

# Introduction

This report was delivered in February 2009, the core data and analysis relates to the 2007/08 tax year and was correct at the time of publishing.

This is the latest edition of IFA Promotion's annual investigation into the ways in which the returns from savings and investments could be increased by using allowances available from the tax system. Since the first report was produced there has been a shift in responsibility for the management of personal tax away from HMRC to the individual. This shift has moved beyond self assessment which has been steadily bringing more and more individuals into its net and now includes tax credits which require the individual to apply for a tax rebate or an additional allowance to reduce their tax liability. The potential losses to the tax system, which once only placed the higher net worth individuals at risk of paying too much tax, now also places the lower earners at risk of paying unnecessary income tax.

This year has seen a major shake for the tax system as political events have taken more of a central stage, with the government being forced into a number of dramatic reversals of their tax plans as the decline in the state of the economy places pressure on both the individual and corporate tax payer. The proportion of income used to pay our tax liability has increased to its highest levels since the 1980's while increasing pressure from the fall out of the credit crunch has further added to the pressure on incomes. The report examines the ways an individual taxpayer could increase the value of gifts and bequests made as well as income from employment and investment/savings, it also highlights some of the allowances available to parents and their working partners. The estimated number of individuals who could share in these savings will be shown, as will the approximate savings by region.

Two distinct categories of waste have been identified and for the purpose of this report have been identified as:

- \* Error waste refers to that tax, which is only paid as a result of consumers' error or omission - much of this can be reclaimed, once the individual has identified the waste.
- \* Avoidable waste is our estimate of that tax which individuals would save if they made changes to the way in which they manage their finances. Savings can either be made by simply changing the product used to a more tax efficient alternative or by changing the way in which the money is managed.

We add these waste areas together and show a total of the possible wastes. However, it should be noted that not all of them would realistically apply in full and at once, even to those who would be regarded as High Net Worth Individuals.

The number of ordinary individuals involved is very large; RAKM estimates that almost every adult has a potential tax waste. In most individual cases, the annual sums are in tens or low hundreds of pounds rather than more, but important to the individuals concerned, and in many cases more than they may gain from the changes in personal allowance announced in the budget tax changes. The document is not a guide to esoteric tax-dodges aimed at the rich in order to shelter their wealth; it is an indication of the ways ordinary taxpayers lose out, to the extent that many of the waste headings discussed will apply to millions of individuals.

# Headline results; the wasted tax totals

The analysis is largely based on information published by the HMRC - the main source for tax matters - combined with analysis from other sources. Among these are analysis of data collected for the Family Resource Survey carried out for the Department for Work and Pensions.

This document is not a technical guide. We give details of the kind of individuals to whom each type of waste is likely to apply, although most ways of eliminating waste are subject to conditions hence, the report is a commentary not a handbook. **An individual's tax position comes out of the details of their own personal situation and what may seem to apply to a category of individuals may not be appropriate for all individuals within it. No statement within the document constitutes a recommendation for any particular investment or course of action.**

## Abbreviations

<b>AVC</b>	Additional Voluntary Contributions
<b>BMRB</b>	British Market Research Bureau
<b>CAF</b>	Charities' Aid Foundation
<b>CGT</b>	Capital Gains Tax
<b>CRT</b>	Composite Rate Tax
<b>CTC</b>	Children's Tax Credit
<b>CTF</b>	Child Trust Fund
<b>DWP</b>	Department for Work and Pensions
<b>FRS</b>	Family Resource Survey
<b>FSAVC</b>	Free Standing Additional Voluntary Contribution
<b>HMRC</b>	Her Majesties Revenue & Customs
<b>IFAP</b>	Independent Financial Adviser Promotion Ltd
<b>IHT</b>	Inheritance Tax
<b>IR</b>	HMRC
<b>ISA</b>	Individual Savings Account
<b>NS</b>	National Savings
<b>NSSR</b>	National Savings Stock Register
<b>PAYE</b>	Pay As You Earn
<b>PEP</b>	Personal Equity Plan
<b>PRP</b>	Profit-Related Pay
<b>SERPS</b>	State Earnings-Related Pension Scheme
<b>TDSI</b>	Tax deduction Scheme for interest
<b>TESSA</b>	Tax-Exempt Special Savings Account
<b>UCITS</b>	Undertaking for Collective Investments in Transferable Securities

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# Headline results; the wasted tax totals

		Error	Avoidable	Total
		£m	£m	£m
1	Tax & personal allowances	310	39	349
2	ISA's	109	35	144
3	Gilts/National Savings	35	105	140
4	Capital Gains Tax*	-	309	309
5	Charities and gifts	543	599	1,142
6	Pensions	-	720	720
7	Inheritance	324	1,912	2,236
8	Self assessment	319	184	503
9	Share Incentive Plans	-	171	171
10	Tax Credits	4,235	-	4,235
11	Childs Trust Fund	63	-	63
<b>Totals</b>		<b>5,938</b>	<b>4,074</b>	<b>10,012</b>

\* CGT error could be mitigated, but only by action before disposal  
Source: RAKM for IFA Promotion

# Headline results; the wasted tax totals

	Error	Avoidable	Total
	£m	£m	£m
Greater London	856	571	1427
Rest of South East	822	596	1418
East Anglia	551	324	875
South West	534	298	833
Wales	279	202	481
East Midlands	435	278	713
West Midlands	481	393	874
North West	563	405	968
Yorks/Humberside	515	315	830
North	260	140	400
Scotland	472	433	903
Northern Ireland	168	122	290
Totals (rounded)	5,938	4,074	10,012

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Note: figures may not always add up to the totals owing to the effect of rounding of underlying amounts and percentages

Source: RAKM for IFA Promotion

# Headline results; the wasted tax totals

## Tax waste per person by region

### Waste per head, by region, 2009

Base: adults

	Tax wasters region m	population that waste tax %	Waste per taxpayer £
Greater London	6.7	89	213
South East	7.5	90	189
East of England	5.0	88	175
South West	4.6	89	181
Wales	2.6	87	185
East Midlands	3.6	81	198
West Midlands	4.6	85	190
North West	5.9	86	164
Yorks/Humberside	4.3	84	193
North	2.2	87	182
Scotland	4.3	84	210
Northern Ireland	1.4	80	207
<b>Totals</b>	<b>52.4</b>	<b>86</b>	<b>191</b>

Note: sums are quoted with precision but there is some rounding of underlying amounts and percentages, which render them, approximate; they may not always add to totals due to the effect of this rounding

Source: RAKM for IFA Promotion

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# TAX AND PERSONAL ALLOWANCES

## Tax Legislation

- Every Individual has an entitlement to earn a certain amount of their income free of tax, their personal allowance.

**Figure 1** Income tax personal allowance amounts, 2004/05 –2009/10

	2005/06	2006/07	2007/08	2008/09		2009/10
	£	£	£	£	£*	£
Personal allowance	4,895	5,035	5,225	5,435	6,035	6,475
<b>Age allowances</b>						
Personal (age 65-74)	7,090	7,280	7,550	9,030	n/c	9,490
Personal (age 75+)	7,220	7,420	7,690	9,180	n/c	9,640
Married couple's (one born before 06/04/1935 but aged under 75)	5,905	6,065	6,285	6,535	n/c	No longer applicable
Married couple's (either 75+)	5,975	6,135	6,365	6,625	n/c	6,965

\*Revised 13/05/08

## Child Tax Credit

	2006/07	2007/08	2008/09	2009/10
	£ per year	£ per year	£ per year	£ per year
Family element <sup>1</sup>	545.00	545.00	545.00	545.00
Family element, baby addition <sup>(1)</sup>	545.00	545.00	545.00	545.00
Child element <sup>(2)</sup>	1,765.00	1,850.00	2,085.00	2,235.00
Disabled child additional element <sup>(2)</sup>	2,350.00	2,440.00	2,540.00	2,670.00
Enhanced disabled child additional element <sup>(2)</sup>	945.00	980.00	1,020.00	1,075.00

## Notes

1. Only one family element is available per family. Families are entitled to the family element and the baby addition in the first year of a child's life.

