A savings tax review

The way savings are taxed is being reviewed by the Office of Tax Simplification (OTS).

The OTS is looking at the way in which savings and investment income is taxed, which can be very complicated. According to its paper, published in May 2018, "the interactions between the [tax] rates and allowances is sufficiently complex at the margins that HMRC's self-assessment computer software has sometimes failed to get it right".

The complex marginal rules mean that, "many taxpayers continue to worry about the tax treatment of their savings income even when they do not in fact have anything further to pay, and there are also many specific complexities which taxpayers find difficult and confusing".

To make matters worse, the OTS also found that 95% of people do not pay tax on savings income, thanks to a combination of the personal savings allowance (£1,000 for basic rate taxpayers and £500 for higher rate taxpayers) and the dividend allowance (£2,000).

The OTS paper makes a range of recommendations, including:

- Changing the personal savings allowance and dividend allowance into genuine allowances. They are currently misunderstood nil tax rate bands.
- Increasing the flexibility of ISAs by removing some of the rules about in-year subscriptions and transfers.
- Reviewing the early withdrawal penalty on Lifetime ISAs which have experienced "slower than predicted" uptake.
- Reviewing the use of emergency tax codes for lump sum pension withdrawals. The system generally results in an overpayment of tax and the need for a subsequent reclaim. Around £37 million of overpayments have been returned to date.
- Ending the differential tax rates for dividends (7.5% at basic rate, 32.5% at higher rate and 38.1% at additional rate), to bring them in line with other tax rates on savings.

We can expect to hear more, probably including the announcement of a formal Treasury consultation document, in the Autumn Budget. In anticipation of this, the OTS has already made the plea that, "it is important not to make piecemeal changes, which risk adding further layers of complexity".

In the meantime, if the tax treatment of your own savings and investments is concerning you, do talk to us. Remember, even HMRC struggle to get it right.

The value of tax reliefs depends on your individual circumstances.

Tax laws can change.

The Financial Conduct Authority does not regulate tax advice.