The Taxing Wealth Report 2024

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

Reforming income tax and capital gains tax

Changing the conditions attached to ISA tax relief

Brief Summary

This note proposes that existing ISA savings arrangements should be scrapped because they provide almost no overall economic return to the country as a whole, very largely subsidise the savings of the already wealthy, and divert funds away from much more constructive use.

Green ISAs are proposed in place of existing ISA savings arrangements. These Green ISAs would have to be invested in either government backed savings accounts or bonds or private sector equivalent accounts, all of which funds would be required to invest the proceeds of sums raised in:

- The transition to net-zero that this country requires.
- Social infrastructure, such as new housing.
- Related activities such as education, training and appropriate support services.

[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. © Finance for the Future LLP 2023

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The option of simply leaving cash in moribund bank accounts or of speculating funds on stock markets, which is how the £700 billion or more now saved in ISA accounts is currently used, would disappear over time as existing ISA account arrangements expired and new ones took their place. £70 billion a year goes into ISA accounts at present, the main appeal being their tax-free status.

The creation of a new source of capital for public investment from this source would as a result turn the current £3.7 billion (and rising) annual cost of subsidising such accounts from being lost money into a valuable source of funding for new investments that would in themselves generate new taxation revenues. At the very least the entire cost of the tax subsidy for these accounts would be saved by the tax paid on that new investment (with the actual sum generated likely to be very much higher). As such it is suggested that at least £3.7 billion of tax cost will be saved a year as a result of these changes.

The proposal	To end all existing ISA (Individual Savings Account) savings arrangements and to put in their place new Green ISA accounts, the sums saved in which accounts would be required to be invested in the green transition in the UK economy and other social infrastructure projects.
Reason for the proposal	1. To make better use of the near £4 billion tax subsidies being given to ISA account holders in the UK at present when the return to society from the provision of this subsidy is, at present, very hard to establish, and may not exist. 2. To provide a source of capital for new infrastructure investment in the UK that will meet climate and social need. 3. To raise additional tax revenues as a consequence of investments made.
Estimated tax that might be raised as a result of the recommendation made	The tax that would be raised as a result of this change would result from the increase in investment activity that it would give rise to in the UK economy, the economic

	multiplier effects[2] of which would be large, meaning that the tax raised as a result of new investment might be very much greater than the tax subsidy given to ISA accounts in the future. This is a complete reversal of the current situation where no value for the subsidy given is obtained and permits the suggestion that at least £3.7 billion of tax subsidy might be saved as a result.
Ease of implementation	The changes proposed will take time to implement as they have a significant impact on the profile of savings products on offer in the UK. There will also be technical issues involved in defining the taxonomy of acceptable uses of investment funds that will take time to resolve. However, none of these issues represent significant technical problems to implementation.
Likely difficulties that might result from implementation	There will be resistance from the financial services industry to this change, but if they are given the opportunity to engage with and also market the resulting savings products, even if they are invested in government backed accounts, these problems should be overcome. Once introduced few difficulties should arise from implementation.
Likely time required to implement the change	A reasonable time period for this change will be required. It could not take less than two years and three may be required.
Consultation period required.	As noted, generous consultation periods will be required to get all aspects of this change right.

Background

Individual savings accounts (ISAs) and were introduced in 1999 by the then Labour

[2] A multiplier effect is a measure of the amount by which income is increased or decreased as a result of additional spending within an economy. If a multiplier effect is greater than 1 then the additional spending produced an increase in income of greater than its own amount, and vice versa. The largest multiplier effects are usually associated with healthcare spending and capital investment, where returns that are several times the size of the sum initially expended can result. In contrast, defence spending has very low multiplier effects. Some multiplier effects e.g. those resulting from spending on education are hard to measure because of the extended time periods involved.