2. As well as one family element, a family will be entitled to a child element for each child for whom it has responsibility. For each child, the child elements which are appropriate may be added together to arrive at the maximum amount available for that child.

Source: HMRC

# TAX AND PERSONAL ALLOWANCES

- Individual's may receive many different types of income but not all types are taxable. The main types of income which tax may be payable are:
  - ♦ Income from employment
  - ♦ Profits from Business
  - ♦ Occupational pensions
  - ♦ Interest from building societies and banks
  - ♦ Dividends from shares
  - ♦ Income from property
  - ♦ Some social security benefits (retirement pension, jobseekers allowance and incapacity benefit.)
  - ♦ Some national savings products
- An individual's taxable income is calculated by adding together all of their sources of liable income and then subtracting any allowances and relief's that are available to the individual. The net amount is then subject to income tax, with; basic rate (20%) being applied to taxable income of £1 to £37,400; and higher rate (40%) being applied to taxable income of £37,401+. However, the calculations have been complicated by the provision of a 10% band for savings income only, with a limit £2,320, after which basic rate tax will be applicable, if an individual's non-savings income is above this limit then the 10% savings rate will not be applicable.
- In addition to an individual's personal allowance there is an allowance available to married couples. For the majority of tax payers this allowance has been phased out, being replaced with the Children's Tax Credit from April 2001 (which in turn has been superseded by the Childs tax credit and Working tax credit from April 2003) . However, married couples with one member born before 6<sup>th</sup> April 1935 will still receive a married persons allowance (see Fig 1).
- Married persons allowance reduces tax liability by 10% at the starting and basic rate.

## Income Tax Collected

- The majority of income tax is collected directly from individuals' wages through PAYE.

# TAX AND PERSONAL ALLOWANCES

- Self-assessment now generates over 13% of net personal income taxes and has all but replaced assessed income tax. The potential waste associated with Self-assessment is dealt with in greater detail later in this document.

**Figure 2** Income tax; gross receipts by source of income, 2003/04- 2007/08

	2003/04	2004/05	2005/06	2006/07	2007/08	% change
	£m	£m	£m	£m	£m	2003/08
PAYE*	107,381	114,992	113,894	124,799	126,760	+18.0
Assessed income tax	183	194	174	173	208	+13.7
Self assessment**	15,772	17,141	18,077	20,306	22,443	+42.3
Tax deduction scheme for interest (TDSI)	2,092	2,266	2,969	3,124	4,134	+97.6
Other tax deducted at source	1,081	1,188	1,400	1,744	1,564	+44.7
Other receipts	2,637	2,645	3,416	3,290	2,603	-1.3
<b>Total receipts</b>	<b>123,153</b>	<b>132,137</b>	<b>139,930</b>	<b>153,435</b>	<b>157,712</b>	<b>+28.1</b>
Repayments other than self assessment	-9,185	-9,213	-9,213	-10,108	-10,388	+13.1
<b>Total net receipts</b>	<b>113,968</b>	<b>122,924</b>	<b>130,480</b>	<b>143,327</b>	<b>147,327</b>	<b>+29.3</b>

\* net of tax credits

\*\* net of repayments following analysis of individuals returns

Source: HMRC Statistics/RAKM for IFA Promotion

- From 1996/97, banks and building societies deduct tax (at the rate of 10% for the first £2,230 of income from savings and 20% from income over this amount of taxable income) from interest paid on accounts held with them (TDSI) unless the investor is not liable to pay tax and has registered to receive interest gross. Higher rate taxpayers, however have to declare interest earned and face an additional tax charge on all liable savings interest. However, from the tax year 2008/09 the 10% rate for savings would only apply as long as non savings income did not exceed the limit; if other income exceed the 10% band limit the savings rate would not apply and all savings income would be taxed at the basic rate of 20%.

# TAX AND PERSONAL ALLOWANCES

- Account holders not liable to tax who have not registered this fact, and those who have had more tax deducted than they are due to pay (i.e. their incomes less personal allowance produces only a small taxable charge that is less than the tax taken from their interest), can claim a repayment from the HMRC of the excess tax deducted. Form R85 is used to claim interest gross from a bank or building society and a separate form must be used for each institution/branch that holds an account that is liable for tax on interest paid.

## Tax Payers

**Figure 3** Numbers of income taxpayers, 1989/90-2008/09

	Individuals	Males	Females	Higher rates
	000	000	000	000
1990/91	26,100	15,400	10,700	1,700
1996/97	25,700	14,900	10,800	2,080
1997/98	26,200	15,200	11,000	2,120
1998/99	26,900	15,600	11,300	2,350
1999/00	27,000	15,500	11,700	2,480
2000/01	29,300	16,900	12,400	2,880
2001/02	28,600	16,400	12,200	3,000
2002/03	28,900	16,500	12,400	3,040
2003/04	28,500	16,100	12,400	2,960
2004/05	30,300	17,000	13,300	3,330
2005/06 (prov)	31,100	17,600	13,500	3,590
2006/07 (prov)	31,500	17,800	13,700	3,770
2007/08 (est)	31,900	18,000	13,900	3,870
2008/09 (est)	30,600	17,500	13,100	3,640
Change 1990/91 2008/09	+17.2	+13.6	+22.4	+114.1

Source: HMRC Statistics/RAKM for IFA Promotion

- The average income tax liability for 2008/09 is estimated to be £ 4,535; this compares with an average income tax liability of £2,139 in 1989/90, an increase of 97.3%.

# TAX AND PERSONAL ALLOWANCES

- The total number of taxpayers has increased by over 21%, while the tax liability has increased by over 193% since 1989/90. The increase in the number of higher rate taxpayers is a reflection of the increase in the average earnings and the tendency of the government to increase personal allowances in line with the RPI rather than the Average Earnings Index.

## Calculating the waste

- The overpayment of any tax is unnecessary.
- The failure to reclaim tax that has been deducted erroneously because of the non-completion of a form can be quickly rectified. HMRC, used to run a special publicity campaign during November "taxback week", the last week run in 2000 estimated that there was approximately £300 million due to be claimed under the R85 form scheme. We believe that since this campaign has been dropped the amount available will have increased, although only slightly, to **£310 million**. This we describe as an **error waste**. Tax overpaid in the previous 5 years can also be reclaimed from the HMRC using form R40(2000); examples of how "taxback" works are found in [http://www.inlandrevenue.gov.uk/taxback/examples01\\_02.htm](http://www.inlandrevenue.gov.uk/taxback/examples01_02.htm)
- The transfer of assets between partners subject to different tax rates can also result in the reduction of tax liability and therefore recover an overpayment. The rules for married persons allowance makes such transfers between members of couples with an individual born before 6<sup>th</sup> April 1935 more beneficial.
- If only one partner in a marriage is a non-taxpayer/pays a lower rate than the other, they should consider whether any income from sources other than employment could be redistributed by transferring the title of the underlying asset. If savings generating interest are held by the higher-earner, this is taxed at that partner's rate while the other would pay less, or no tax on the same income. This obviously has more important where one partner is liable to be taxed at 40% and the other only liable to be taxed at 20% or nothing, however, the change in the treatment of savings interest have also added a further dimension to this equation as a non-taxpaying partner could still take advantage of the marginal savers rate of 10% on earnings between the upper

# TAX AND PERSONAL ALLOWANCES

limit of their personal allowance and the £2,440 savings limit. (Personal allowance of £6,475 [aged under 65] with no tax liability from any income and £6,476 to £8,915 from savings income as long as there is no other income e.g. employment or pension.)

