The Taxing Wealth Report 2024

Every politician's guide to "How to pay for it"[1]

The reform of income tax and capital gains:

Imposing a lifetime limit on ISA contributions

Brief Summary

This note proposes that:

- The current limits on ISA contributions are not working and are creating opportunity for some to accumulate considerable wealth in the UK in a tax-free environment when that was never the intention with regard to these accounts.
- That the contribution limit to ISA accounts should now be stated as a lifetime limit of £100,000. Transfers between ISA accounts would be ignored for this purpose. Withdrawals would not, however, reset the limit. Those who have now contributed this sum would not be able to make further contributions to ISA accounts.
- That any income or gains on ISA accounts where aggregate balances now exceed £200,000 should be subject to income tax and capital gains tax. If sums held in ISA accounts are not reduced below this level in a reasonable time period then exemption on all such accounts should be lost by the person owning them.
- Given that ISAs were always meant to encourage those with limited means to save more these changes are entirely consistent with the original intention of those who introduced these accounts. The significant increase in contribution limits in recent years has subverted the supposed economic reasons for the existence of these accounts, which are now a simple subsidy to those with wealth and considerable sums to save.
- This recommendation might save £100 million in ISA tax reliefs a year.

[1] This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See https://www.financeforthefuture.com/taxing-wealth/. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP.

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Finance for the Future and Sheffield University Management School

The proposal	To impose a limit on the total contributions that a person can make to an ISA during their lifetime to £100,000 and to limit the benefit of ISA tax reliefs to funds not exceeding £200,000 saved within ISA accounts. ISAs are Individual Savings Accounts, as defined by law. They exempt the income and gains generated by the sums saved in them from charge to income tax and capital gains tax. Subscriptions are at present capped by annual limits.
Reason for the proposal	1. To improve the horizontal equity of taxation, which is currently undermined by the excessive use of ISA tax reliefs that mean too large a disparity in rates of tax paid on savings income and gains has now developed between taxpayers within the UK tax system. 2. To increase the prospect of vertical equity of taxation in the UK which is heavily dependent upon the creation of improved horizontal tax equity, and which is undermined when the excessive use of ISA tax reliefs is permitted. 3. To reduce the tax spillover effect that the excessive use of ISA tax reliefs has created. 4. To raise additional tax revenues from those most able to make such payment.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation is likely to be limited. The number of people it will impact is relatively small. They will not stop saving because of this change in ISA tax reliefs.
Ease of implementation	Relatively straightforward, not least much lower limits for permissible savings in ISA accounts existed relatively recently.

	An estimate of £100 million, or £0.1 billion, of revenue raised from this change might be fair without having access to more detailed information held by HM Revenue & Customs. The proposal is made to improve the equity of the UK tax system and to indicate that tax reliefs must be targeted to be effective in achieving their goals.
Likely difficulties that might result from implementation	Few. Some small technical issues with identifying funds in existing ISA arrangements that exceed £200,000 in value might arise but otherwise HMRC has all the available data to make this new arrangement work since ISA account usage is already tracked by them.
Likely time required to implement the change	Months in the year preceding the year of actual change.
Consultation period required.	Short, largely because of the familiarity that already exists with multiple rates of corporation tax.

Background

As The Independent newspaper reported[2] in August 2023:

> The number of "ISA millionaires" has surged to more than 4,000, according to HM Revenue & Customs (HMRC) figures.
>
> Some 4,070 savers were sitting on ISA pots worth more than £1m, as of April 2021, according to the data, obtained following a freedom of information (FOI) request on behalf of financial services network the Openwork Partnership.
>
> The number of ISA millionaires has nearly tripled year-on-year from 1,480 in 2019/2020, according to the HMRC figures.

ISAs are properly termed Individual Savings Accounts[3]. Introduced in 1999 to replace a previous Conservative government-created tax-incentivised savings plan, ISAs were meant by their Labour Party sponsors to achieve three things.

First, they were meant to increase savings.