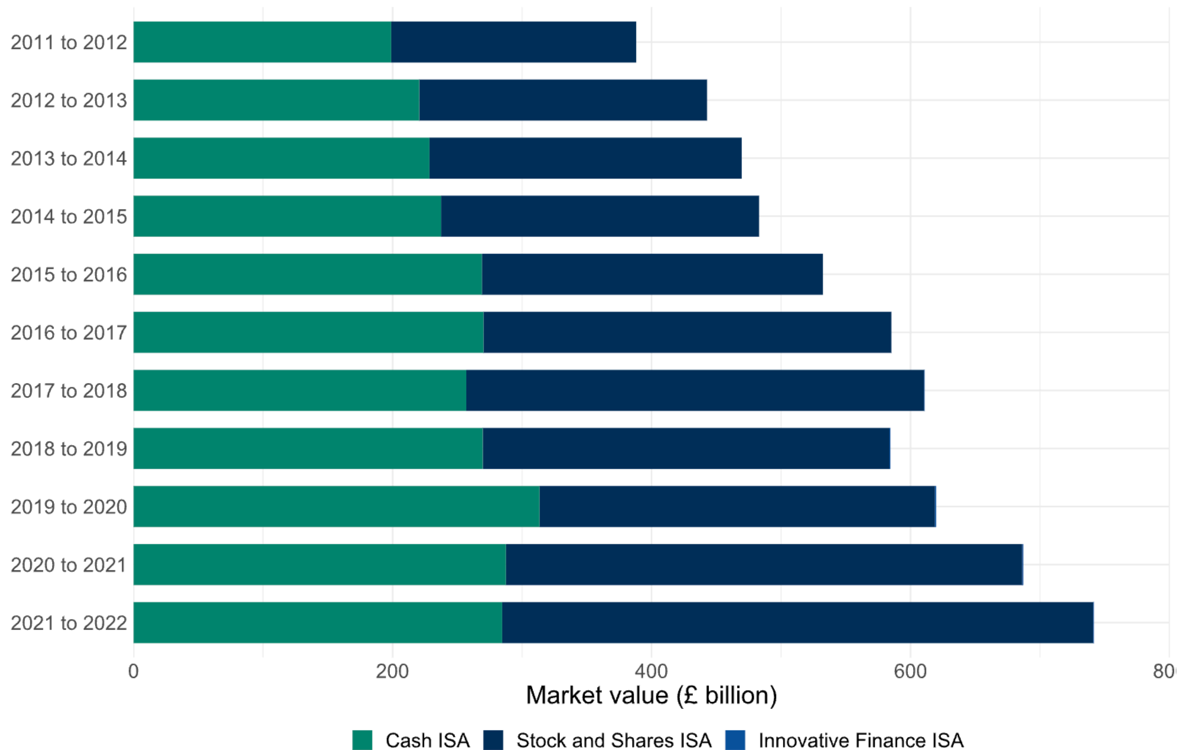
government. They replaced a previous, solely shared based, savings scheme created by its Conservative predecessor.

Over the years since their introduction, ISAs have become more complicated, have allowed significantly greater sums to be saved per annum (with this trend being very marked in more recent years), and have been modified to encourage saving for particular purposes e.g., to assist buying a home. However, the broad principle has remained the same.

That principle is that, subject to annual allowed contribution limits not being exceeded, the income derived from sums that a UK resident individual might save in an ISA are exempt from liability to income tax and capital gains tax. In addition, that income arising need not be referred to by them on a UK tax return, so simplifying the tax system for some people.

The arrangements have been surprisingly attractive to savers. Recent data on the amounts saved, provided in statistics published by HM Revenue & Customs[3], suggest that savings made in this way have enjoyed a broadly upward trajectory, with almost consistent growth in the sums held in such accounts:

Chart 1 – Adult ISA market values 2011 - 2022

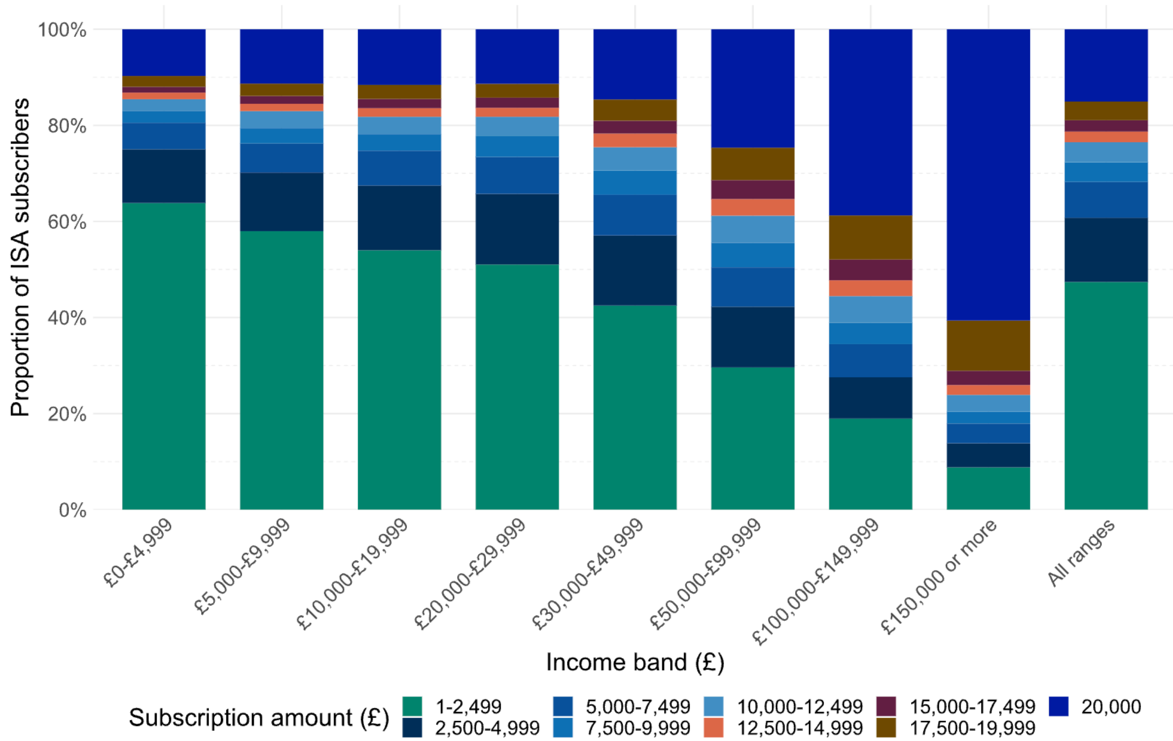


[3] https://www.gov.uk/government/statistics/annual-savings-statistics-2023/commentary-for-annual-savings-statistics-june-2023#:~:text=Chart%201%20below%20shows%20that,ISAs%20increased%20by%20around%20345%2C000.

More than £700 billion is now held in ISA accounts.

The same data source shows that the annual contributions made unsurprisingly increase significantly depending upon a person's income:

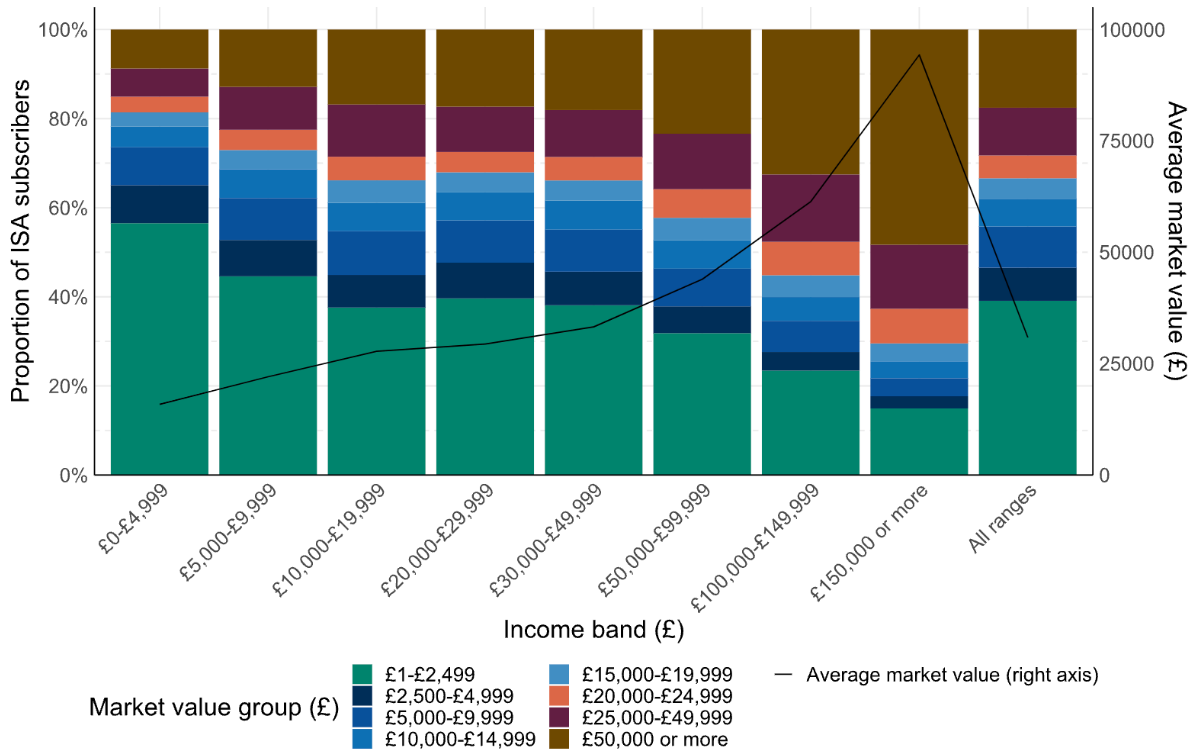
Chart 2 - ISA subscriptions by income band and size of subscription in 2020 to 2021



As is apparent, the group that is by far the most likely to make the maximum permitted £20,000 annual ISA contribution is that made up of people earning £150,000 or more a year. Quite clearly, those with wealth are taking greatest advantage of this scheme.

This is also apparent in the average size of balance ranked by income:

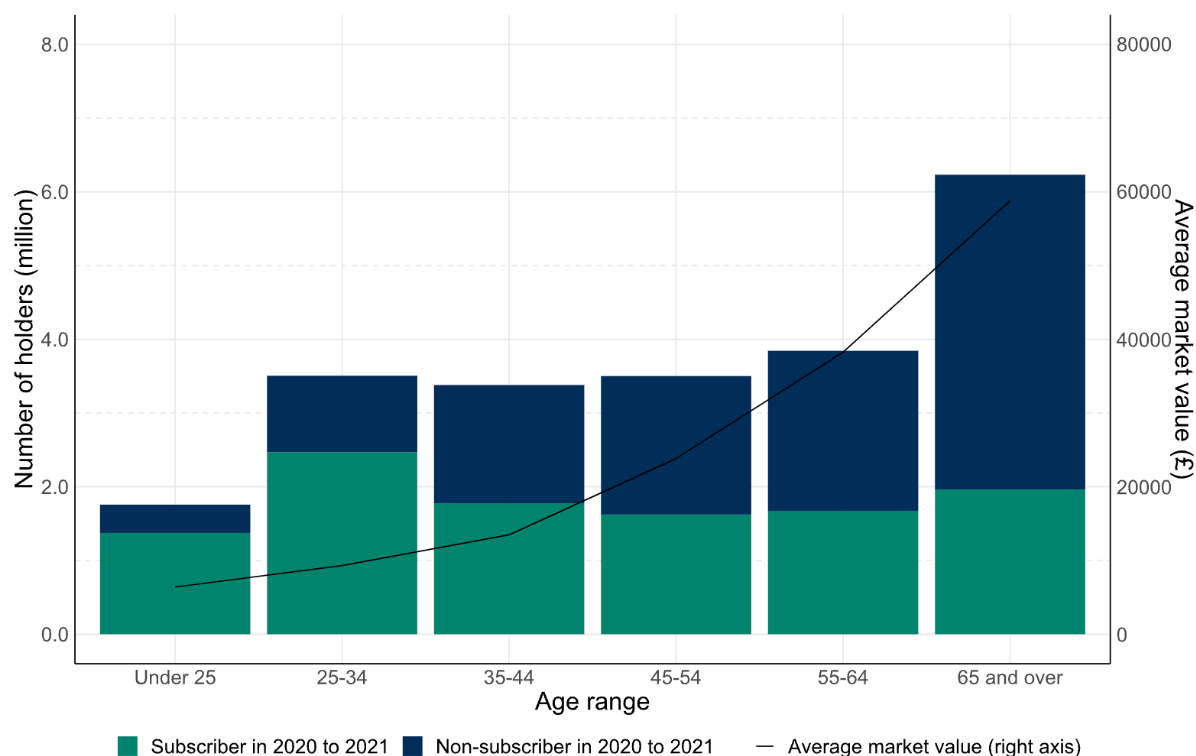
Chart 3 - ISA holdings by income band and ISA market value in 2020 to 2021