**Figure 4** Non-taxpaying partners in households liable to tax at basic and higher rates, 2009/2010

	No 000	% of all adults
Aged under 65, income £6,475 or less; household income £15,390	1,353	2.7
Aged 65+ income £9,490 max, household income £21,420+	426	0.9
Aged 65+ income £9,640 max, married income £21,720 (one partner born before 06/04/1935)	64	0.1

Source: ONS/DWP, FRS/RAKM for IFA Promotion

- The Bank of England shows time deposits of £709 billion held by non-businesses (households).
- The average deposits held by individuals are £13,451.
- If two thirds of this was transferred to a non tax-paying partner (£8,967) and invested in an instant access account paying 1.85% gross a saving of £29 in tax could be made if income tax was paid at 40%.
- In the lower-interest rate environment that now exists, we believe that most of the 1.35 million non-taxpaying partners in higher-income households would be able to have an extra slice of savings income in their own name, entirely tax-free, and thus save some **£39 million in tax**. We class it all as avoidable since it would require a gift between partners.

# INDIVIDUAL SAVINGS ACCOUNTS

## Tax Legislation

- ISA's were introduced in April 1999 as a replacement for the TESSA and PEP, which ceased to be available to new investors.
- ISA's allow tax favoured investments and savings to be made in three main areas:
  - Cash
  - Stocks and Shares (including Unit Trusts, Investment Trusts and UCITS)
- As with its predecessors the ISA has annual limits for overall investment but has the additional restriction that limits annual investments into Cash deposits and Life insurance policies.
- The investment limits for the initial year of ISA's (1999/2000) are:
  - Overall £7,000
  - Cash £3,000
- Unused investment allowances may not be carried over into subsequent years.
- There are two types of ISA wrapper; the maxi ISA that requires all money to be placed with a single provider who may offer only stocks and shares based investment or a combination of the three ISA elements. The second wrapper is the mini ISA that allows separate providers to be used to supply each of the three ISA elements.

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## Value of Market

- In addition to new funds invested in ISA funds, funds are still held in PEPs. PEP's may be held indefinitely.

# INDIVIDUAL SAVINGS ACCOUNTS

**Figure 5** The number of ISA's and the value of investments made each year, 2000 and 2008

	No. of accounts		Stocks and Shares		Cash		All elements		Average investment	
	000		£m		£m		£m		£	
Mini ISA	04/00	04/08	04/00	04/08	04/00	04/08	04/00	04/08	04/00	04/08
Stocks and shares	1,278	1,662	1,587	2,904	-	-	1,587	2,904	1,240	1,750
Cash	4,591	11,468	-	-	11,575	25,204	11,575	25,204	2,520	2,200
Total	5,985	13,130	1,587	2,904	11,575	25,204	13,218	28,107	-	-
Maxi ISA	3,293	1,584	14,467	7,535	731	57	15,213	7,592	4,620	4,810
Total	9,278	14,714	16,054	10,438	12,306	25,261	28,431	35,699	-	-

Totals may not agree because of rounding

Source: HMRC/RAKM for IFA Promotion

- The number of ISA's have continued to grow with the numbers of mini ISA's subscribed in 2006/07 almost double those seen in April 2000, the number of new maxi ISA's subscriptions has fallen by nearly half, although the average subscriptions, in stocks and shares are slightly higher than those recorded in 2000, while average investments in cash ISA's are down by almost 14% compared with those seen in April 2000.

## Calculating the Waste

- ISA accounts investments as at 5<sup>th</sup> April 2008 are provisionally valued at £35.7bn a net increase of £2.7bn on the year.
- Data gathered by DWP on the ownership of equities, deposit and savings accounts suggest that approximately 4.7 million adults held bank or building society savings accounts and stocks and shares but no ISA's. The same research showed that only an estimated 980,000 adults held a PEP, and an ISA.

# INDIVIDUAL SAVINGS ACCOUNTS

- Further analysis of the Family Resource Survey data shows that some 6.2 million adults held a savings or deposit account, and no ISA. Over 4.6 million of these savers are estimated to have added to their accounts during the financial year.
- Some 1.7 million taxpaying adults hold equities, but no ISA. Of those investors 128,000 are estimated to have increased their investment in the previous year.
- The Bank of England recorded additions to savings of £45.3 billion pounds in the 12 months to December 2008, an average of £4,925 per individual saver (based on the estimate of 9.2 million individuals increasing their savings). If £2,000 had been invested in cash ISAs returning 2.1% (source: Bank of England) per annum, the average saving in tax would be £11.80 per investor, giving a total of **£108 million error waste**.
- Investment in equities has fallen over the past 12 months as a result of very volatile markets. A large proportion of the remaining activity has been speculative and as such the ISA is not a suitable product for such investment. There is, however, a large proportion of investment made for the long term, which could be effectively wrapped up in an ISA.
- Using the same formula that we originally developed for PEP's, an investment of half the maximum (£3,500) into a maxi ISA would produce a notional average return of 3% which would be subject to an estimated average tax charge of 18.0% (outside the ISA Wrapper) generating a saving of £31.33 per individual. ( $£3,500 @ 5\% = £105.00$  taxed at 18.0% = £18.90) If 60% all who had added to their shareholdings last year made the decision to use an ISA this year the waste would be:  $£18.90 \times 76,800$  or **£1 Million error waste**.
- If the other 1.6 million holders of shares outside ISA's took the decision to transfer an average of £4,000 of their holdings into an ISA, the tax saving generated would be £22 per head ( $£4,000 @ 3\% = £120$  taxed at 18.0% = £22), which is equivalent to **£ 35 million avoidable waste**.

# GILTS/NATIONAL SAVINGS

## Tax Legislation

- Investments in Savings Certificates, Children's Bonus Bonds, and Yearly Plan certificates are exempt from income and capital gains tax, as are Premium Bond prizes.
- Most NS products; namely Capital Bonds; Income Bonds; Investment Account; the Pensioners Bond; as well as Gilts on the National Savings Stock Register all pay interest gross, but are subject to tax.
- Interest on the NS Ordinary Account is subject to tax, although the first £70 per holder (£140 for a couple) is exempt. The First Option Bond follows the pattern of other deposits, in that interest is paid after tax at basic rate, subject to self-certification permitting gross payment and top-ups from high rate taxpayers.

**Figure 6** Estimated cost of exemptions on National Savings returns, 2000/01-2008/09

	2001/02	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
	£m	£m	£m	£m	£m	£m	£m
NS certificates	170	120	120	110	150	170	170
Premium Bond prizes	110	150	150	170	210	280	270
Save As You Earn	30	20	20	20	20	n/a	n/a
<b>Total</b>	<b>310</b>	<b>290</b>	<b>290</b>	<b>300</b>	<b>370</b>	<b>450</b>	<b>440</b>

Source: HMRC Statistics/RAKM for IFA Promotion

- Gilts other than on the NSSR (those normally bought and sold through stockbrokers) are potential sources of error/waste by those not reclaiming all of their tax allowance.

