the savings allowance will not be available to personal representatives or executors of estates in administration. Currently, HMRC do not require the completion of a tax return for certain estates in administration – the main criterion being that the tax liability must not exceed £10,000.[5] The cessation of the deduction of income tax at source from bank and building society savings interest may result in some personal representatives facing an increased compliance burden, for example where the basic rate tax deducted at source previously satisfied all the tax liability in respect of savings income. Together, the ending of the deduction of tax at source from interest and the abolition of the dividend tax credit may mean there is an argument for considering an increase in the figure for informal settlement, with a view to minimising compliance costs for estates with small tax liabilities.

3.7 We think that it is unfortunate that the word "personal" has been dropped and that the allowance is now being referred to as the savings allowance – this creates potential for confusion with Individual Savings Accounts (ISA) and Self Assessment (SA).

3.8 It is notable that the savings allowance does not operate as a typical allowance. It is a nil rate band of tax that does not extend the basic or higher rate bands. It would be more transparent and simpler to term it a zero tax band rather than describing it misleadingly as an allowance.

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[4] For every £2 excess over the basic rate limit, you would taper back the allowance by £1, until down to £500. Likewise, the taper could reduce the allowance from £500 to zero for income exceeding the higher rate threshold.

[5] http://www.hmrc.gov.uk/manuals/tsemmanual/tsem7410.htm

3.9 Given the points made above with regards to confusion and complexity, clear guidance and good communications are essential. We call on HMRC to ensure that clear guidance is made available and also that there is sufficient publicity to draw people's attention to the changes, to ensure that individuals understand the savings allowance. It is essential that HMRC help individuals to understand whether or not they are eligible for the savings allowance (and if so what amount), what type of income is eligible for the allowance, how much of their savings income falls within the savings allowance and how much is liable to tax, and how much tax they have already paid on their savings income. In addition, HMRC will need to ensure there is clear publicity on how to calculate and pay any additional tax liability and, where appropriate, how to claim a tax refund. It would be ideal if this could include worked examples and also calculators. As the changes to the taxation of savings income may result in some low-income, unrepresented individuals having to enter self assessment for the first time, it is essential that HMRC raise awareness about the need to notify HMRC of untaxed, taxable income. Finally, it is essential that such information is available in hard copy format as well as online, as many of those on low incomes who will benefit from these measures are digitally excluded.

4 Comments on draft legislation

4.1 *Savings allowance, and savings nil rate etc.*

4.1.1 Clause 1 sets out amendments to the Income tax Act 2007 (ITA 2007) and proposes new sections 12A and 12B. Sub-section (5) of section 12B gives the Treasury the power to change the amount of the savings allowance to which an individual is entitled at any time before the end of the tax year in which they will have effect. We are not in favour of such a retroactive provision, as this will reduce certainty for taxpayers. We suggest that this should be amended such that the regulation has to be made prior to the start of a tax year. We welcome sub-section (6), requiring Parliamentary approval for any regulations that would reduce the amounts of the savings allowance.

4.1.2 The method for transition from one allowance level to the other as set out in the draft legislation is slightly different, depending on whether the transition is from the £1,000 to the £500 allowance or from the £500 allowance to no allowance. Draft clause 12B (8)(a) does not contain a sub-clause equivalent to draft clause 12B (8)(b)(ii). It may be that this is an oversight. If not, it seems to add further complexity for no apparent reason. We request clarification on this point.

4.2 *Deduction of income tax at source*

4.2.1 We have no comments on the draft legislation.

LITRG
3 February 2016