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Inquiry on

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3.35 pm

Witnesses: Sue Martin and Grace Stevens

Keith Richards and Dermot Callinan

Members present

Lord Hollick (Chairman)
Lord Bilimoria
Baroness Drake
Lord Forsyth of Drumlean
Lord Kerr of Kinlochard
Baroness Noakes
Lord Teverson
Lord Turnbull
Baroness Wheatcroft

Examination of Witnesses

Sue Martin, VAT and Operational Taxes Director, Lloyds Banking Group, and **Grace Stevens**, Director of Group Tax, Legal & General Group

Q38 The Chairman: Good afternoon, Miss Martin and Miss Stevens. Thank you very much for joining us, and welcome to this hearing. As you know, we are looking at a number of different aspects of the Finance Bill. We are particularly interested in hearing something from you about the consequences for your businesses of the changes that have been made. The tax deduction scheme for interest is obviously going to change. It would be useful to know how big a change that will be for your organisation. How will you cope with that change? Are you confident that you can cope with it within the timeframe? Do you feel that the introduction of this measure has been signalled sufficiently in advance to enable you to get across your possible concerns about the implementation and impact that it will have on your clients? Who would like to start?

Sue Martin: Lord Chairman, Committee and clerks, thank you for the opportunity to give the evidence you to your inquiry on the Finance Bill. My name is Sue Martin and I am VAT and operational taxes director for the Lloyds Banking Group. The changes to the TDSI rules are the most significant to come in for many years on the taxation of savings and investments. It is going to be a very technical challenge, but the objective is to make it simple for customers. This is part of a much bigger, broader approach to simplifying tax that is being brought in. From a Lloyds Banking Group perspective, we have a group-wide programme—one of the largest in the group—that is going to deliver the changes needed. We are also putting in, as part of that, an educational plan for our colleagues, so that within the organisation itself we

will make sure that our colleagues are in the best place to understand the rules that are coming in. We will then work with HMRC to make sure that the changes that are brought in are smooth from a customer perspective. Obviously a longer lead-in time would have been better, but we appreciate that this is only as part of a broader range of changes. It is part of many regulatory changes that we are looking at as a wider package. So from our perspective it is a case of working with our customers to make sure that they understand the changes and that this is reflected accordingly.

The Chairman: Does it require you to completely rejig your computer system and record keeping? What does it entail?

Sue Martin: Yes, from our perspective it means there will have to be changes to IT systems. As the TDSI rules go back many years, a lot of IT programming has been in the system for many years. We have to go into those systems and make sure that, from a group perspective, we identify where all the interest deduction is within them and make sure that we put the necessary changes in.

Grace Stevens: Lord Chairman, thank you for the opportunity to come and talk. I am Grace Stevens, the chief tax officer for Legal & General. I look after the Group's tax affairs as a business and make sure that we provide the right information to our customers. We are very supportive of any measures that make life simpler for our customers. However, unlike my colleague, ours is not a deposit-taking institution, so for much of our business there is not actually an impact from the removal of the TDSI rules. Where it does impact us is in our retail platforms and fund businesses. For many of those, they will still have to withhold income tax on bond fund distributions and the things that they receive into those funds. Under the new rules, some of those will be received gross, but some will still be received net of tax. For us, it is about making sure that our communications to our customers can cope with that distinction and that we are able to provide the right information. To make sure that they can do that, we are in the process of updating our processes and systems, our communications to our customers and staff training. As a further simplification in the future, we could support the removal of the requirement to deduct income tax at source on those fund distributions. This would be a further simplification in the fund space for those investors and create a level playing field with the European funds.

Q39 The Chairman: Do you think that there is any risk that, by paying interest gross, there is a compliance problem for HMRC, which may collect less than it would otherwise do?

Grace Stevens: I do not have any statistics on how much it collects via us versus interest paid gross. However, in conjunction with the simple assessment stuff and the data they get from other people, it should work together as a package of measures to address that.

The Chairman: So you would provide your clients—savers, if you like—with an annual return about the interest they have earned and what, if anything, has been deducted. Is that how it would work?

Grace Stevens: Yes. How often those would come through would depend on the product, but they will get at least an annual statement that tells them what return they have made during the period, what has been received gross, what has been received net, anything that they do need to reclaim, and what their own information is. It is about making sure that the communication sets out the types of consequences that they will need to consider and that they have that information in a clear format.

The Chairman: So if there is a mix of interest paid net and interest paid gross, you will provide your savers with a computation that shows interest, any deductions that have been and the amount they would need to return in their tax return.

Grace Stevens: It is unlikely to be a full computation of that sort, but it will clearly set out what has been received gross, what has been received net and what tax has been withheld. They will still receive tax vouchers for any tax that has been withheld.

The Chairman: And if you invest in, say, international bonds, you would have to calculate and show, on the statement, tax that had been deducted, maybe by another jurisdiction.

Grace Stevens: Yes, and we are still looking at the easiest way to communicate that and in the simplest way. It requires updating and making sure that it is user friendly.

The Chairman: Is that not quite a big exercise? If you have a bond fund that has international and UK bonds in it, you have to segregate them and each investor will then have a sliver of the income.

Grace Stevens: Yes. That is what we are doing at the moment. Where you now receive interest net but will receive it gross is a simplification. A further simplification would be to remove it from the bond funds rules as well, so you do not have to withhold income tax at source on those.

The Chairman: Your IT systems are certainly going to have to be very sophisticated to do all that.

Grace Stevens: Luckily I have people for that. I would not be able to do it myself.

Lord Teverson: I have a question for Sue Martin. I am trying to understand the cash flow implications of this for banks. I am not sure when you actually pay HMRC the money that does not go to taxpayers at the moment. Does that reshuffle anything? Are all outgoings the same thing? Do you make a windfall gain or loss of cash?

Sue Martin: At the moment we pay the money over to HMRC on a quarterly basis. It is accounted for as part of a CT61 return. Every quarter, the tax deducted from interest payments to our customers is paid over to HMRC.

Lord Teverson: Right. So is that when you pay it now, or when you will pay it, to your clients?

Sue Martin: As we make the interest payments to our customers, the tax is deducted and goes into the tax account.

Lord Teverson: So it is effectively cash flow-neutral to you.

Sue Martin: Absolutely, yes.

Q40 Lord Turnbull: All this is linked in timing with a change in the way taxpayers account to HMRC. They will receive much of their interest gross, some net and some a bit of each. How do you ensure that the information you are sending to your customers is the same as the information you sent to the Revenue and which the Revenue then uses to pre-populate the forms? The danger is that you would get something from the Revenue saying, "This is what we think", look at your own statements from the various investments, banks et cetera and spend hours and hours trying to marry the two up.

Sue Martin: That is no different from what we do now. We complete annual returns for the Revenue for the interest payments for every customer who has an account. That is driven from the accounts on our systems, so the returns that go to HMRC come from customer account information. The statements that we send our customers with details of the interest paid and the tax deducted are also driven from those same accounts and those same systems, so the information that is sent to HMRC and to our customers is being fed from the same system.

Lord Turnbull: The difference is that now for basic rate taxpayers—the main body of taxpayers—the tax is taken off.

Sue Martin: That is correct.

Lord Turnbull: So you are concerned only with the difference at the margin. Now, customers will need information to enable them to calculate the total tax they should be paying on the interest.

Sue Martin: That is right, and we are working with HMRC at the moment to understand its future vision as regards digital tax accounts and the timing of returns. We understand that from a digital tax return perspective it is piloting returns at the moment. It is taking the returns that we have submitted to it and it is pre-populating those pilot accounts with the information that we have given it. We understand that while it is still working on an annual basis, any changes will be reflected in tax codings, but we anticipate that it will go on to more of a real-time basis.

Lord Turnbull: When is this all due to start? In eight weeks' time?

Sue Martin: It is going through phases at the moment. The tax deduction will be switched off in April 2016.

Lord Turnbull: Are you ready for that?

Sue Martin: Yes. We have a group-wide project in place to make sure that we meet those requirements.

The Chairman: Do you feel that you have had adequate notice of these changes?

Sue Martin: Because they are big changes, a longer lead-in time is always better, but once we know when the changes have to be implemented, we obviously work with our people who need to be involved—the IT people—to make sure that we meet the deadline and that we do the best for our customers.

Lord Kerr of Kinlochard: I can see why great institutions like yours would rather like this change. In a way, you have been doing the Revenue's work for it until now. This means simplification for you and, if I understood aright your answer to Lord Turnbull, a small cash-flow advantage. I can understand why the Revenue likes it, but what about the taxpayer? How many are we talking about? How many people have interest-bearing accounts with banks?

Sue Martin: I do not know the full number off the top of my head, but we have a significant number of customers, and a significant number of those accounts are interest-bearing.

Lord Kerr of Kinlochard: How many does Lloyds have?

Sue Martin: I do not have that number.

Lord Kerr of Kinlochard: Presumably most people have an account that might, in happier days, pay them interest. The work will now fall on them. Simplification means less work for you and for the Revenue but not for the individual. Do you think the individual has understood yet that this task is going to fall on him or her?