## Individuals Incurring Waste

- Detailed owner profiles are not available for all NS products. We have grouped those, which are available by their broad tax treatment.

# GILTS/NATIONAL SAVINGS

**Figure 7** National Savings product holders by probable tax status, 2008/09

	Premium Bonds	National savings Bonds
	%	%
All	23	3
Non-taxpayers	15	3
Basic rate	22	3
Higher rate	31	4

Source: FRS, DWP/RAKM/RAKM for IFA Promotion

- There are in excess of 750,000 individuals whose tax position indicates that they may be losing out by using exempt products. The numbers of non- (or starting rate) taxpayers who may be losing out by not reclaiming tax paid on the interest on Gilts and Capital Bonds cannot be calculated with precision but is most unlikely to have reduced by a larger margin than other un-reclaimed deposit waste.

## Calculating the Waste

- The same basic assumptions that apply to the other savings related calculations apply to Gilts and National Savings. However, the returns offered by these products reflect the need of the Government for liquidity rather than the performance of the underlying financial markets; as such, returns may be less volatile than those that can be obtained from other institutions.
- Analysis of the ownership data derived from the Family Resource Survey and detailed in Figure 7, shows over one million non taxpayers holding exempt national savings products, money that could be reinvested elsewhere to produce a higher return. Similarly over a million tax payers are holding on to products which pay interest gross and therefore require a payment of tax due to the revenue.
- We estimate that in the current environment some **£35 million error waste** is generated by overpaid tax (this as always is a very tentative estimate of the situation), with a further **£105 million avoidable waste** being generated through the use of products that are inappropriate for their tax status.

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# CAPITAL GAINS TAX

## Tax Legislation

- Capital Gains Tax like Inheritance tax (covered elsewhere in this document) is a tax charge that arises from the disposal of assets. CGT has some features in common with income tax; it is charged on the profits made, Until the financial year 2008/09 profit was calculated after indexation for periods between 1982 and April 1998, and a taper relief for profits accrued after April 1998. These allowances were designed to eliminate the effect of inflation enabling individuals to offset any actual losses against profit made.
- From the new tax year capital gains tax will be charged at a flat rate of 18% but each individual may have some gains (£9,600 in 2008/09) free of tax. In addition individuals will be entitled to a reduced rate of CGT resulting from a gain made on the disposal or part disposal of a business of up to £1million. The rate of tax charged on this gain is set at 10% (calculated as 5/9ths of the flat rate).
- At present the assessment and collection of CGT is based on a calendar at some variance with income and other taxes; it works according to a collection year to October, after taxpayers have declared gains to 5 April of that year, usually in their tax return.

# CAPITALS GAINS TAX

## What is the value of CGT

- In 2006/07, 225,000 individuals paid CGT on profits above their exemption amounting to £4,541 million; paying an average tax of over £20,182 each.

**Figure 8** CGT charged to individuals on disposals 1988-2007

	Number	Gains	Tax
	000	£m	£m
1988/89	135	5,366	1,637
1989/90	127	4,832	1,495
1990/91	96	2,912	869
1991/92	75	2,634	804
1992/93	60	1,885	539
1993/94	77	2,740	809
1994/95	64	2,212	651
1995/96	86	3,131	890
1996/97	97	3,902	1,205
1997/98	142	5,444	1,657
1998/99	135	5,958	1,936
1999/00	185	8,761	2,821
2000/01	178	7,732	2,425
2001/02	122	4,556	1,324
2002/03	133	6,588	2,052
2003/04	153	6,869	2,037
2004/05 (provisional)	175	8,786	2,656
2005/06 (provisional)	197	11,085	3,432
2006/07 (provisional)	225	14,354	4,541

Source: HMRC/RAKM for IFA Promotion

## Calculating the Waste

- It is likely to be true that a professional adviser who is acting as intermediary between individuals and the revenue will carry out the majority of calculations.

# CAPITALS GAINS TAX

**Figure 9** CGT; Assets giving rise to CGT, 2002/03 and 2005/06

	Disposal numbers		Disposal values		Chargeable net gain		Net chargeable gain as % of disposal	
	%		%		%		%	
	02/03	05/06	02/03	05/06	02/03	05/06	02/03	05/06
UK listed shares	48	44	13	12	9	9	42	39
Fixed interest investments	2	2	1	1	1	1	48	46
Other shares and securities	24	16	44	11	56	8	73	42
Ordinary shares not listed on the London Stock exchange	-	21	-	36	-	51	-	75
<b>Financial assets total:</b>	<b>73</b>	<b>83</b>	<b>58</b>	<b>60</b>	<b>67</b>	<b>69</b>	<b>66</b>	<b>61</b>
Agricultural property	1	1	2	2	2	3	55	58
Commercial etc property	2	2	5	7	3	5	42	36
Residences (eg let property)	1	10	25	19	15	12	34	33
Other land and buildings	2	1	3	6	2	5	48	40
Antiques, etc, other misc.	5	3	8	6	11	7	72	63
<b>Tangible assets:</b>	<b>27</b>	<b>17</b>	<b>42</b>	<b>40</b>	<b>33</b>	<b>31</b>	<b>48</b>	<b>41</b>

Source: HMRC/RAKM for IFA Promotion

- There may be a small waste involved within married couples, both partners have annual exemptions. We suspect that there is some CGT incurred unnecessarily on disposals by one partner. When it would be perfectly in order for a gift to be made of some of the assets, with the unrealised gain still attached, to the other partner whose exemption may not be used up.
- Shares in ISA's are free of CGT when they are sold. Though, in the context of the tax sums charged, a maximum total ISA investment of £50,000 (not gain), might be thought to make little difference to a wealthy taxpayer, but successive annual ISA investment of £7,000 will allow significant savings.
- Cashing in a £2,000 PEP after ten years, would have saved tax on an average £800 gain, even where the person had no other gains against which to set any of his or her exemption; this would be £176 for the basic rate and £320 for a high rate taxpayer.
- The absolute amount of CGT fluctuates, but in the latest year over £618 million was charged on tradable, and shelterable, stocks and shares. We repeat our

# CAPITALS GAINS TAX

estimate that half of this could have been saved by the systematic use of ISA's and the annual exemption. It cannot be done retrospectively, but individuals may have "wasted" an **avoidable £309 million**.

# CHARITIES AND GIFTS

## Tax Legislation

- Everyday donations to charity (for example in response to a street collection or making a purchase from a charity shop), are generally made in cash and are almost always made from post tax income. The overwhelming responses to the raft of natural disasters that occurred in the 12 months following the Boxing Day Tsunami in the Far East have seen considerably more donated to charities than in previous years, much without the benefit of the additional tax reward that could have been provided through Gift Aid.
- Donations made to registered charities qualify for tax relief, however, these donations must be made through one of the following schemes:
  - Deed of Covenant
  - Gift Aid
  - Payroll giving
  - Inheritance tax relief (covered in later section).
- Deeds of Covenant are legal documents by which an individual or a company agrees to pay a fixed sum to a specific charity each year for a minimum of three years. There are no restrictions on amounts donated by covenants.
- Gift Aid covers larger amounts (the lower limit was reduced from £400 to £250 in 1993 and finally abolished in April 2000).
- Payroll giving (Give as You Earn) asks employees to dedicate a regular sum, taken out of their pay by their employers and given to their own chosen charity/ies via an agency. Schemes may accept amounts ranging from £2.50 per month to a maximum, which rose to £1,200 pa in April 1996, however the upper limit on donations was finally abolished in April 2000.