Unsurprisingly, the largest ISA balances are held by those with the largest incomes.

ISA account holders with the largest balances also tend to be amongst the older members of the UK population:

Chart 4 - Age distribution and average market value of ISA holders in 2020 to 2021



As a result, it is clear that the expenditure on subsidising ISAs is a subsidy to the more elderly and wealthier elements of the UK population. This subsidy increases inequality as a consequence.

The consequence of ISA account growth has been that the cost of ISA tax reliefs has also grown. This data is also from HM revenue and Customs[4]:

Table 1 – Cost of ISA tax reliefs (* = estimated)

Year	**2016 to 2017**	**2017 to 2018**	**2018 to 2019**	**2019 to 2020**	**2020 to 2021**	**2021 to 2022**
Cost (£ million)	2,600	2,850	3,500	3,400	3,050*	3,700*

[4] https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/estimated-cost-of-tax-reliefs-statistics

Despite the significant multi-billion pound cost of ISA savings arrangements, in terms of tax not paid, it appears that there is little question raised, or estimate made, of the value for money that this arrangement provides to the UK Exchequer. Nor has there been any apparent significant testing of whether the arrangement actually induces additional saving or simply increases the net after tax return to those who would save savings anyway.

Discussion

There are good reasons for questioning the economic value of ISA savings arrangements to the UK government, and quite possibly to the UK population as a whole.

Approximately half the sums saved in ISAs are held in cash based accounts, with the proportion changing slightly over time. Cash based saving was rarely rational during much of the period covered by the HMRC data noted above because of the low rates of interest paid on sums deposited, and yet very large sums were saved in that way, largely because of the inherently cautious nature of most savers. There is no criticism implied here with regard to that behaviour: each saver should be able to determine their own risk profile.

There was, overall, likely to have been a higher rate of return to those who saved in equity shareholdings over this period, but that said the return in question might have been very volatile, and unstable. Not everyone will necessarily have benefited by saving in this way.

More importantly, from a macroeconomic perspective, neither of these savings mechanisms adds any significant value to the UK economy. Cash held on deposit does at a macroeconomic level represent money withdrawn from circulation within the economy as a whole, and as such has a deflationary effect on overall economic activity. Few would suggest that this was of economic benefit during the course of the period since 2010 when austerity was already prevalent and growth was low.