Sue Martin: At the moment that has not been widely publicised, and it is something on which we are very keen to work with the Revenue. One thing that we are looking at as part of our group-wide project, certainly on our digital banking platform, is when they log in having pop-up screens that will educate the customer and point them to places where they can go for further information, obviously with links to HMRC and government websites. We are very keen to work with the Revenue to make sure that we support the public information that it puts out, to make sure that we all work together and to make sure that the customer fully understands the changes.

Lord Forsyth of Drumlean: Chairman, just before we leave this point, if someone is a basic rate taxpayer but is not in employment and would previously have got the interest on their accounts with you, under the new system they will have to pay the tax on that interest and will be asked to pay a bigger sum than they would otherwise have done. How are they going to pay that if they are not in employment on a PAYE system and if they do not complete a tax return? How will it work?

Sue Martin: They will be given a personal savings allowance. A new personal savings allowance is coming in that will give them a £1,000—

Lord Forsyth of Drumlean: But if they exceed that?

Sue Martin: If they have these digital tax accounts—

Lord Forsyth of Drumlean: But those will not be in place in April, will they?

Sue Martin: No, they will not.

Lord Forsyth of Drumlean: So if in April I am someone in the circumstances I have described, how do I pay? You will send me a piece of paper that tells me what is being deducted and what is not being deducted, but how do I pay? What do I do?

Sue Martin: That is something on which we will be working closely with the Revenue. Obviously we want to be able to help our customers who do not pay tax.

Lord Forsyth of Drumlean: You say that you are working closely with the Revenue, but this is going to happen in April, which is two months away. I guess that most people do not understand this, so you are going to have quite a lot of people who are confused ringing you up.

Sue Martin: Yes, and that is why, as I said, we are working with the Revenue. We are trying to understand from the Revenue whether it will have any mechanism in place to allow payments back to customers without them having to complete a self-assessment return.

Lord Forsyth of Drumlean: When is the tax due? Do people get until the end of the tax year to pay it, or is it payable quarterly, or what?

Sue Martin: It will depend on their circumstances. If people exceed their personal allowance, the Revenue says that any changes will be put into their tax codings, but obviously if they are not in a PAYE system it will not be put into a coding, and they will have to pay that amount. Again, we are trying to understand what the Revenue will have in place to enable people to do that.

Lord Forsyth of Drumlean: In your earlier answer, you said that you thought you had been given adequate notice, but clearly you have not.

Sue Martin: We have been given adequate notice to make the changes that we will need to make from a corporate perspective. We are working with customers and giving them as much information as we can, and we working with HMRC and are trying to understand what changes HMRC is making so that those can be reflected in that information.

Q41 Lord Kerr of Kinlochard: I want to turn to dividends, where it all gets much more complicated as far as I can see. First, on Lord Forsyth's question about timing, I am a director of a finance company, but let us suppose that I was the chairman of a company that had its AGM in May and the AGM was required to approve the final dividend for the year 2015. That dividend would normally be payable to shareholders with a voucher indicating what tax had already been deducted. Is that going to happen this year if it is a payment in the next financial year? Is the voucher going to be sent out or not? If not, should not I, as the chairman, be preparing my annual report and warning people that this change is going to happen?

Sue Martin: From a Lloyds Banking perspective, obviously at the moment we have an obligation to issue tax vouchers. On those tax vouchers we have to detail whether a tax credit or a notional tax credit is attributable to that dividend. Lloyds Banking Group is going to continue to issue tax vouchers. When the requirement to deduct the tax ends, we will show a nil tax deduction on those vouchers.

Lord Kerr of Kinlochard: So you will not be required by law to do it, but you are choosing to do it.

Sue Martin: Yes, we are choosing to do it.

Lord Kerr of Kinlochard: Good. Still on Lord Forsyth's point, do you think that the shareholder in general is aware that this change is happening and happening so soon?

Sue Martin: I have no knowledge of the shareholders' view on that. I have seen no indication of whether they are fully aware or not aware.

Lord Kerr of Kinlochard: Taking the whole of the taxation of dividends dossier, you have the new dividend allowance coming in, you have no increase in the ISA, and you have three rates of tax payable on dividend income, which are different from the standard income tax rates. You probably have a requirement, if you are a saver, to rethink your strategy, particularly because of the £5,000 and particularly if you are a higher-rate payer. Do you think that the whole structure has been sufficiently publicised and understood? You probably ought to be thinking right now about the decisions about what you are going to do with your investment strategy.

Sue Martin: Yes, and I think that different investors will want different things from their savings. For us it is about helping them understand the constituent parts. A key thing is putting the information out to our customers. As an organisation, we are trying to educate our customers and give them as much information as we can. We also have to bear in mind that we are trying to complement that with what HMRC is issuing, so that we make it simple and easy for our customers to understand.

Lord Kerr of Kinlochard: It was all sold as a simplification. The Government said that it would modernise, reform and simplify dividend taxation, but it all looks quite complicated to me, and I think it will look quite complicated to most of the punters out there. They will need a bit of advice and will need to think about it.

Sue Martin: Absolutely, yes. As I said, we are doing as much as we can. We cannot give our customers actual tax advice, but we can help them understand what the changes are. We are putting things in our online systems to give them pop-ups about what things mean and help them get the advice they need.

Lord Kerr of Kinlochard: If there had been a consultation exercise—there was not—would you have advised the Revenue that, for the amount of income they wished to take from dividend taxation, to do it in this way this way?

Sue Martin: From a Lloyds Banking perspective, the key thing for us on dividends is just one of communication; just notifying what the tax is. It would not have been a big enough thing for us to have dictated how we saw it working.

Lord Turnbull: Having seen some calculations from our advisers about tax credits, I can see that this is a much simpler scheme, but it does mean that people have to rethink their

finances. A very simple example is a husband and wife; one is a higher-rate taxpayer and one is a standard-rate taxpayer. At present, it would make sense for the husband to hold the ISAs and the wife to hold the shares, but now the obvious thing is for the husband to hold as many shares as will exhaust the £5,000 and no more and then leave the rest with the wife. I have not seen anything that advises anyone about this that tells them that is probably the natural response to this.

Sue Martin: I think that all savers will have their own individual needs and requirements as to how to structure their affairs. With different allowances coming in, people will want to make the most of them. It is very difficult to try to put out general information, because different individuals will have different requirements according to their own personal circumstances.

Lord Turnbull: This is looking very similar to the interest, where the two big players, so to speak, have sorted things out for themselves but the public are underinformed about how it will affect them.

Sue Martin: That is one reason why we are trying to work with our customers and give them as much information as we can without giving them specific tax advice, which we cannot do.

Lord Turnbull: Can I just touch on one point that Lord Kerr made? There is a piece of advice we want here. If the dividend declared is a final one that, for a normal calendar year company, would be in the spring some time, which has to be approved by shareholders, often at an AGM in, say, May, it is taxed from the date at which it is declared payable, even if the funds are transferred some time after that. It is likely that this will all hinge on when the annual report is actually issued. Is that right? You are the expert on this.

Baroness Noakes: The AGM.

Lord Turnbull: That is not when it is declared payable, is it?

Baroness Noakes: Yes it is. It is when it is agreed at the AGM.

Lord Turnbull: The calendar year people will have to go somewhat to get their AGM before the end of March.

Sue Martin: Yes.

Lord Turnbull: So your last dividend, which you will pay at the AGM in the spring, is going to be on the new basis?

Sue Martin: Yes.

Q42 Lord Forsyth of Drumlean: This question follows the line taken by Lord Turnbull. I assume that both of you sell ISAs to your customers. Are you worried about getting done for mis-selling? For example, there may be somebody who has a small inheritance or something of that kind. Unless they are setting up a number of ISAs each tax year on a cumulative basis, they could be better off not having an ISA than having one, because of the allowances and the costs and fees involved in setting up an ISA. Are you concerned about that?

Grace Stevens: We will be looking at our TCF—treating customers fairly—rules to make sure that all our literature and processes deal with that problem. That is part and parcel of updating our processes and systems.

Lord Forsyth of Drumlean: But you can see that there is a problem.

Grace Stevens: It would depend on an individual's facts and circumstances, the charges involved—a whole range of things. It comes back to communication, staff training and making sure that we have the right systems in process to provide the information to allow people to make an informed decision.

Lord Forsyth of Drumlean: If you are not allowed to give tax advice, it is difficult to see how you could advise them not to have an ISA.

Grace Stevens: It would depend on their own circumstances across the piece and whether they have come via an IFA. A number will be referred by an IFA, who will give that kind of advice. We can give examples and make sure we set out what our charges are and how things will work within a given product.

Q43 Baroness Wheatcroft: Lord Chairman, I declare an interest as a director of a savings and investment company, but my question is not related to that area at all. I would like to ask Miss Martin about the smaller business customers of Lloyds. There is a belief that a fair number of them incorporate so as to remunerate their owners by way of dividends rather than salary. HMRC would like to get its hands on more of that money and believes that this change will accomplish that. Do you think it will be effective?

Sue Martin: Obviously we cannot give tax advice to our actual customers. For us, the dividend change is one of communication only. I do not have a view on what those businesses are doing.

Baroness Wheatcroft: Do you have indication of how many of your small business customers are incorporated?

Sue Martin: I do not have that information with me.

Baroness Wheatcroft: It might be quite useful if we could get hold of that information. Would that be possible?