Details of the amounts given under these various schemes and the amount of tax relief they generate are shown in the appendix of this document.

## Calculating the Waste

- Most of those individuals who do not have large amounts to give or who are not prepared to make a long-term commitment, could still follow a more tax-efficient route.

# CHARITIES AND GIFTS

- Even those who prefer to contribute only one-off amounts, almost on impulse, to charities are "wasting" a further 28% (25% relief plus an additional 3% transitional relief until 2011) of what they give if their contributions add up to the average donation of £287.89 (source: CAF), they could give another £51 at no extra cost.
- The Charities Aid Foundation has been in existence for over 70 years, and now operates fully flexible schemes where consumers set up a "credit balance" (with tax relief added) and then draw against it by means of "cheques"(vouchers) or telephone instructions.
- The waste is only to a small degree incurred by individuals on their own account; that avoidable element is restricted to those paying high rate tax who make gifts and then fail to reclaim the 15% difference between the 25% they have deducted (and charities reclaimed) and the 40% they are taxed
- There is, however, a little-known downside to this; if non-taxpayers make donations in this way then they are liable to pay the 25% back to the Revenue, as it has been reclaimed but not paid in the first place. We believe this liability is rare; few non-taxpayers are in a position to make regular commitment to charities or donate large sums.
- Inheritance Tax does not apply to bequests to charities; the IR estimates that £380 million will be saved in IHT on gross bequests of some £950 million in 2008/09 (IHT is charged at 40%).
- The CAF suggests that if all employees were to become members of payroll schemes contributing up to the former maximum of £1,200 pa, they would force the Exchequer to donate another £4 billion to charities. This is an exaggerated estimate, but it makes a forcible point.
- A realistic amount, we believe, would be for payroll giving to apply to 20% of those identified as working and donating more than £5 per annum. At present average donation amounts (£396; source Charities Aid Foundation), this would multiply the tax refunds to **£310 million** an amount that we classify as **an avoidable Waste**.

# CHARITIES AND GIFTS

- Despite the value of donations through gift aid dropping back to 64% for those giving £1,300+ in 2006/07, we remain convinced, although without firm evidence for this, that with more work to promote public awareness, the amounts for Gift Aid could easily grow by a third of the amount again. This would generate an **avoidable waste of £289 million** more for the charities.
- Research carried out for the CAF and NCVO in 2008 found that 64% of donors who give more than £100 or more per month use Gift Aid to wrap up their donation. This group represent only 8% of all donors to charity – approximately 2.2 million people – yet they donate around 51% of the total amount given, which in 2006/7 was estimated as £10.6 billion. The average donation of this group is £2,457, with approximately 790,000 not taking advantage of gift aid, the waste is **£543 million, which we classify as an Error Waste.**

# PENSIONS

## Tax Regulations

- Amounts paid into approved pension funds - run by employers or individually arranged – currently receive full income tax relief. The investments made are exempt from tax on capital gains in their accumulation. There is no CGT to pay when a personal fund matures and switches to its long-term function, namely providing income at retirement.
- These concessions are granted in return for very strict rules on the amounts that may be paid into a pension and the use which, may be made of the accumulated funds.
- The amount that may be paid by an individual into their occupational pension scheme is limited to 15% of earnings.
- The Finance Act 1989 also placed limits on contributions into Personal Pension Schemes. There is currently an “earnings cap”, (i.e. the level of earnings from which contributions into the scheme attracts tax relief), of £117,600 in 2008/09.
- From 6<sup>th</sup> April 2006 the package of measures known as 'Pension Simplification' was introduced, this shifted the main restrictions on pension contributions from the hitherto complex annual contribution and final benefit limits to two key controls – *the annual allowance and the lifetime allowance*.
  - An individual's combined annual contributions to any of their registered pension schemes on which tax relief will be given are now limited to the lower of 100% of relevant annual earning (or £3,600 if this is higher) and an annual allowance, initially set at £215,000 in 2006-07.
  - A single lifetime allowance (LTA) on the total amount of pension savings that can benefit from tax relief.
- Both the annual allowance and the LTA will be reviewed every four years with limits set for each of the four years. Currently they have been set to 2010-11 and are as follows:

	Annual Allowance	LTA
2007-08	£225,000	£1.6m
2008-09	£235,000	£1.65m
2009-10	£245,000	£1.75m
2010-11	£255,000	£1.8m

# PENSIONS

- Stakeholder pensions were introduced on 6 April 2001, in association with a simple integrated tax regime for personal and stakeholder pension schemes. The main features of this are:
  - contributions are allowed into personal and stakeholder pension schemes up to the higher of £3,600 or the existing income and age related personal pension limits;
  - no link with earnings where contributions are less than £3,600 a year. Contributions in excess of £3,600 allowed by reference to the existing person pensions limits for up to 5 years after earnings have ceased;
  - all contributions by a scheme member to be paid net of basic rate tax. Pension providers will recover tax at the basic rate from the HMRC with the contributor recovering, if appropriate, higher rate tax through their self assessment return;
  - the maximum permitted annual level of charges for stakeholder pensions will be 1 per cent of the member's accumulated funds;
  - stakeholder pension schemes will allow members to stop and re-start contributions or transfer into or out of a stakeholder pension without facing any extra charge;
  - stakeholder pension schemes which require minimum contributions cannot set this above £20, although some may accept less than this;
  - concurrent membership of a personal or stakeholder pension scheme will be permitted for active members of occupational schemes if they are not controlling directors of a company and if in at least one of the previous 5 tax years their earnings did not exceed the remuneration limit (set at £30,000).

**Figure 10** Limits for contributions to PPP's by age, 1989 onwards

Age	maximum % of earnings
50 or less	17.5
51 to 55	20
56 to 60	22.5
61 to 74	27.5

Source: HMRC Statistics/RAKM for IFA Promotion

# PENSIONS

- In addition to Stakeholder, occupational pension scheme and PPP's, there are also the state pension schemes, currently the National Insurance linked Basic State Pension, or SERPS
- Employees are either contracted into or out of SERPS either by their employer on a scheme wide basis or by the individual using a special Personal Pension Called an "Appropriate Pension Scheme". Individuals aged over 30 who contract out of SERPS using an APP currently receive an incentive of 1% on top of their contribution from SERPS.

## Calculating the Waste

- The wastes in terms of under-contribution to pensions are almost incalculable. Few individuals, even with high incomes, have provided for retirement to the maximum that they could have done. In almost all cases, extra provision would have attracted tax incentives - though individual circumstances differ and concentrating all investment into a pension fund at the expense of all other savings or investments would not be advisable.
- A key waste is generated by savings and investments held by those nearing retirement age, intended to provide more comfort in old age/income on top of the pension. If income in retirement is the key objective, using any medium with lesser tax privileges can be described as a waste (voluntarily forgoing the refunds which could be added to the same money contributions) where there is less than the maximum allowable contribution being made from earnings. The only immediate refunds would be of 17% for top-rate taxpayers, but the tax amount would be working to gear up the amount invested.
- Under provision is the worst problem, given shorter/more disrupted working lives/longer life thus a longer time in retirement, and demographic change in the developed world leading towards fewer workers/more pensioners, there are strong arguments for starting provision at an earlier date.
- A further waste is incurred, at least potentially, by those who hold a PPP already (or are self-employed but without a pension) taking out a mortgage. A pension mortgage would generate tax relief on premiums designed to repay the lump sum at the end of the loan, not currently available to an

# PENSIONS

endowment policy. Again, however, assessment of priorities and the balance between the tax saving and other uses anticipated for the lump sum at retirement/the cost of extra premiums, must be made on an individual basis.