[2] https://www.independent.co.uk/news/uk/home-news/isa-millionaires-uk-business-b2385379.html
[3] https://www.gov.uk/individual-savings-accounts/how-isas-work

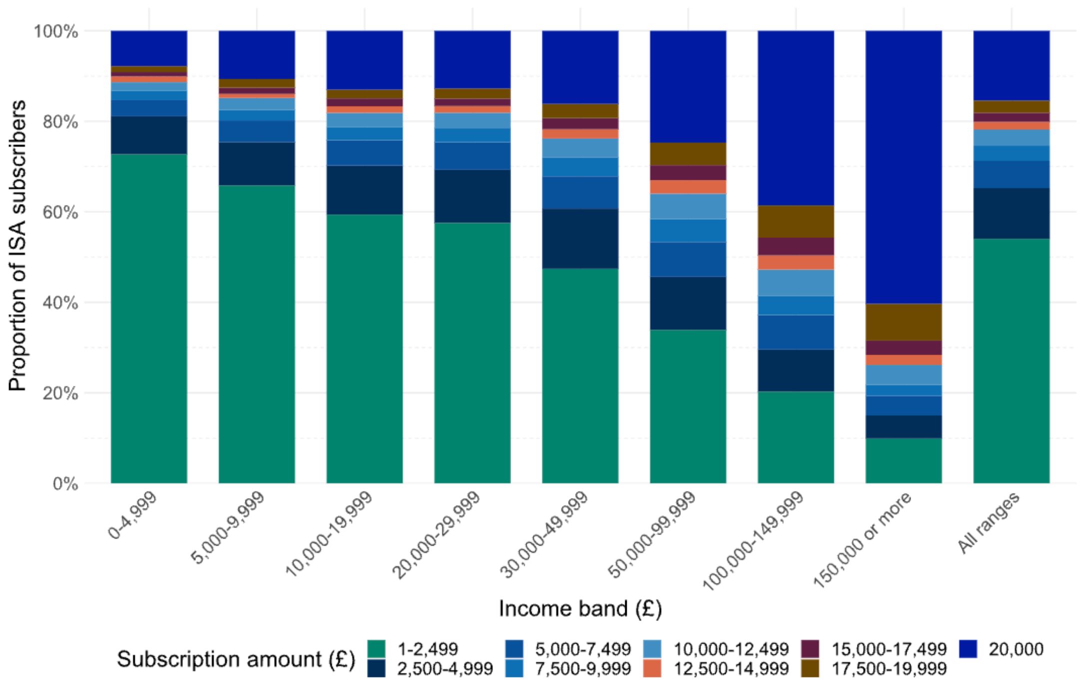
Second, they were supposedly targeted at those with more limited means to save because caps on the annual amount that could be saved were relatively limited at first, obviously with the obvious intention of restricting the opportunity for abuse.

Third, they were meant to do this by providing a subsidy in the form of tax-free income and capital gains for sums saved within the ISA.

Until 2010 the total annual subscription limit was at most £7,200, with half of that sum having to be held in shares. Since then, the limits have increased considerably. £20,000 may now be saved per annum, with all of that being capable of being held in cash if the saver so desires. However looked at, saving £20,000 per annum is not a normal economic activity when UK median household income is approximately £27,700 before tax per annum[4].

Recent data from HM Revenue & Customs[5] shows that the amount subscribed to ISAs varies considerably dependent upon the income of the person subscribing:

Chart 1: ISA subscriptions by income band and size of subscription in 2019 to 2020



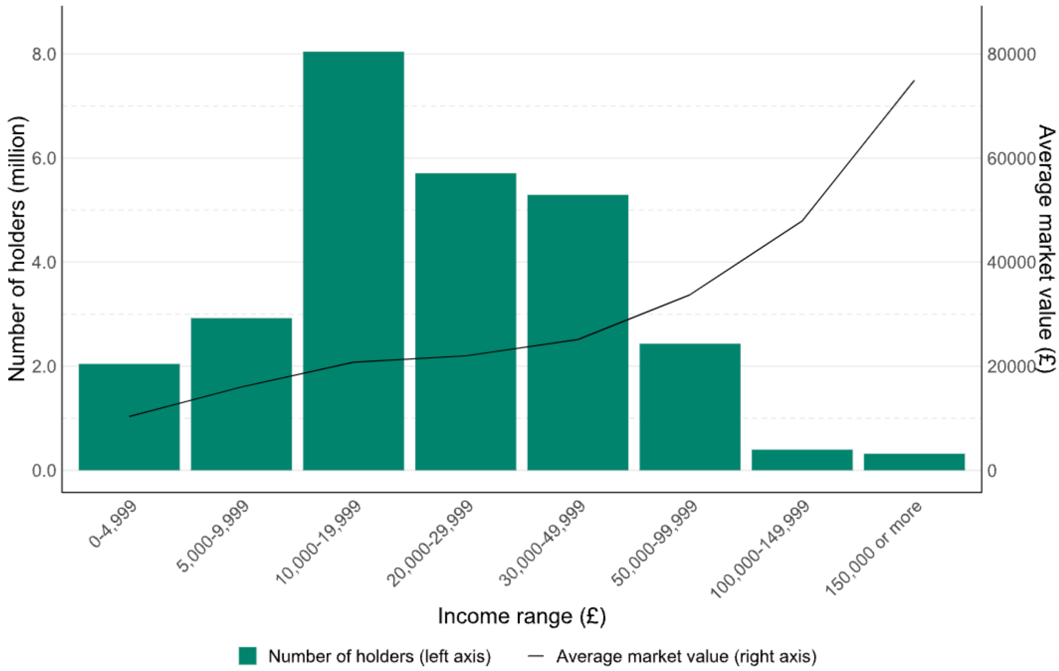
4 https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/earningsandemploymentfrompayasyouearnrealtimeinformationuk/latest#median-monthly-pay