Sue Martin: It might be something I could look into getting hold of, yes, but—

Baroness Wheatcroft: At the moment, it is anecdotal that a lot of people pay dividends rather than remuneration by salary. If that is one of the motivations for the change, it would be good to have some evidence as to whether it is justified. If you were able to get any information for us, it would be appreciated.

Sue Martin: Okay. I will look into it and see if we have that information.

Lord Turnbull: Coming back to interest again, can you give me some idea of the quantitative significance of non-TDSI interest? What kind of products are they and how will they be treated? The idea that you get a return on a “mixed product” did not sound very appetising to me. It would be like getting a PID dividend from a property company.

Grace Stevens: I do not have the numbers on the amount of products that we have, but we can certainly provide that information later. It would be things like a unit trust or investing in a bond fund via that. For that, income tax would still be withheld at the basic rate when it pays out. We also produce statements for that: if you would like to see an example of that kind of statement, I could certainly provide one if it would be useful.

Lord Turnbull: What kinds of things are outside the scheme, apart from bonds? Are Zopa and those sorts of companies in it? I am talking about companies that lend money to a family member and pay you interest. Are they in the scheme? What else is excluded from the scheme?

Sue Martin: Compensation payments are excluded from the scheme as well. The TDSI is about deducting tax from deposit-takers—that is, deposits of money. If a compensation payment to a customer involves an interest payment, that interest payment has to be taxed, and that falls outside the TDSI.

Lord Turnbull: There must be other classes of investment, apart from bonds, where effectively interest is paid but that are not inside the scheme.

Grace Stevens: I think that the peer-to-peer stuff is still under consideration, but at the moment that falls outside the scheme because it is not deposit-taking. Other forms of informal loans may fall outside the scheme in the same way. There will be various things. As Miss Martin says, the TDSI is restricted to deposit-taking.

Lord Turnbull: You do not think that there is a problem that these more varied, sometimes more informal and less structured interest payments are not in the scheme?

Grace Stevens: Certainly from the perspective of our fund portfolio, we would support further simplification involving the removal of that difference. We do not provide some of the other things, so it is difficult to comment on that.

Q44 Lord Teverson: Staying on the subject of simplification, one area that is changing is that companies are no longer required to issue a dividend voucher showing tax credits to shareholders and so on. My question is: do you regard the measures as a whole as simplifying the tax system and that they are therefore positive? How will the administrative burden on your companies change? Do you see this whole area of simplification as a positive way forward or as an interim step, or it is going to make the whole thing a heck of a lot more difficult for everybody?

Sue Martin: From a Lloyds Banking perspective, we see working towards simplification as positive. This is a part of broader measures to implement digital tax accounts. Within a digital tax account, our customers will have various forms of income and have allowances to offset against a specific type of income—hence making things a lot simpler for them. So we see this as part of the simplification process and we are working towards that.

As regards the burden of the dividend changes on our organisation, as I said, from our perspective we are going to continue to issue tax vouchers but they will show a nil tax rate. Obviously there will be an increased cost in changing those vouchers, but other than that we do not see any increased burden.

Grace Stevens: I would echo that. We are very positive about any measures that simplify the system for our customers, and we think that this change offers that. Regarding dividends and the burden for us as an organisation, we are still assessing what we are going to do. We may not necessarily provide dividend vouchers as they currently exist, but we will still provide information on our dividends to our shareholders as part of the normal course of business. We are in the process of updating our systems and documents to work out what that will look like going forward.

Lord Teverson: I am also interested in two areas that come out of that. One is the change in systems. One thing I had drilled into me is that ty bank account is based on Fortran language, which goes back to the 1960s. We know that in banks, although perhaps not so much Lloyds,

small changes can make big differences to those core systems. Is that definitely not an issue with what is happening here?

Sue Martin: We are in a digital world now, so we are constantly looking at changes to our systems. It is a case of making sure that the programmes that we have in place look across the piece so that we include all the systems that need to change, and that we have the infrastructure and projects in place to make sure that the changes are fully tested and supported before they are implemented.

Lord Teverson: Of course, I meant COBOL, not Fortran, but it seems that there is no issue with that. On the simplification side again, we have taken evidence here about the Office of Tax Simplification. I am not absolutely sure how it operates. Do you give evidence to it? Do you ever interact with the Office of Tax Simplification? Do you have any communication with it at all?

Sue Martin: No, I have not.

Lord Teverson: Do you think that would be useful?

Sue Martin: Possibly, yes. If it is looking at changes that are being made as part of a simplification, it might be useful to do that.

Grace Stevens: We have responded to one or two of its calls for evidence and consultations that it has done. I have sat on a couple of tax committees and the OTS will often come and engage in that format, whether it is at the ABI or the CBI, so I have engaged directly there. Anything that keeps tax simplification on the agenda is really valuable. I have always been very impressed by the interactions that we have had and I look forward to those continuing.

Lord Teverson: Do you feel that that OTS paid attention to you? I am not trying to prompt you to be negative at all. Hopefully it listens, and that makes a difference. What is your feeling about that and about responding to its consultations?

Grace Stevens: We responded to the consultations and I think that the OTS does a good job. Trying to simplify the several thousand pages of our tax legislation is not an exercise that I would personally like to do, but the OTS makes steps forward and it makes a good job of it.

Q45 The Chairman: It seems that these changes will require a significant further investment in IT. Although you do not give tax advice, there is an element of hand-holding, if I can put it like that. People ask, "Is this the right bond or the right fund for me?" A question for both of you is: do you see these changes as increasing the costs of providing the investor products that you currently provide?

Sue Martin: We already have to provide a wide range of products for our customers. It is a case of reacting to customers' needs. As I said, we try to put as much information as possible into the brochures that we publish on our products to help our customers to understand those products and what they mean. We are constantly reviewing our products to make sure that we have the best ones available for our customers. This is just another process to make sure that we have the right guidelines for our customers within those products.

Grace Stevens: In that sense, it is very much business as usual and involves a product review, terms and conditions, and literature. Every time there is a change in legislation, we have to make sure that what we say on our website, in our product literature and on the TaxFacts app, which gives more general tax information, is all up to date. We are doing that as part of the normal processes. This just forms a part of that.

The Chairman: So there will be no increase in the fees for clients.

Grace Stevens: I cannot possibly comment on the actual fees. It is part of our cost of doing business.

Baroness Drake: Just developing your point, do you think that the industry will respond to these changes by coming up with products that take advantage of the £5,000 dividend allowance alongside the ISA—coming forward with a set of propositions that take advantage of that? Do you see that evolving in the offerings being made?

Grace Stevens: I think that anything is possible, but it is not something that we are currently looking at. There are a number of other organisations out there that provide a number of products. Anything like this will potentially result in some sort of behaviour or product change, but I think it is too early to say.

Baroness Drake: What about Lloyds? Does it retail these kinds of products?

Sue Martin: We are obviously a UK retail-centric bank, and we have the largest ISA customer base in the UK. I am not aware that we are looking to review any of those products in line with any tax changes at this time.

Baroness Drake: You are not or you are?

Sue Martin: We are not, no.

Baroness Drake: No, you are not.

Lord Bilimoria: Can I just refer to some research that was undertaken for HMRC in May 2015, which found that awareness among higher-rate taxpayers of the requirement to declare and pay additional tax on savings, following the initial deduction of 20% under TDSI,

was very low? What do you think the implications are of this finding for the introduction, from April 2016, of simple assessments of tax liabilities based on third-party information? Can financial institutions do any more to raise awareness of savers' tax obligations?

Sue Martin: As we have already said, LBG is certainly keen to help its customers understand the changes and how they are affected. We are looking to introduce as much help on their online accounts as possible. As part of this, pop-up screens will focus on the changes. If they go into them, they will point to additional information and to other websites that they can go into and look at as well. As I said, we have a group-wide project that is implementing these changes. One thing it is looking to do is provide a leaflet that will explain the personal savings allowance and the dividend allowance. The key thing for us is to communicate the changes to our customers and to educate them. It is also key to work with the Revenue to make sure that all the information out there is being complemented between us and the public sector.

Lord Bilimoria: Do you think that HMRC should also be raising awareness about this more?

Sue Martin: Yes. We have already had discussions with it about the personal savings allowance and we understand that it is going to put information on the GOV.UK website. That is one of the discussions that we are having: to complement what will be on there with what we are able to tell the customer.

Lord Bilimoria: For example, do savers know that they have to check and maybe amend these forms?

Sue Martin: I understand that at the moment HMRC is not changing its website until this changes. It can be confusing to change half way through, when people are still looking at one regime. It is keen to put the changes on when they come in, to make it clearer for the customer.

Grace Stevens: To make the same point, it is about no surprises for our customers. In the long term, the move to simple assessments will be a positive step. However, the transition needs to be managed carefully. People are used to the systems they have at the moment; whether they are filing an annual tax return or if they are used to getting interest withheld under TDSI, they are used to that system. It is about managing the transition and providing communication. Similarly, we will update the information that we provide. We will potentially look at providing links to the information available on HMRC's website. HMRC

has already produced a fact sheet on the dividend allowance and I would expect to see more guidance on that come through as we get closer.