- Our calculation is derived from just one aspect of pension waste, the failure of higher rate taxpayers to make additional contributions to their company Pension scheme.
- HMRC analysis shows in 2005/06 that nearly 1.4 million individuals who were covered by company pensions who are likely to have a liability to high rate tax, with around 78% of whom have not made an AVC.
- If all the high-rate taxpayers covered by company schemes could make an AVC or FSAVC of £1,650 (or half of them £3,300) then **£720 million of avoidable waste** would be due in reclaim from the Exchequer.

# INHERITANCE

## Tax Legislation

- IHT is very different from the other taxes covered in this document; it is charged on a deceased's estate, after certain approved liabilities have been met, where the value of that estate exceeds £312,000.
- IHT is charged at 40% on the total value of liable estates. Some inheritances are exempt; those by spouses and bequests to charities are subtracted from the estate before tax is calculated and thus can be made gross. Gifts during life fall out of the estate according to a sliding scale; if the donor survives for seven years, then the gifts are no longer count in the taxable value of the givers estate.
- As an extension of IHT, there is a further form of tax on death, which applies when individuals have a) not made a Will or, worse, b) lost touch with all known relatives. If there is no Will, it is rarely realised that while inheritances follow set patterns, these are not automatically (as most individuals think) "spouse (if any) inherits all". The law is different in England and Scotland, but spouse, children and parents can all be involved, as well as any other dependants who might make a claim. If unwelcome heirs take part of the estate (for example, estranged parents or children) it must be an unsatisfactory result; almost a perverse form of tax.

## Value of the Market

- In 2007/08 over £3.8 billion was collected in Inheritance tax. Inheritance tax is charged on all assets of the deceased not just the financial assets, and as such time is given for the beneficiaries to liquidate assets such as property so that the tax charge may be paid. If the beneficiary does not sell the asset, the revenue allows the payment of the tax charge to be staged over a period of up to 10 years.
- There are several important ways in which IHT is incurred unnecessarily. Probably most widespread, though not necessarily of most value, is the inclusion in estates of the proceeds of life assurance policies. Where the estate is below the limit/the spouse is the beneficiary, this is not taxed but in

# INHERITANCE

most other cases the policy could have been written in trust so that it was not part of the estate on death.

- Another major element in IHT is the pattern, which inheritances take. If an elderly widow/er inherits a very large estate under the spouse's exemption, then there is a likelihood that in due course, there will be a tax bill to be paid on that spouse's death. Diverting up to £312,000 out of the first estate (using if necessary a deed of family arrangement) would have cut the value of the second by a similar amount, without leaving the survivor destitute.
- Without a Will, the administration of the estate must be handled through more cumbersome channels which are more time-consuming and often more expensive (even before IHT) than execution of a Will. There is a clear and absolute need for all individuals with any assets, urgently to make a Will. Even if they have no relatives, most would prefer to see charities inherit than the Crown - and charitable donations attract no tax.
- Almost a third of adults say that they have made a Will - near two thirds of those over 65. This proportion has consistently crept up over recent years but there is no sign of a real breakthrough. It is also impossible to know whether the Wills are valid and if they would be effective in carrying out their authors' wishes in the event of death.

# INHERITANCE

## Calculating the Waste

- All IHT could be classed, at least in theory, as a waste as the tax applies to few estates and advance planning would enable almost all of these to bear a nil charge. However, this is not realistic; the house in which individuals live is often a large part of their wealth, IHT planning by gifting assets away can backfire to leave them all but destitute in later years, and in most couples the desire to see the survivor provided for takes priority over later tax implications.
- As in previous years, we classify half of the life insurance payments into estates above the IHT limit as error, unnecessary waste. In the latest year this was over £647 million; **an error waste of £324 million**. Further, we believe that up to half of the tax on estates in any one year could have been saved by some basic planning; as a result a further **avoidable waste of £1,912 million** was incurred.

# SELF ASSESSMENT

## Tax Legislation

- Self-assessment applies to the self employed, company directors and higher rate taxpayers who previously received a tax return
- If we are informed of tax we owe and fail to pay the amount demanded within a month, then interest will be charged. If we fail to tell the Revenue about earnings not already taxed and the allowances we are claiming for the current year within a reasonable time, then penalties may be incurred and interest charged on any tax we are then found to owe. A reasonable time is, in theory, within a month of receiving a tax return but it is Revenue practice to allow until 31 October of the tax year then in progress.
- If returns are not sent in to the revenue by 31st January, the revenue will apply a fixed penalty of £100, if the return is still outstanding six months later there is a further penalty of £100. If, despite these penalties the revenue still receives no returns they are able to apply a daily penalty of up to £60 per day. However, if a return is submitted late and the amount of self-assessed tax is less than the penalty applied, the revenue will reduce the penalty applied.
- If the tax payment made to the revenue on account or as a balancing item is found to be too low, then interest will be applied to the amount of under-payment. However, if there was an over-payment by the taxpayer then the revenue will pay interest on the amount of over-payment.
- If tax is still outstanding after the 31 January final payment date, a range of different surcharges will apply
  - A 5% surcharge on any tax for the previous tax year which is unpaid by 28 February after the end of the tax year (one month after it was due).
  - A further 5% surcharge on any of those amounts still unpaid by 31 July (six months after the tax was due).
  - If returns are not sent in by 31st January, and taxes not paid, the HMRC can determine the amount of tax they believe is due, plus surcharges and penalties, and collect that amount, although this tax charge can be amended when the completed tax return is finally sent in.

# SELF ASSESSMENT

- In addition to these penalties for late return a further penalty of up to £3,000 may be charged for each year in which adequate records of the taxpayers different incomes are not kept. Normally records should be kept for a period of 22 months after the tax year to which they relate. If the taxpayer is self-employed however, the records must be kept for a period of five years after the tax year to which they relate.

## Calculating the Waste

- In 2008 some 1,021,600 self-assessment forms were received after the 31<sup>st</sup> January deadline and the majority incurred a penalty of £100. If only 1% increase occurs in 2009 there will be over 1,038,000 late returns incurring an **avoidable waste of £104 million**.
- The revenue issued some 642,202 notices of 1<sup>st</sup> surcharge to taxpayers. A 5% surcharge could be made against all of these individuals and if the tax unpaid were an average of only £2,500 the resulting penalty would represent **an avoidable waste of over £80 million**.
- If errors were made by 5% of those returning their forms (9.8 million), which resulted in a penalty of £650 being imposed, a further waste of **£319 million** under the **error waste** category could be made.