5 https://www.gov.uk/government/statistics/annual-savings-statistics-2022/commentary-for-annual-savings-statistics-june-2022#:~:text=Chart%201%20below%20shows%20that,ISAs%20increased%20by%20around%20860%2C000.

Unsurprisingly, those with highest income make by far the largest contributions to their ISA accounts, with a deposit of £20,000 being commonplace amongst those earning £150,000 or more a year and frequently occurring amongst those earning £100,000 to £150,000 a year. In comparison, amongst lower income earners (and all those earning less than £50,000 a year) the most commonplace subscription per annum, by far, is of less than £2,500 a year. The benefit of ISA tax relief is, therefore, likely to be heavily biased towards those with higher levels of wealth as a result. That is especially the case because those with higher levels of income also save both income tax and capital gains tax at higher rates when sheltering savings within ISA accounts.

The resulting estimated market value of ISA accounts is as follows:

Chart 2: **Number of ISA holders and average ISA market value by income band in 2019 to 2020**



As is apparent, most ISA accounts have a market value of less than £100,000. They are, therefore, likely to be unaffected by the proposals made here. A few thousand accounts may be and it would seem that they are most likely going to be held by those earning £100,000 or more a year.

So, how do ISA millionaires come about? That required good stock picking and saving in shares, probably to the maximum amount permitted in each year. The result is a considerable likely tax subsidy to those who have used the scheme in this way.

What is clear is that the spirit of this scheme, which was focused on smaller savers, is being abused as a result.

Both the horizontal equity and vertical equity of the tax system are being undermined as a consequence. Income of similar sorts is not being taxed in the same way (horizontal inequity), and progressive taxation is also being undermined (vertical inequity). At the same time, tax subsidies (ISA subsidies cost about £4.3 billion a year[6]) are not being used as intended.

Recommendations

The actions required to address this abuse are threefold. First, there should be a lifetime maximum subscription to ISAs. £100,000 might be fair and is still well beyond the reach of most people as the above noted data shows.

Second, in exchange for the tax relief, the funds saved should be used for social purposes. They could, for example, be linked to a requirement to save in green bonds[7] issued by NS&I.

Third, if the funds in an ISA grow to more than a limit (£200,000 would appear generous), then it is suggested that funds in excess of that sum should be transferred to an account not enjoying tax exemption. A reasonable time limit for doing so should be provided but if not done then the ISA account holder should become taxable on all funds in ISA accounts.

As it is, this relief is being used to increase income and wealth inequality in the UK, and that is unacceptable and is not a purpose of tax relief. The suggested reforms seem to be an obvious step to take in that case.

The sum saved as a result of this change would be modest. An estimate of £100 million, or £0.1 billion, might be fair without having access to more detailed information held by HM Revenue & Customs. The proposal is made to improve the equity of the UK tax system and to indicate that tax reliefs must be targeted to be effective in achieving their goals.

[6] https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs/non-structural-tax-relief-statistics-january-2023#:~:text=NICs%20(estimated%20at%20%C2%A324.7%20billion%20in%202021%20to%202022)

[7] https://www.nsandi.com/products/green-savings-bonds