Baroness Drake: On the point raised earlier by Lord Forsyth about how people in certain circumstances simply find out how they pay the tax or its impact on their personal allowance, will your communications specifically address the key questions that people will need to know, even if it is a link? Are your comms being subjected to consultation or oversight by HMRC? Is there an iterative process between financial institutions and HMRC about what their comms contain when it comes to April, or is it left to your discretion, based on what you think your regulatory duty is?

Sue Martin: From a banking perspective, we work very closely with the British Bankers' Association—the BBA. We tend to have those discussions with HMRC from an industry perspective, so we can see what information it is going to put out. We also like to keep it consistent within the industry to make sure that customers are seeing something very consistent. We work very closely with the trade bodies and HMRC to make sure that there is a consistent approach that customers can understand.

Baroness Drake: So is it the idea that the industry and HMRC are working together and saying, “These are the 20 pieces of information that people will typically ask for or want to know. Let’s make sure that everybody’s comms cover these issues, even if there is a link to where they find out the information”?

Sue Martin: Absolutely, yes.

Baroness Drake: So that is a perfectly viable thing to do. You could have 50 questions if you needed to, but are you trying to capture the kind of base information and key questions that need to be answered in the comms that go out from most financial institutions?

Sue Martin: Yes.

Baroness Drake: So in effect that is work that is taking place?

Grace Stevens: Yes, it would be the Investment Association for us but it would be the same kind of thing. HMRC will often publish guidance for consultation before, in which case we would feed in on that as well.

Q46 Baroness Drake: We have seen a series of changes to dividends, to savings tax and to a generous and more flexible ISA. Taken as a whole, with your experience and knowledge of the consumer, will those things, taken together, make the personal finance experience simpler or more complex for the UK saver?

Sue Martin: Different customers have different savings needs, so it will vary from customer to customer, depending on what they have their investments in. As we have already discussed, this is part of a broader set of packages that are coming into to bring the whole thing together to make it simpler. Once the digital tax account is up and running, our customers will be able to go into their digital tax accounts, see where their different streams of income are, and put their allowances to those different streams. As an organisation, we are very keen to educate our customers and tell them what information we are going to provide to HMRC to populate the digital tax accounts. So it should make it very simple for the customer. Our research has shown that our customers feel that by having a digital account they feel more in control of their finances. By extending that to a digital tax account they should feel in control of their tax as well.

Baroness Drake: So on balance that is a yes. Do you share that view?

Grace Stevens: Yes. We are supportive of anything that simplifies things for our customers and anything that encourages people to save, and we think this does that. How that impacts on individuals will depend on their individual facts and circumstances. However, for the vast majority of savers this will be a simplification and they will be able to take full advantage of the allowances.

Baroness Drake: Do your organisations have an understanding or a belief in what you think is the Government's direction, in terms of savings and investments. Do you think you know where the journey is going, or are you dealing with it incrementally?

Sue Martin: I think there are big encouragements and incentives for people to save. It is about working on the legislation that is there and having the products to give our customers a wide range of alternatives to help them to invest so that they can get what they want from their savings.

Baroness Drake: Lloyds is a major bank and Legal & General is pretty big in terms of the funds that it has under management. Do your organisations have a sense that you know where the Government are travelling to?

Grace Stevens: There has been a clear steer of encouragements for savings, both in this and in the pensions reform. I cannot presume to speak for the Government or the Chancellor, but that pro-savings agenda comes through and that is what we are working towards delivering for our customers.

Q47 Baroness Noakes: You have spoken about digital tax accounts. I know that HMRC is going to be consulting on the details of that, but I just wonder whether you have any early comments on the implications for you as a bank or insurance company in handling what you perceive to be the information requirements to allow digital tax accounts to go ahead.

Sue Martin: As you said, HMRC is going to be consulting on that, but from a banking perspective we already send HMRC vast amounts of information on our customers—we report annually to HMRC on our customers. As HMRC starts to consult on its journey into digital tax accounts, it is about working with it just to make sure that the information that we then send to it is the information that it wants in the right form at the right time.

Baroness Noakes: Do you think it will require you to get any additional information? You do not necessarily capture tax references or even national insurance information at the moment.

Sue Martin: No. Obviously from an ISA perspective we collect National Insurance numbers for our customers. Going forward, we have just implemented the FATCA reporting regime for our customers with US indicia. We are also moving on to the common reporting standard, which is the OECD initiative to report on customers with overseas income.

Baroness Noakes: But that will not cover the bulk of your customers, will it?

Sue Martin: It will not, but there are various reporting regimes. We currently send to HMRC the bank and building society interest returns on our UK customers. We have the European savings directive, which we send to HMRC on our European customers. We will have the FATCA, which will be US customers, and going forward we will have CRS. All those reporting regimes have slightly different variations of customer requirements and the information that has to be gathered. As we are moving forward with the reporting regimes, we are looking at our onboarding processes for our customers, making sure that we are capturing information upfront and holding the information that is required of us, ready to report the information to HMRC that we need to. As information requirements change, we can react accordingly and capture the information that we are legally required to and then report it to HMRC if we are legally required to.

Grace Stevens: It is similar for us. The things that we are thinking about are what we already provide to HMRC, what might we be asked to provide in the future and how we would do that. As Ms Martin says, the framework that we have in place across the USD and CRS would allow us to collect that information on UK people, if that became a requirement. There is

then the issue of how we communicate with our customers about what we collect and provide to HMRC and how that works. Then there is the impact on us as a business, if we are providing our own digital accounts and how we do that. The other thing that we are thinking about is the digital first approach, which will be welcomed by many people as a good thing. However, a number of people are not digitally enabled and do not have access to the internet or are not able to do so because they have certain vulnerabilities. One thing that we are concerned about and are thinking about is how we and HMRC manage engagement with those customers.

Q48 Lord Forsyth of Drumlean: This is a question slightly from left field. If the Scotland Bill currently before Parliament is passed, it will give the Scottish Parliament the ability not only to alter rates but to alter thresholds, although for savings and investment income there is a UK rate. Do you anticipate any confusion or difficulties arising from that ability to change the thresholds, or will there be a threshold that applies for savings income and another threshold that applies for earned income?

Grace Stevens: That is not something that we have considered in any detail as yet. It will be being thought about somewhere. I think it will all come down again to individual facts and circumstances. It comes back to the point about clarity on guidance on how it will work and communication with customers to make sure that they are not disadvantaged by any changes.

The Chairman: Ms Martin and Ms Stevens, thank you very much indeed for your helpful answers this afternoon.

Examination of Witnesses

Keith Richards, Chief Executive, Personal Finance Service, and **Dermot Callinan**, Head of UK Private Client, KPMG

Q49 The Chairman: Mr Richards and Mr Callinan, thank you very much for joining us this afternoon. As you know, we are looking into a number of aspects of the Finance Bill—important changes in tax deductions relating to interest and the introduction of the new personal savings allowance. It would be helpful if you could explain the administrative and operational consequences of these changes in terms of your own businesses. Would you like to start, Mr Richards?

Keith Richards: From a personal finance or professional adviser's perspective, there will be few administration changes or efficiencies, given that there will still be a need to deliver an annual statement on capital gains tax to advisers' clients. So for typical advice clients, there is unlikely to be a significant saving from an administrative point of view, other than of course for firms that issue the tax dividend statements.

Dermot Callinan: KPMG is a global accounting firm and we have the largest tax practice in the UK. As of yesterday, we finished filing 15,500 personal tax returns. The consequence of the changes that are being proposed is that we will need to take them all into account when advising clients on filing self-assessment tax returns. The complexity that these measures begin to introduce, which has to be seen in the context of the inherited complexity, requires us to both train people and incorporate the changes, no doubt working with software providers to ensure that in future the computational changes that are introduced are in the system.

The Chairman: Do you believe you will have sufficient time to do that before these changes become live?

Dermot Callinan: Yes, I do. The organisation that I work within will be ready. Whether everyone will be, I do not know.

The Chairman: In terms of advising your clients and helping them to understand the consequences of these changes, are you going to have to take on more staff? How are you going to rise to that challenge?

Dermot Callinan: In the main, all the changes involved are capable of being absorbed within the current resources that we have available to us. Our clients are represented taxpayers, which is obviously a fundamentally different position from that of the general population. As represented taxpayers, they have us to advise them. As long as we are equipped and our systems are up to the standard to inform them of the correct thing to do both in responding to HMRC and in paying the right amount of tax, they will be well serviced.

Keith Richards: Advisers often work in partnership with qualified accountants, so the dynamics are slightly different but complementary. You might say that most typical IFA clients will already be fully cognisant with their tax position and therefore the changes will be less likely to have a significant material impact, other than perhaps in considering future investment strategies.

The Chairman: You believe that this will pass off without causing your industry great administrative difficulty and that it will be relatively easy for your clients to understand what is going on.

Keith Richards: Simplification is clearly welcome, but there are always degrees of complexity that come in with any change. Generally, the feedback is that there is a general lack of understanding of what has been announced or what that will be. In many ways the services of our members are increasingly in demand at times like this to ensure that the transition is as smooth as possible or that clients fully understand the implications for them. I am not entirely sure that simplification works as well for people who are unadvised at present.

Q50 The Chairman: Do you think that there is a risk that the payment of interest gross could lead to a loss of revenue for the Exchequer?

