Low Incomes Tax Reform Group.

A voice for the unrepresented.

HM Revenue & Customs Call for Evidence
Individual Savings Accounts: Compliance and Penalties
Response from the Low Incomes Tax Reform Group (LITRG)

1 Comments

1.1 We welcome the opportunity to respond briefly to this call for evidence. Our comments are made on behalf of ISA investors who are not in a position to afford tax advice or who are perhaps not accustomed to seeking tax advice if they are usually a PAYE taxpayer.

1.2 With the aim of demonstrating that HMRC need to take care when looking at how enforcement of ISA compliance should be approached, we begin (in paragraphs 1.3 to 1.5) by giving some examples of how people might come to hold ISA investments without necessarily being fully conversant with ISA rules. Such lack of knowledge could lead to inadvertent non-compliance by investors.

1.3 The taxation of savings income for low-income taxpayers can be complicated, perhaps even more so than for taxpayers higher up the income distribution. This is because of the existence of three separate 'allowances'[1] which may be used against savings income: the personal allowance, the nil-rate starting rate for savings, and the personal savings allowance. If a taxpayer has dividend income,

[1] We use the term 'allowance' in a broad sense, although strictly the starting rate for savings and personal savings allowances are nil rate bands of tax.

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then the dividend allowance is also relevant. All these allowances operate in different ways and the way they interact can be confusing.[1]

1.4 Investing in an ISA offers the attraction of avoiding these complexities – even if no tax may be payable were that investment made outside of an ISA. Furthermore, prior to the introduction of the personal savings allowance in April 2016, when just £1 of savings income outside a tax-free wrapper could potentially have generated a tax liability, ISAs offered a more obvious tax incentive and thus taxpayers may have been inclined to open one as their primary savings vehicle. Status quo bias means these taxpayers may have retained these ISAs, and the habit of investing in them, even after April 2016 when non-ISA investments may have offered better savings rates without generating a tax liability. We think this is likely to be especially true of unrepresented taxpayers.

1.5 Furthermore, those who have apparently 'significant' savings and investments may still be on a 'low' income if the savings are their only or main source of income (as is the case for some retirees, for example). For these reasons, ISAs remain important for this population.

1.6 In addition, there may be people who are unaccustomed to taking tax or financial advice who hold Junior ISA savings for minor children. These might have been converted from Child Trust Funds (the last of which were opened in 2011)[2] or opened to save gifts from family members, for example.

1.7 The above groups of people may not be aware of the tax compliance obligations on their ISA provider, nor the consequences of failures. And – as the call for evidence acknowledges – the investor has no control over the ISA manager's compliance with the ISA regulations. It therefore seems right to ensure that the ISA managers themselves suffer the consequences of such non-compliance rather than the investor (in the form of the ISA becoming void).

1.8 We therefore agree that ISA managers should have processes in place to ensure compliance with the ISA regulations, and that any penalty regime needs to be an effective deterrent. This may also be accompanied by some kind of publicity so that investors are made aware of the failures of ISA managers. Not only might this offer some warning for potential investors against choosing an ISA manager with whom their ISA might become void, but it would also offer additional market incentive for ISA managers to ensure compliance.

1.9 Turning to investor compliance and particularly question 16 of the call for evidence, we are not convinced of the merits of HMRC applying charges directly to investors when there has been no loss of tax, except perhaps in rare cases as discussed below. Raising penalties where there is no loss of tax is not consistent with the tax penalty regime which applies more generally to individuals, nor with the statement on page 7 of the call for evidence: 'Clearly any penalty should reflect the tax that would have potentially been paid if the ISA was voided…'. In the majority of cases, it may be sufficient for the ISA to be treated as void in cases of investor non-compliance.

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[1] We publish guidance aimed at low-income taxpayers here: https://www.litrg.org.uk/tax-guides/savers-property-owners-and-other-tax-issues/savings-and-tax. See the example of *Eric*.

[2] https://www.gov.uk/child-trust-funds

1.10 The issue of appropriate penalties for investor non-compliance particularly needs to take into account the possible background to failures and the behaviour of the investor (and here, as above, we might draw an analogy with other penalties for tax compliance failures which are behaviour-based).

1.11 For example, as it is possible to have both cash and stocks and shares ISAs in a single tax year,[1] it is not necessarily immediately obvious to the investor what has been subscribed to each – both products have to be checked and totalled together. It is easy to envisage, for example, how the Junior ISA subscription limit might be unintentionally breached if family members have been given the account details and are able to directly deposit funds without this necessarily being immediately obvious to the accountholder (the child's parent or legal guardian)[2].

1.12 Similarly, the rule around tax residence might be unwittingly breached. For instance, it may not be possible at the time of making the ISA subscription to determine an individual's tax residence status for the tax year as a whole. Further, in some cases, the complexity of the Statutory Residence Test means that unrepresented taxpayers might easily get their residence status wrong.

1.13 Given this background, it seems probable that at least some (and possibly a great many) investor failures will simply result from ignorance or misunderstanding, for which a penalty as a deterrent is no solution. An educational approach would possibly be more appropriate in the first instance rather than the 'warning' referred to at the top of page 11 of the call for evidence. In limited circumstances, where there was evidence of an investor deliberately/repeatedly ignoring the rules, a financial penalty might be appropriate. This should, however, be accompanied by a statutory right of appeal.

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 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.

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[1] https://www.moneyhelper.org.uk/en/savings/types-of-savings/isas-and-other-tax-efficient-ways-to-save-or-invest

[2] https://www.moneyhelper.org.uk/en/savings/types-of-savings/junior-isas#:~:text=A%20child's%20parent%20or%20legal,apart%20from%20in%20exceptional%20circumstances.

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.

LITRG
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