# SHARE SCHEMES

## Tax Legislation

- Although various share option schemes already exist, they are already linked to either a tax efficient savings vehicle (SAYE), an approved profit sharing schemes or share option schemes with set limits and well defined rules on exercising the option. However, not all employees in a company would be eligible to benefit from such schemes.
- The Share Incentive Scheme, launched in 2001, was described by the HMRC as “the most tax-advantaged all employee share scheme ever introduced into the UK”. The main features of this new scheme are:
  - Employers can give up to £3,000 worth of “free shares” a year to employees free of tax and national insurance.
  - Employees can buy up to £1,500 of “partnership shares” from their pre-tax monthly salary or weekly wages, free of tax and National Insurance Contribution liability.
  - Employers can give employees up to 2 free “matching shares” for each partnership share the employees buy.
  - Employees who keep their shares in the scheme plan for five years pay no income tax or NIC on profits made on their sale.
  - Employees who take their shares out of the scheme plan after three years will pay income tax and NIC on no more than the initial value of the shares. Any increase in value recorded while the shares were held in the plan will be free of income tax and NIC liability. As will be any dividends reinvested in more plan shares, provided those shares are held for at least 3 years.
  - Companies must offer all employees whose remuneration is within Case 1 of schedule E income tax, the opportunity to participate in the plan whether they work full or part time.

# SHARE SCHEMES

- The Scheme plans are to operate through UK resident Trusts. The Trust will buy or subscribe to shares that are subsequently awarded to the employees. The money to buy the shares either comes from the company itself or – if the plan incorporates partnership shares – from the employees.
  
- Enterprise Management Incentives (EMI) are tax advantaged share options designed to help small higher risk companies recruit and retain employees with the skills that will help them grow and succeed. They are also designed to reward employees for taking a risk by investing their time and skills in helping small companies achieve their potential.
  - Tax advantaged options over shares with a market value of up to £100,000 may be granted to any number of employees of a company, subject to a maximum share value of £3 million under EMI option to all employees. The shares must be in an independent trading company that has gross assets of less than £30 million. For options granted before Royal Assent of the 2001 Finance Bill, EMI options could be granted to each of up to 15 key employees.
  - The grant of the option is tax-free and there will normally be no tax or National Insurance Contributions for the employee to pay when the option is exercised
  - There will normally be no National Insurance Contributions charge for the employer
  - When the shares are sold at a gain any Capital Gains Tax charge may be reduced because taper relief will normally start from the date that the option is granted

# SHARE SCHEMES

## The potential for waste

- Currently there are only 10,840 companies running a tax-advantaged employee share scheme, the majority of these are smaller unlisted companies.

**Figure 11 Employee share schemes in operation 04/04 - 04/07**

	Number of schemes				% change
	04/04	04/05	04/06	04/07	04/04-04/07
Savings related share option scheme (1980)	860	820	760	780	-7.4
Company Share Option plans (1996)	2,960	2,710	2,440	2,450	-17.2
Share Incentive Schemes	570	750	870	940	+64.9
Enterprise Management Incentives	4,500	5,660	6,790	8,020	+78.2
Total Companies with tax-advantaged Employee Share Schemes	7,580	8,570	9,600	10,840	+43.0

Source: HMRC/RAKM for IFA Promotion

- If the half of the level of investment allowed under the Share Incentive Plan (£1,500) was made for/by the estimated 570,000 staff currently in savings related share option schemes a tax cost of **£171 million** would be accrued; this we would class an **avoidable waste**.

# TAX CREDITS

- The whole regime of Tax Credits have been subject to considerable change. In April 2003 Working Families' Tax Credit (WFTC), Disabled Person's Tax Credit (DPTC) and Children's Tax Credit will be replaced by two new tax credits. These will be called Child Tax Credit and Working Tax Credit. These new tax credits will provide support to a wider range of people through a single framework.
- In addition to the changes to HMRC sponsored tax credits, the Department of Work and Pensions have introduced have introduced a Pension Credit, designed to provide additional help for the retired. This Credit becomes available in October 2003. Although not an income tax based credit it has been included in this edition of Tax Action as it is an area where waste can easily occur.

## Tax Legislation

### Child Tax Credit

This is for families with at least one child. It is made up of the following elements

- A family element that is payable to any family responsible for a child. It is paid at a higher rate to families with at least one child under the age of one. This is known as the baby element
- A child element for each child that you are responsible for. This is paid at a higher rate if the child has a disability and at an enhanced rate for a child with a severe disability. This is known as the disabled child element

### Working Tax Credit

This is a tax credit for people who are in paid work. You may be eligible if

- You are a single person

or

- You are a married couple living together

or

# TAX CREDITS

- You are a man and woman living together as if you are married

**and**

- You are in paid work (including working as a self-employed person) for the required number of hours

The amount you receive will depend on your annual income, and you must be 16 years of age or over, to be able to apply for the tax credits.

## **Elements of Working Tax Credit**

- A basic adult element which is paid to you if you meet the above criteria
- An extra element which is paid to single parents and couples
- An extra element which is paid if you and your partner, if you have one, work a total of 30 hours or more a week
- An extra element which is paid if you (or your partner) are working and have a disability
- An extra element which is paid if you (or your partner) are working and have a severe disability
- A child care element which is paid to help households who are working and have to spend money on childcare
- income they receive from their savings ignored entirely;

## **Pension Credit**

- Pension Credit is an entitlement for people aged 60 or. It guarantees everyone aged 60 and over an income of at least:
  - £109.45 a week if they are single; or
  - £167.05 a week if they have a partner.
- For the first time, people aged 65 and over will be rewarded for some of their savings and income they have for their retirement. Pension Credit will change this by giving new money to those who have saved – up to:
  - £16.44 if you are single; or
  - £21.51 a week if you have a partner.
- The person who applies for Pension Credit must be at least 60; it does not matter if their partner is under 60. *We use 'partner' to mean your husband or wife, or a person you live with as if you are married to them.*

# TAX CREDITS

## Where is the waste?

- In theory there should be no waste arising from the availability of these tax and pension credits, however, the same was true of Married persons allowances, and as previous editions of the Taxaction report showed considerable waste can occur. For this exercise the following assumptions are made before the waste calculation can take place:
  - No waste will occur among high rate taxpayers (the vast majority will not be able to claim these benefit because they are income related);
  - All parents with children (over whom they have parental responsibility) will have them resident at their homes for at least part of the tax year.

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## Calculating the Waste

- When first launched the take up of tax credits were patchy with certain groups, such as lone parents showing a higher level of take up than families with both parents present in the household. The streamlining of the credits for 2003 will RAKM believes result in a higher take up by all qualifying families, however we still believe as many as 8% of entitled families will miss out. The HMRC estimates weekly amounts per family will average of £3,245 per annum if this average remains the same RAKM estimates that **around £1,850 million will remain unclaimed this we count as an error waste.**
- The pension credits are administered by the DWP rather than the HMRC and are designed to replace the Minimum Income Guarantee that was available to all Pensioners. The DSS monitors the take up of Pension Credit for pensioners and has found that the rate of take up has declined with the DWP estimating that between 24-31% of pensioners have failed to claim

# TAX CREDITS

entitlement with a result that somewhere between £1,960 million and £2,810 million remained unclaimed. We have therefore taken the midpoint of this estimate as the basis for our waste figure and allocate the sum of **£2,385 million which we classify as error waste.**

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# CHILD TRUST FUND

The Child Trust Fund is a new long-term savings and investment vehicle developed by the government to encourage saving for children. The Government has introduced the Child Trust Fund to:

- ensure that children have accrued some savings by the time they reach the age of 18;
- encourage children to get into the habit of saving;
- teach children about the benefits of saving; and help them to understand something about personal finance.

Children currently living in the UK and whose parents are in receipt of Child Benefit and who were born on or after 1st September 2002 are entitled to open a Child Trust Fund account. To get the account started, the Government will send the a voucher for £250 to open up the account, an additional £250 will also be contributed by the government for children in families on lower incomes and then more when the child reaches the age of seven. (The amount of the 7<sup>th</sup> birthday contribution is yet to be decided). The account belongs to the child and when they turn 18, they are allowed to access the funds and use them in any way they like.