Keith Richards: There certainly feels to be a risk. Tax is currently taken care of at source, particularly for those who do not exceed the higher-rate tax banding, whereas the onus will now be on individuals to carry out self-assessment and to understand when they have to submit the returns. From that point of view, there is a potential risk of lost revenue for HMRC.

Dermot Callinan: We have no evidence that the withdrawal of TDSI or indeed the further consultation in relation to other savings and deduction of tax at source will have an impact on tax-revenue-raising ability. From our perspective, there is clearly a simplification for the industry, which is otherwise held responsible for tax deductions. In the further consultation, we made the point that we see the attractiveness of having a level playing field across the board so that tax deduction at source becomes less of a feature of the tax landscape. However, what happens next depends very much on progress with regard to digitisation and tax collection. If it is successful and taxpayer digital accounts are accurate, and if they are issued to the right taxpayers and appeals are dealt with in the right way, it could become the norm. But the whole principle behind tax deduction at source in the past has no doubt been to avoid the complexity of trying to obtain tax from individuals who have not voluntarily made returns or have not dealt with the assessments that they have subsequently received. I am old enough to remember the old system of assessing individuals' tax liability and them having 30 days within which to appeal. HMRC at the time—and I am going back some time, before the mid-1990s—came up with an assessment of an individual's tax liability. I would like to think that with the passage of so many decades, the effectiveness and accuracy of

HMRC digital assessments will be completely different compared with the experience that we had at that time, as well as in relation to the difficulty of dealing with appeals. Much depends on implementation rather than the proposal itself.

Lord Forsyth of Drumlean: I will just follow up on that point. There will be some people who are not paying under PAYE might be caught up in the way that you describe. I think that the proposal is that an assessment will be sent out by the Revenue. I suppose they would have to have substantial income because of the allowance, but if they have several accounts with several different providers, do you anticipate that the Revenue will break that down, or will it just get a number? If it just gets a number, how will it be possible to check it?

Dermot Callinan: Your first point is absolutely correct. Some people will have gross income. I think the point was made in earlier evidence concerning the state pension, for example, which could be tucked up with other savings. I do not know exactly how the Revenue will receive information, but I would have thought that, practically speaking, each organisation operating an account would have an obligation to report the content of the account in terms of interest, et cetera, to HMRC directly, and HMRC will assimilate that information to produce a single digital assessment. If the systems are successfully implemented, that may not be where there is an issue. The issue may be broader than that, for example if the same individual has other sources of income that are not being reported directly to HMRC. That is when there may be some confusion as to whether the individual should be completing a tax return—they may have been notified that they should—or whether they should not.

Coming back to your original point, I also agree that the presumption behind all this is that 95% of taxpayers will not be affected because they will benefit from an increased personal allowance, the starting rate for savings income and the personal savings allowance such that they will be non-taxpayers for this purpose. My concern rests more with those on the margins—those who are perhaps not sufficiently wealthy to enjoy the services of an accountant or a personal adviser but are sufficiently wealthy to exceed the thresholds laid down by the Government.

Q51 Lord Forsyth of Drumlean: Turning to the taxation of dividends, we have had it suggested to us that the proposed changes will modernise, reform and simplify dividend taxation, and alternatively that the dividend allowance is an example of the proliferation of tax reliefs already in the system that add to complexity for personal taxpayers. Which view do you think is right?

Dermot Callinan: As an Irishman I can say this. As the Irishman once said, “I wouldn’t start from here if I was you”. When it comes to dividend taxation, you have to cast your mind all the way back to 1973, when advanced corporation tax came into being, to understand the history of how we have got to where we are. Originally, it was a very simple idea: as companies paid corporation tax and dividends to individual shareholders, corporation tax should be paid when the dividend was paid, i.e. early. If it was paid early, and the tax needed to be accounted for, it was accounted for as advance corporation tax. The individual received a dividend and the tax credit was available to frank their income. When it was originally introduced, the tax was paid. In other words, it was not notional. It was not until 1993 that the policy changed. There was a divergence, and as a consequence advance corporation tax stayed at 22.5% but the personal tax on dividends came down to 20%. The more fundamental change came much later, in 1997, when advance corporation tax was deemed to be not reclaimable by many of the institutions that invested in British companies—pension funds, for example—with the consequence that pension funds were the poorer. The other consequence was that we ended up with a tax system with a dividend rate of taxation with a notional tax credit that, by 1999, bore no great relationship to what was paid by the company in corporation tax. Even then, we ended up with a complicated regime that people seldom understand. By moving away from the tax credit that is no longer paid by a company, we are now moving to a system that most practitioners have adopted in their own mind for some time. For some time, practitioners would look at what they considered to be the effective rate of tax on dividends, disregarding the tax credit. If you asked most practitioners what the effective rate of taxation is in 2015/16 for a higher-rate taxpayer, they would say 25%. They would say it was nothing for a basic-rate taxpayer and for an additional-rate taxpayer 30.5%, because they do the arithmetic in their mind and subtract and add the tax credit and apply the tax rate to it. Where we are moving to is simpler to understand in a sense. I certainly find it simpler to explain to a client. If you are a basic-rate taxpayer, apart from a nil rate of £5,000 the rest at the basic rate is going to be taxed at 7.5%, 32.5% for a higher-rate taxpayer and 38.1% for an additional-rate taxpayer. I will also need to explain to the client that this is, in fact, a tax increase.

Lord Forsyth of Drumlean: Just for my own information, may I ask about the impact of the Scotland Bill, which is currently before this House, under which the Scottish Parliament will be able to alter thresholds as well as rates but cannot change the rates on savings and

dividend income? Does that mean that the thresholds will be treated differently as well, or is this going to create a complication?

Dermot Callinan: I am sorry to answer a question with a question, but do you happen to know if the power to alter thresholds means that they can alter the basic rate band?

Lord Forsyth of Drumlean: Yes.

Dermot Callinan: If it does, then yes. If the legislation is as proposed and not amended.

Lord Forsyth of Drumlean: They cannot alter the starting threshold, but they can alter the subsequent bands.

Dermot Callinan: Take, as another example, the personal savings allowance. That does depend on what rate you are at. If you are an additional-rate taxpayer you are not entitled to it. If you are a higher-rate taxpayer you are entitled to a lower sum of £500. There is a direct correlation there. In relation to dividend taxation, the rate depends upon the rate band, so again it will impact. As with other sources of income, if that came to pass, I suppose you could end up with a taxpayer liable to taxation in Scotland at a different rate to a taxpayer liable to taxation in England.

Lord Forsyth of Drumlean: On dividend.

Dermot Callinan: On dividend.

Lord Forsyth of Drumlean: Even though the scheme is supposed to be that it will not be affected the affect will be because of that.

Dermot Callinan: Yes.

Q52 Baroness Noakes: We are told that one of the reasons for the dividend tax changes is to deal with the issue of private companies, including but not limited to personal service companies, using dividends as pay rather than employment income, thereby avoiding national insurance. So one of the impacts is that it brings the tax rates closer together. What are the implications for any of your clients, or indeed the clients of your members, in dealing with this? What are they doing to respond to the new rules?

Keith Richards: There is a general acceptance and understanding of why the change is being brought in. It is fair to say that a number of firms have operated within the current framework.

Most advisers are now working, in association with accountants, to advise firms or clients on how they are affected by these changes and what their options are. The dynamics here are that it is not just the advice to our members' clients: many of our members are small firms

themselves and actually use this mechanism to effect. I think there is a general acceptance that it is going to result in increased tax, which in some respects will now change the impact on the operating costs of the firm. There is a general acceptance that it may not force people to rush away from utilising that structure.

Dermot Callinan: I think the Government's intention was quite clearly laid out in the summer Budget Red Book. The changes were intended to start to reduce the incentive to incorporate and remunerate through dividends, but they wanted the tax system to continue to encourage entrepreneurship, including through lower rates of corporation tax. This measure seems to be intended to reduce the gap but, it appears, not to completely eradicate it. To one side, with regard to personal service companies, I think the Revenue has sufficient powers to tackle the abuse of these companies through IR35 et cetera. So I do not see that as being a contemporary problem necessarily. However, the broader use of the legitimate choice of having either a company or a sole trade by many people who are independent in business will be affected by this, because the gap is narrowed. I saw some very good work on this by Rebecca Benneyworth of the ICAEW. She reported on its website on 19 August and took the trouble for her members of going through and calculating how it would affect various different scenarios. She also calculated—I follow her calculations—the impact for people who form companies. She takes the example of a singleton company of an individual with a single personal allowance and calculates the effect at different rates of income. I can see from that that individuals are still, in those circumstances and taking these common factors, benefitting from being corporate. However, that is not so if they are at a much lower level of income: not at all at £18,000 and probably, with costs, not if their income is around £40,000 per annum. However, rising above that, there is a benefit, but a much reduced one. It seems to me that the purpose is to narrow the gap and it is effective in doing so. You can already see from the responses to Rebecca's calculations from members of the ICAEW that there is genuine concern and uncertainty about how their members will do the computation. Going back to the original question about how it affects us, our members and our work, I do not think it affects us—a large firm of accountants—as much as it will all the independent practitioners who are members of the ICAEW who will have to tackle this problem, on a case-by-case basis, with their individual clients who have companies but who could have been self-employed and who have to constantly make the choice. That will be the front line for this measure, and it will cause complexity in that area. At the moment, it

appears that it will still make sense to have a company, but, again, as I said earlier, the real difficulty for all these measures is on the margins.

Baroness Noakes: In relation to buy to let, before the removal of interest deduction was announced, there were suggestions that there would be a move towards incorporation. Are you aware of the prevailing view on the strategy for buy-to-let investors?

Dermot Callinan: Our view would be to proceed with caution because a buy-to-let investor should weigh up much more than simply the interest deduction. With relatively low levels of interest historically, I would be surprised if many buy-to-let investors benefited from incorporation. Incorporating costs money. Companies have to be maintained, and when profits are realised within a company, they are then taxed in the company and they need to be extracted. If they were to incorporate, they might end up not knowing what the ultimate consequences would be. So I would say "Proceed with caution". Perhaps if a company is running a larger property-letting business with many properties, it may begin to make sense, but, then again, that is what an ordinary English limited company is there for.

Lord Forsyth of Drumlean: On that point, why do you think the Chancellor suggested that you can benefit if you have more than 15 properties? What do you consider is the thinking behind that?

Dermot Callinan: Do you mean benefit from incorporating?

Lord Forsyth of Drumlean: No, benefit in that you can deduct the interest.

Dermot Callinan: I really do not know, sorry.

Q53 Baroness Drake: What impact do you think the dividend changes might have on the investment strategies that might be recommended by financial advisers? Do you think that there will be an impact?

Keith Richards: It very much varies from client to client, but in most instances clients who are under advice already have some pretty firm strategies in place. We do not think that these changes will have any significant impact, unless of course there is a dependency on a high level of dividend income. Advisers will go through each of their client's portfolios to assess whether they are optimising the various allowances and tax wrappers available to them in the light of any tax change.

Baroness Drake: But you do not anticipate a significant behaviour response from advisers.

Keith Richards: We certainly do not sense that at the moment from the feedback from advisers across the country, but of course individual cases will be made where there is a

higher impact on one client rather than a general impact. So from a general point of view, there does not appear to be significant concern.

Baroness Drake: In terms of products for investors, will the industry develop new products to take account of the £5,000 dividend allowance alongside ISAs? Can you see that happening?

Keith Richards: In many ways, the simplification and alignment of language in personal allowances seems to follow a sensible thread that will probably provide a benefit once people become more aware of what is available to them. From the savings strategy point of view, there is some support with the personal savings allowance, the dividends allowance and the ISA allowance increases. There has been an argument that while perhaps there is not an advice gap, there is a needs gap, and the Government currently also have an advice market review under way in recognition of the fact that there certainly needs to be increased access to generic information that empowers people to make more informed decisions and gives them more confidence to invest in the market. So I think that some innovation will follow as a result. But the bigger challenge is that consumers who do not have the benefit of being under advice tend to be hugely suspicious of investing in the markets, and more needs to be done to incentivise them to enter a different landscape.

Baroness Drake: The industry can hesitate on developing new products if it is not confident that the rules are going to hold for a reasonable amount of time and there is going to be quite a lot of change. Do you have any sense of whether the adviser community or the wider industry has a feeling of the direction that the Government are going in the taxation of investments and savings?

Keith Richards: I think there is a level of confusion about the real drivers behind the obvious interest in generating revenue for HMRC versus the fact that there is a need to engage the public more broadly into a savings culture, given the need to help people who are living longer than they have ever lived before to have less dependency on the state later in life. The public pension reforms, for example, are stimulating a lot more interest from the public. In one fell swoop, effectively the tarnished reputation of the word “pension” seems to have been swept away, and perhaps a lot of that is geared around the fact that people can now access money that may not have been easily accessible to them. It seems to have stimulated an interest in the accumulation stage: giving people greater freedom when they get to retirement or at earlier stages seems to be creating a lot more interest, with people

approaching advisers for strategies on how to save for the future better and more effectively. The industry is not entirely sure where all the drivers are coming from, but clearly we know that a win-win situation would be the right solution.

Lord Teverson: Mr Richards, I should probably know this by now, but could you explain to me what difference, if any, this makes to collective investment schemes other than investment trusts, which I presume would be dealt with in the ordinary dividends way? I am not even quite clear how they are dealt with at the minute. Obviously a lot of income is rolled back into unit-based collective investment schemes. If you take income out of it, how is that affected, and does it create any reason or motivation to change investment strategies?

Keith Richards: That is a good question. We were talking about this before we came in. Dermot, you have an example of that.

Dermot Callinan: The answer is, first, that we are not completely clear about the extent to which deduction of tax at source on funds, for example, will fall in line with the abolition of the deduction of interest at source on accounts. Part of the Government process at the moment is the consultation document on the deduction of income tax from savings income. That was issued in July and submissions on it are now in. In our own submission, my colleagues Rachel Hanger and Paul Bradbury put forward the proposition that there should be as level a playing field as possible by withdrawing the withholding tax on interest distributions from authorised investment funds. Our view is that the industry and taxpayers will benefit from some clarity on this. We hope that our representation will be received well. In fact, having looked at the HMRC assessment of the representations, we are probably in line with most of what people have said.

Lord Teverson: Is there any argument not to do that, given that, as you say, it would be distorting if it did not happen?

Dermot Callinan: I am not sure whether this is an argument, but certainly it is a concern. If individual taxpayers receive much more gross income, will they have a much greater reporting requirement? Will more taxpayers fall within the self-assessment regime? I think you may have heard evidence from our institutes. If digital statements and information passing efficiently from organisations to the Revenue cover the position, there should not be a problem, but that is the only concern that I am particularly aware of.

Q54 Lord Bilimoria: I want to build on Baroness Drake's question and declare my interest. I have been a personal client of KPMG, and the company in which I am a senior director is also a client of KPMG. Would you agree that the complexity of tax is increasing significantly with these changes? From an IFA point of view, are the changes creating more of a burden for you, or are they creating more business for your financial advisers? Also, from an accountant's point of view, these constant changes must be good for business.

Keith Richards: I guess my answer would be that the demand for advice has been increasing, and it did even prior to the pension reforms. Since the pension freedoms were introduced, demand has increased further. We are now seeing a lot more active engagement from consumers, who are now actually thinking about investment strategies, so any changes to tax regimes clearly increase demand for effective advice. Therefore, the answer to your question is that, although we see some attempt at simplicity being introduced, those at the margins who are self-reliant may get caught in not declaring tax when it is due.

Referring back to the financial advice market review, the cost of advice has increased over time with the increasing costs of regulation and operation. Now, lower-cost or more simplified advice solutions are being sought, and that in itself could help to aid increased access. A very large part of an adviser's role is to look at optimisation of tax allowances and the most tax-efficient wrappers to use, but the general public who will be self-serving or who will not necessarily be encouraged to see an adviser would not be aware of the most tax-efficient ways in which to invest. So I think that more needs to be done, and that seems to be recognised through the financial advice part of the review. Certainly "need" is there; "demand" is questionable, but we have been seeing a demand for professional advice over the last two years.

Dermot Callinan: There is clearly complexity coming into the tax system at the bottom end, but it seems to be with a good intention, which is to encourage savings and to take more people effectively out of taxation with savings income. An interesting equation would be to see just how many individuals are lifted out of taxation as a consequence of this, despite the adverse consequence—if it exists—of complexity. I know that I have already emphasised this point, but I think that it is around the margins where there is complexity and where the following sorts of questions will be asked. Am I entitled to the personal savings allowance, or not? Where do I fall in relation to the starting rate of income tax? Should I transfer my personal allowance, or not? Should I receive a dividend, because it is going to be covered by

the nil-rate band, or not? Will the dividend that I receive exceed the £5,000 and push me into a higher rate? Will I straddle two rates? So it is at these margins that we have complexity.

I am very confident that most chartered accountants and chartered tax advisers will be well equipped to advise their clients, and I am sure that in that regard the changes will produce more work, particularly around the whole question of whether it is worth an individual becoming a company. There might also be increased demand for a lower-cost tax return service if individuals find it much more difficult to deal with their personal tax affairs on their own.

Realistically, there is an inherited tax regime that itself is very complicated. When I studied for my tax exams, I had two volumes of legislation about that wide. Now, if I had wanted to bring it with me today, I would have needed a wheelbarrow because it is about eight volumes and about that wide. Tax legislation is inherently complicated, but the world we live in is inherently complicated, so I do not know whether we are right in our expectations for simplification, with a person working out their personal tax with a calculator and a piece of paper. In 2016 the question may be, “Will HMRC provide me with adequate tools to work out my tax position?”

Q55 Baroness Wheatcroft: It seems that there has been talk from government and HMRC over recent years about a different way of forming tax policy that involves more consultation and road maps, et cetera. Do you think they are sticking to their word on this, or does the current legislation seem to you to be rather piecemeal and abandoning a lot of consultation?

Keith Richards: I am not sure where the consultation or engagement came in initially. I think that the changes are very well intended, and we are now trying to catch up and understand what the unintended consequences might be. We saw a very similar approach of no consultation prior to the announcement of the pension reforms, and we are very much doing a catch-up job there. It is very difficult not to see where the Government are coming from and why they have implemented those reforms. To answer your question, prior consultation might not have changed the outcome but we might not have been trying to catch up after the announcement.