## Key facts about the Child Trust Fund

- **a long-term savings and investment account** where the account holding child (and no-one else) can withdraw the money when they turn 18
- **neither the contributor nor the beneficiary child will pay tax** on income and gains in the account
- **£250 voucher to start each child's account**
- children in families receiving **Child Tax Credit (CTC)**, with a household income below the CTC limit, will receive an extra payment
- a **maximum of £1200 each year** can be saved in the account by parents, family or friends
- money cannot be taken out of the CTF once it has been put in – once your child is 18 they will be able to decide how to use the money
- children can start to make decisions about how the money is managed when they are 16

# CHILD TRUST FUND

- the Government will make a **further contribution when your child is seven** - the amount has not been decided yet
- **not just one type of CTF account** – you choose the type of account you want for your child
- it will not affect any benefits or Tax Credits you receive
- learning about how to make the most of your money is a key part of the CTF .

Parents have 12 months to open an account for an eligible child - after that the HMRC will automatically open a stakeholder account for the child. The parent can move the account to another provider, or change the type of account. The parent will need to be the registered contact to do this. There's no charge for doing this but where it is necessary to buy or sell investments to transfer the account there may be a charge for the costs involved. The new provider will notify the HMRC about the change so that the individual child's records are kept up-to-date.

There are three types of accounts available under the child trust fund scheme:

- **Savings accounts**

With a savings account any money you invest is secure. For example if an investment of £500 is made, the child will get that sum of money back as well as earning some interest. As with all accounts the provider will charge for the cost of running it. It might not be possible to identify this cost as it will not appear on the trust fund statement, but providers cover these costs when deciding how much interest to pay on savings.

- **Accounts that invest in shares**

These accounts invest the child's money by buying shares in companies. This type of account has the potential to do well when money is invested for a long time. The charge on this type of account is usually a percentage of its value. You should check how much this would be with your chosen CTF provider.

# CHILD TRUST FUND

- **Stakeholder CTF account**

Stakeholder accounts invest the child's money in shares in companies when the account is opened. The Government has made certain rules for these accounts to reduce the risk of investing in shares.

The child's money is not put into just one company, as they could lose out if that company does badly. Instead, it is invested in a number of companies in order to reduce the risk.

Once the child is 13, money in the account starts to be moved to lower risk investments or assets. CTF providers will consider how well shares are performing to decide how much to move over into safer assets and how quickly. This means that although the child's money may not benefit if the stock market is performing well, it is protected from stock market losses as they approach their 18th birthday.

Once the account is open, all providers must accept a minimum contribution of £10 into a stakeholder account – but they can accept less if they wish.

The charge on the stakeholder account is limited to no more than 1.5 per cent a year – which means the charge can be no more than £1.50 for every £100 in the account. The charges on all other types of CTF account are not limited in this way.

The stakeholder account is the one the HMRC will open if you don't use the CTF voucher before it expires

All CTF providers are required to publicise their policy about social, ethical and environmental investments, if they have one.

Only one Child trust Fund may be opened per child, however, once opened any person can deposit money into the fund up to the annual limit applying. The start date for each year is the child's birthday.

# CHILD TRUST FUND

Currently the limit of £1,200 applies to each year separately. Contributors can't 'carry forward' any unused amounts to the following year. Apart from the contribution rules for stakeholder funds, there are no rules about minimum contributions for other types of account – however, the provider may apply their own rules about how payments are made, e.g. whether by cheque , cash or both.

The child will get statements about their account every year. These will be addressed to the registered contact and will show the total amount in the account.

## Calculating the Waste

Since the introduction of Child Trust Funds some 4.3 million vouchers have been issued to eligible children, however, in the same period only 3.1 million accounts have been opened. Parents have one year to open the account from the date that the voucher is issued, if they do not open an account in this time HMRC will arrange for a stakeholder account to be opened for the child; HMRC has a list of suppliers who have agreed to open such accounts and the vouchers will be shared out between these providers – this is likely to generate a significant waste in the future as parents who have not bothered to open a CTF account are unlikely to keep details of the default accounts in a safe place for their children.

In the first quarter that vouchers were issued only slightly more than 28% of parents opened an account, since then the proportion has risen to 56% of eligible children having an account opened for them. Data released by HMRC in January 2009 showed that only 24% (just over one million accounts) of opened accounts received any additional funding and only 1.0% (45,000) received maximum funding. If half of those accounts which had no additional funding received the maximum contribution significant waste could be avoided we believe that this would result in **£63 million that we would describe as an error waste.**

# APPENDIX

obtained from the HMRCs published statistics

**Figure A1** Personal taxes within net revenue receipts, 1986/87-2008/09

	Income Tax	Capital gains tax	Inheritance tax	Total personal tax	As % of inland revenue income
	£m	£m	£m	£m	
1986/87	38,499	1,064	995	40,558	70.9
1987/88	41,402	1,379	1,078	43,859	68.1
1988/89	43,433	2,323	1,071	46,827	67.9
1989/90	48,801	1,854	1,232	51,887	67.8
1990/91	55,287	1,852	1,262	58,401	70.8
1991/92	57,493	1,140	1,299	59,932	73.3
1992/93	56,797	982	1,211	59,010	77.5
1993/94	58,442	710	1,333	60,485	78.1
1994/95	63,100	926	1,411	65,437	74.9
1995/96	68,049	796	1,518	70,363	72.6
1996/97	69,071	1,131	1,558	71,760	69.1
1997/98	76,838	1,435	1,684	79,957	68.1
1998/99	86,507	2,002	1,786	90,295	70.5
1999/2000	93,910	2,122	2,047	98,079	70.0
2000/01	105,177	3,236	2,221	110,634	72.4
2001/02	107,994	3,034	2,355	113,383	73.8
2002/03	109,507	1,596	2,354	113,457	75.0
2003/04	113,968	2,225	2,504	118,697	76.3
2004/05	122,920	2,283	2,922	128,125	34.5*
2005/06	130,481	3,042	3,259	136,782	34.3*
2006/07	143,327	3,813	3,545	150,685	35.6*
2007/08	147,324	5,268	3,824	156,416	34.6*
2008/09 (prov.)	151,190	4,910	3,090	159,190	35.6

\*Inland Revenue merged with Customs & Excise to produce HM Revenue & Customs responsible for collection of direct & indirect taxes.

Source: HMRC Statistics/RAKM for IFA Promotion

# APPENDIX

**Figure A2** Numbers of individual taxpayers, 1988/89-2008/09

	Income tax	CGT*	IHT*
	000	000	000
1988/89	25,200	151	30
1989/90	25,000	144	31
1990/91	26,100	108	28
1991/92	25,700	85	25
1992/93	25,400	70	24
1993/94	25,000	90	23
1994/95	25,300	70	24
1995/96	25,800	100	25
1996/97	25,800	120	18
1997/98	26,200	170	20
1998/99	26,900	160	20
1999/2000	27,200	210	23
2000/01	29,300	200	24
2001/02	28,600	140	25
2002/03	28,900	145	27
2003/04	28,500	165	32
2004/05	30,300	190	34
2005/06 (est)	31,100	210	35
2006/07 (est)	31,500	260	37
2007/08 (est)	31,900	260	31
2008/09 (est.)	30,600	350	21

\* these taxes suffer an assessment and reporting "lag".

Source: HMRC Statistics /RAKM for IFA Promotion