Dermot Callinan: It seems to us that there has been a lot of consultation across a broad range of measures. Certainly with regard to my own subject area, substantial resources are devoted to responding to consultations that are presented to us, and we welcome that

opportunity. I suppose that there will be occasions when government does not perceive consultation as so much of a priority, depending on the measure being brought before us. Our preference would be to have the opportunity to consult on each and every occasion, but I am not sure that that is always possible.

Lord Teverson: Perhaps I could quote from HMRC's research in 2015. It said, "Awareness among higher rate tax payers of the requirement to declare and pay additional tax on savings interest, following the initial deduction of 20% under TSDI, was very low"—i.e. the awareness. What are the implications of this finding, as we are only some eight or nine weeks away from the start of the regime of simple assessments of tax liabilities based on third-party information? Can the institutions, or indeed anyone else, do more, or is there co-ordination of any sort between HMRC and the institutions? Are we going to win through here and keep the customers aware, if not happy, so that at least they know what they have to do?

Keith Richards: I do not think the findings will surprise anyone. People often find tax affairs quite daunting, and as a result they probably do not pay quite as much attention to them as they should. One could argue that that is not a lot different from how it was in the past. People generally have to catch up. The industry can do more with HMRC's support, for example with some generic quick-reference guides and some simple material. Firms are communicating with consumers all the time, so finding ways of simplifying the information and bringing it to people's attention would be a good start. Going across the whole industry—whether it is banks, building societies, insurance companies, advisers, tax advisers or wherever there is a regular communication path—having a generic form of information that helps to inform people of the changes and explain what they might mean to them would be a good, consistent starting point. The more you use consistent language and terminology, the easier it is for people to understand.

On top of that, we need some form of simplification. I have mentioned the financial advice market review probably three times, but it means reducing the number of access points where people can get information with the fear of it crossing the line of regulation. Tax planning within saving is a very important aspect. More needs to be done to encourage the FAMR output to increase the number of access points where people can get simplified advice, including on tax changes and their implications. That would be another very positive step forward.

Dermot Callinan: Our perspective might be slightly different, because the awareness point is met by people consulting us. If an individual is unsure, they will ask, so the adverse consequences of a lack of awareness are not so apparent to us. My experience of individuals, especially highly intelligent and successful business people, is that they are very seldom experts on tax and therefore need advice. If they do not have it, the more complex the system, the likelihood of error must increase.

Lord Teverson: What are the implications if there is no greater awareness? I accept entirely that the people you are dealing with be aware because they are dealing with you, but what about the other people you are talking about? Will there be a crunch, with something going wrong down the track in 15 months' time?

Dermot Callinan: If the concern is awareness, the answer must be communication. When I was preparing for today, I did not see a very large amount of communication about these tax changes and how they will affect individuals. If we ourselves were running this as a business process, we would want to increase the amount of communication so that people could understand how it affected them. Complexity itself is not necessarily the problem; the problem is how you deal with it. If there is an adequate level of communication—with worked examples, tools, explanations and access points—then complexity can be absorbed.

Lord Teverson: In these days of social networking and all sorts of other technologies and apps, do you have a feeling that there are better ways of disseminating this information, or are we still in the 20th century as far as this is concerned?

Dermot Callinan: To give you an example, you would associate firms such as KPMG with larger corporates, because historically KPMG has undertaken more complex work. It is a large organisation with over 13,000 people in the UK and we do not necessarily act for all the individuals at the margins whom you may be concerned about. However, we recognise that there is a market for accounting services if, to an extent, they can be automated and centralised, and we have embarked upon that. So we have a small business accounting service and it operates successfully in 2016, but only because of technology, whereas it would have been impossible in, say, 2000. With technology, we have been able to enter this market and provide the opportunity for self-employed individuals and small companies to gain access to our systems, enabling them to be compliant taxpayers and compliant accounts preparers. So it is possible to face complexity on a large scale with modern solutions.

Keith Richards: The challenge with technology is that a whole number of mechanisms and mediums need to be employed. The question is whether there is going to be an issue further on with people who are caught at the margins and who do not use online tools because they do not realise, or even recognise, that they have a tax liability that they should have been budgeting and planning for. That is the unintended consequence for people who are just caught: some time later, they find out that they did not plan in a liability that they should have been aware of. The problem lies with people who do not pay too much attention and do not Google something unless they have a need to do so. Technology, the online tool systems and the simplification work really well when someone is alert to the issue and they are searching for the challenge. People are becoming increasingly aware that they can use technology to ask simple questions and find the tools to help them through. But there is the issue that if you are not aware of that, you will not be looking for it.

Lord Teverson: Are you saying that awareness is the only problem and that afterwards everybody will know because they will either have done it right or have been told off?

Keith Richards: That is subject to whether everything stays the same, but change is constant. If change has an opportunity to become embedded and common language is used, the chances are that more and more people will become acutely aware of it and it will become far less of a problem. In the short term, there are a number of mechanisms that can be used. Every individual should be written to with a simple guide to help them decide whether the change affects them and what they should be alert to, and there are a whole range of other things that industry can join in. A lot of this has to be driven by HMRC with key messages that are very consumer-centric and help to raise awareness, and which then drive people to the right sources if they need more information. You should never underestimate the challenge of getting the message out to a large number of people.

Lord Teverson: I have one last quick question on this. From my own experience, the people who know most about my financial circumstances are HMRC. I deal with a tax adviser. I presume that HMRC has my email address, but it normally writes to me rather than email me, which is infuriating. Could you not just communicate through email with most of the people who will be affected by this?

Keith Richards: HMRC has over time encouraged people to sign up to e-communications. I am not quite sure where it is on the percentage of people who have done so, but bearing in

mind that a number of older people will not necessarily be so familiar with technology, that could be a challenge.

Lord Teverson: So there would be a certain number whom you could not get to.

Keith Richards: Yes.

Lord Teverson: Thank you.

Q56 Lord Turnbull: We live in a three-tier world in which there are large numbers of people who do not necessarily pay large amounts of tax but their affairs are largely looked after by their employer or tax is deducted at source. At the other end are people with quite a lot of money, from income or wealth, who are advised, and in the middle there is what might be called the DIY market—people who can prepare their own tax returns in relation to income, pensions and investments. However, what seems to be happening is that the looked-after world is getting bigger because of these new allowances and no deduction at source, but the DIY world is getting squeezed. How much simplification should we aim at? Should we not aim at a world in which a reasonably intelligent and reasonably well-organised person is able to prepare their own tax return? We are getting to the point where that looks less and less popular. If you are not in the looked-after world, you are almost getting forced into the IFA world, which has costs. I have known of cases where people have gone to an IFA and the fees—I am not saying that they were unreasonable—have absorbed a very large amount of the extra benefit that people got from taking that advice. It is a very frustrating position to be in. There is so much going on around the £40,000 or £50,000 income level, with all sorts of allowances beginning to disappear or getting clawed back. There are different allowances for different kinds of income to the point where this “middle class” can no longer, without paying for advice, look after their own tax affairs. I regard that as rather regrettable.

Keith Richards: Complexity has increased the need for advice, but it does not just sit around one concept of tax return. For example, optimising tax through the most tax-efficient vehicles can in itself more than pay for the cost of advice—and some. There is a perception that you are paying for something that is spent rather than something that could save you several thousand pounds and puts in place a very effective investment strategy, optimising the current tax regime. That is not well understood. Those who are advised rarely step away from the advice because they can quantify the true value versus the cost. The bigger challenge is for those people who you said are caught in the middle ground and who do not always understand the benefit of seeking professional services. They feel quite confused

about exactly what is going on and sometimes feel powerless to do anything until someone helps them. This comes back to the point about simplifying information that empowers people to make better-informed decisions. That may well mean helping them to understand where the benefits of receiving professional advice and services lie, versus being directed to a simplified online self-serving system with a few tools. With this simplification, there are a lot of people who could well fall outside having to complete tax returns. The risk is for those who do not understand when there is a need to declare additional tax liability.

Lord Turnbull: I confess that I did not know about TDSI and the other thing that we are talking about. I have not heard a peep out of HMRC on this, and I have not seen a lot in the press about this. Clearly a lot of people will probably find out about it when they come to do their return later in the year, but some of these changes in the portfolio ought to be taking place at the start of the year. There is a big gap between what reasonably informed citizens ought to be allowing and what they are not giving.

Keith Richards: I think that is correct. It is a case of trying to separate out the public in all demographics rather than just those who are under advice. Those who are under advice very often do not understand the changes that are coming in, but to some degree that is because they rely on the fact that they are paying for services that protect them, guide them and help them understand the changes.

Lord Turnbull: By the end of the year, once they have been through one round of an annual review, they will get that.

Keith Richards: Of course. That is the point that is being made. People who are not under advice will not necessarily realise that they should get some advice because they do not understand what is happening. They have not heard the news yet and they do not understand what is happening. That is where we have a responsibility.

Lord Turnbull: I suspect that this is around the position in the income distribution where there are quite large numbers of people.

Keith Richards: That is quite possible.

Q57 Lord Turnbull: The other question concerns the TDSI and non-TDSI sources of interest. You referred to bonds and so on and the complications that there might be from collective investments, with a bit of interest coming through one stream and a bit coming through another. What priority do you attach to getting greater convergence so that the scheme covers a much wider range of interest sources?

Dermot Callinan: As I said earlier, there is a value in consistency—not just in the context of these changes but internationally. For example, Eurobonds do not carry a tax deduction at source, but you could be investing in an authorised investment fund in the UK that has, underneath it, bonds that do. Ironing out the inconsistency seems to us to be a good thing. I take your point, Lord Turnbull, about the complexity for those in the middle. One would hope that the communication would enable them to understand that interest is not being deducted at source and that the personal savings allowance is there for them.

Lord Turnbull: You say “the communication”. What communication?

Dermot Callinan: The sort of communication that I have in mind would be from HMRC to help individuals to understand the changes.

Lord Turnbull: Is HMRC planning any? Has it consulted you on any draft leaflets?

Dermot Callinan: I am not aware of what HMRC’s plans for a campaign are. Maybe that is a question for HMRC.

Q58 Lord Teverson: Our clerk very usefully circulated an HMRC myth buster to us before this meeting. The first myth was that businesses will need to do four tax returns a year. HMRC responded by saying that this was completely untrue. It says, “The new digital accounts will integrate all the different information businesses already provide to HMRC into a simple, streamlined system. Instead of one big, onerous tax return each year, once a quarter businesses can check that the information they are collecting digitally is correct, and simply click send to update HMRC”. From your point of view, is that not totally naive in that anything anyone sends to HMRC they are going to check and double check? If you are like me and you have an accountant who checks just to make sure that everything is absolutely squeaky clean, you are going to end up doing that four times a year rather than one.

Keith Richards: It seems so.

Dermot Callinan: I am quoting the *Financial Times* here, which perhaps I should not do, but I think that comment is attributed to Mr Gauke. It says, “This is not going to feel like doing four tax returns a year ... adding that the updates will be ‘far less burdensome than the tax returns of today’ because they will be less complex and will be generated from existing digital records and information passed directly to HMRC”.

Lord Teverson: But you are going to get someone to make absolutely sure that they are right, are you not?

Dermot Callinan: Let us hope they are.

Baroness Drake: I think the point that Lord Teverson is making relates to the behavioural response of people. It is all right for the Government to assert that it is all going to be very easy to do this quarterly, but people will be anxious about sending information to the Revenue with the click of a button. The person, not the Revenue, is going to be anxious and therefore will invest more time, money and effort in checking the veracity of that information. So it is the behavioural pressure on the individual rather than the perception of HMRC that is the point.

Lord Kerr of Kinlochard: I am amazed at your moderation—I have to admire it. It seems to me that our witnesses say that complexity is not the problem; it is what you do about it. I am reminded of Emperor Akbar and the Mughal horde looking down on the rich plains of India. It has to be the accountancy profession that will gain from all this. You guys are going to do extremely well from this. As we have been bringing out, this is quite complex for the individual taxpayer. We have been talking about the taxation of individual income up until now. When you look at companies and quarterly reporting by companies, it seems to me that the requirement for expert advice is going to be even greater. The one clear gainer from this Finance Bill is the accountancy profession. Is that right?

Keith Richards: I am not in the accountancy profession.

Dermot Callinan: It might be a question for me, then. The accountancy profession is very diverse. You cannot really look at KPMG and say that it is the accountancy profession. The accountancy profession is all the individual members of the Institute of Chartered Accountants in England and Wales, and the Institute of Chartered Accountants of Scotland. Will sole practitioners operating in high streets be busier as a consequence of this? They will be, but will it make them richer accountants? Probably not. If you look at the operation of an independent accountant, he or she will have to learn these new rules, which are complicated. That will require extra training, commitment and research, and they have to practise it before they can bring it to their individual clients. Their individual clients have to appreciate the value, and quite often in practice they do not see the value in compliance work. They see it as being a burden which they have to deal with but they do not particularly welcome it. So I am not sure that anybody really wins in a situation like this.

Keith Richards: I would say yes.

Lord Forsyth of Drumlean: Is not the answer to Lord Kerr's question no? The sort of people who are going to be in difficulty and confused are the people whom Lord Turnbull

highlighted. You do not want their business because they are not going to be able to pay the fees, but they are going to be muddled in the middle.

Keith Richards: Yes, quite. I think that is right. That is the population that we ought to focus on, making sure that more generic, straightforward information is provided to them so that they can make better, informed decisions. It has to start with the Revenue. A letter directly from the Revenue will very often get people's initial attention. To complement that, a range of communications can go out from other mediums in partnership with HMRC.

Lord Forsyth of Drumlean: Do you think that the Revenue has a handle on the extent of this? Lord Teverson has been talking about the myth buster leaflet. To me, it reads as though it has been written by somebody from another planet. I am very concerned about people who are not digitally skilled—for example, elderly people, quite a lot of whom will be in this category, or small businessmen who turn up at their local accountant's and hand them a box of paper that has to be sorted out, which is extremely difficult to do. This leaflet says, "Myth: This does not consider those who are not digitally excluded. There is no question of forcing those who cannot go digital to do so. Help will be available for businesses who struggle to use digital tools. People who genuinely can't use digital tools will be offered alternatives, like nominating someone else to update their information for them, or giving information by phone". Yet we read that the Revenue is so stretched that if you ring them up you listen to Vivaldi or something for several minutes. Do you think the Revenue really has a handle on this?

While I am talking, may I apologise to you, Mr Callinen, regarding a question I asked earlier? I implied that businesses with 15 properties would be able to claim interest relief. I was muddled. I was referring to the fact that they would be exempt from the 3% additional stamp duty. That was the point.

Dermot Callinan: I understand. Thank you. The success of this must depend on HMRC's ability to deal with people who are not able to comply with digital systems. Again, it is a question for HMRC as to whether or not it truly is able to do that.

Q59 The Chairman: Coming back to small businesses, I think you were saying, Mr Callinen, that there are a number of choices now facing small businesses, or completely self-employed people who should become small businesses as they would then be advantaged from a tax point of view. Lord Turnbull's muddled middle includes a lot of people who either sit in small businesses or are self-employed—one of the fastest-growing sectors of the

economy. Until we get to the promised land of simpler taxes, those people are going to be faced, are they not, with much greater complexity and costs, which, quite properly, you will seek to pass on for providing advice and help in addressing that complexity. Will your small businesses and self-employed customers not incur greater cost in doing business going forward?

Dermot Callinan: Clearly any change that is a consequence of a change in legislation is not a change caused by the adviser. The adviser may well seek to recover the cost, but, as I mentioned earlier, it is not necessarily the case that all the costs will be passed on. That does not automatically follow. This complexity is not new; generally there is complexity every year with the Finance Bill. We are just considering this year's complexity. Much of the complexity results in the adviser having to absorb an element of the cost of training.

Smaller businesses—we do not represent many smaller businesses, apart from through our separate small business accounting system—may well find it difficult to access instant information about these changes unless their accountants are all very proactive in explaining the changes to them. The only thing I can predict is that that cannot possibly be consistent throughout the whole profession. There will be lots of areas of good response to clients and there will be lots of busy accountants who do not have the time.

The Chairman: You mentioned communication, and clearly it falls to HMRC to communicate as crisply and clearly as possible. From both your experiences, does phoning HMRC with a query in which you seek to understand some of the complexity here tend to yield a very positive result in the sense that people come away saying, “I think I now understand it”? Is that quite a difficult route?

Dermot Callinan: To be honest with you, my staff have not raised issues with me about how calls are dealt with by HMRC, but that may be more to do with the nature of the interaction that we have than the source of the information that you are referring to. That, although I do not know, may relate to smaller cases. I could not put before you evidence that there is a problem when we have not experienced it.

Keith Richards: I would echo that. In fact, the feedback generally is that, when you can get through, HMRC is helpful. Communications sometimes confuse people because they use language that is not always consumer-centric, and therefore uncertainty creates confusion. But HMRC does seem to have a reputation for generally positive feedback: when clients ring it directly, they tend to understand. Most people's concern is a fear of the tax system and a

fear of getting it wrong. Whenever change comes in, older clients in particular tend to worry because people do not want to get their tax position wrong; they do not want the burden of that. Very often, once they investigate or an issue is explained to them, they find that it is not quite as complex as they first thought. That is often the starting point. People say that once they have got their head around it, it is not quite as daunting or as complex as they first thought. For some reason, human nature being what it is, we tend to fear the unknown, and tax has always been one of those subjects that people are generally quite fearful of. We generally find that small businesses will engage an accountant simply because they do not want to get their tax position wrong and not account for, or budget for, appropriate tax liabilities into the future.

Dermot Callinan: We observed that in the summer Budget statement under the heading “Reform and Sustainability” and the section relating to dividends tax, the abolition of credit, the £5,000 allowance and increasing the effective rates by 7.5%, collecting tax from the prior year was expected to yield an additional £2.54 billion in 2016-17. So maybe HMRC will be able to afford some resources to improve the delivery of these services.

The Chairman: On that cheerful note, I thank you both very much for a very helpful session.