In addition, and as is little appreciated, cash deposits do not in any way fund the lending made by the banks with which the sums are deposited. This fact was acknowledged by the Bank of England[5] in 2014. As they noted, at that time, loans made by commercial banks are the result of new money creation. Cash deposits made by one person are never loaned to another customer of a bank. As a consequence, cash deposits are, in effect, dead money within the economy, which is one reason why banks are so reluctant to pass on interest payments to depositors. Cash deposits do not add value to banks and so they are unsurprisingly reluctant to pay for them. What this does, however, mean is that these

[5] https://www.bankofengland.co.uk/quarterly-bulletin/2014/q1/money-creation-in-the-modern-economy

deposit add almost no value to the UK economy, and to subsidise them does, in that case, makes little sense.

There is little reason to suggest that equity share investments made through ISA accounts provide any more economic benefit for the UK as a whole. The vast majority of shares held in ISAs will be held through managed investment funds, most of which will track the performance of large share indices. These funds rarely purchase new shares issued by the companies in which they invest, largely because quoted companies very rarely rely upon this source of finance now. In fact, those companies are usually more intent on repaying their share capital than they ever are on increasing it.

In that case, what this means is that the funds that are held within ISA saving arrangements very rarely, if ever, result in the investment of new funds in new economic activity within the UK economy. They are instead used for speculative, but not investment, purposes. The result is that these savings, just like cash deposits, add almost no value to the UK economy as a whole either by promoting employment or by creating new investment in the productive economy.

Taking these combined observations into account it is apparent that a review of the savings arrangements represented by ISA accounts would now be appropriate. This is most especially the case when it is known that significant new capital is required within the UK economy to fund the climate transition, new social housing and other infrastructure investment.

Recommendation

It is proposed that all existing ISA saving account arrangements should be withdrawn, and that no further deposits into any existing ISA account should be allowed, and that no further new share-based investment from an ISA account should be permitted.

It is, instead, proposed that a new form of ISA account arrangement be made available to all UK resident persons. This would be described as a Green ISA.

All sums deposited in Green ISAs would be required to be invested in accounts, bonds, funds and shares that have as their primary purpose the funding of:

- The required climate transition if net-zero goals are to be achieved.
- New social housing.
- Other new social infrastructure.

- Related training, education and support services.

There are a number of ways in which this can be achieved.

Firstly, UK government already issues green saving bonds through NS&I, which is its own savings bank. These could be used for ISA savings purposes. The use of these funds is noted by the government in occasional reports[6].

These funds could also be saved through the collective purchase of green gilts issued by the UK government, which are now becoming more common place.

If the UK was also to create a properly functioning national investment bank that had as its purpose investment in the above noted categories of assets, on which returns could be paid by their users, then bonds issued by that bank could also be used for green ISA purposes.

Fourthly, private sector funds meeting the required specification for investment could be used for this purpose. This category of investment would, however, carry a higher degree of risk than the first three categories, noted above. A very clear taxonomy requiring strong evidence of the actual investment of funds raised for green purposes would be required for any company to qualify to raise funds in this way.

Because of the differing risk profile of these investments, it would be a requirement that at least one half of all savings be made in the first three categories of government-backed savings products noted above. That would, however, leave at least half available for investment in the private sector if that was the saver's choice. This would mean that the current approximate risk profile of average ISA savings could then be replicated through this new ISA arrangement.

Marketing ISA savings

The tax-free status of ISAs coupled with acceptable rates of return virtually guarantees that any ISA accounts is marketable[7]. The proposed Green ISAs should, however, have particular appeal, most especially if the link between a person's saving and the use of the sum saved for investment purposes is highlighted.

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[6] https://assets.publishing.service.gov.uk/media/651446cdb1bad4000d4fd916/HMT-UK_Green_Financing_Allocation_Impact_Report_2023_Accessible.pdf

[7] 80% of UK savings are in some form of tax incentivised account https://eprints.whiterose.ac.uk/153627/10/modern_monetary_theory_and_the_changing_role_of_tax_in_society.pdf

One obvious category of such ISAs would be those that might be used for green investment purposes. However, it is entirely plausible that more money than is needed for that purpose could be raised from ISAs and as such funds could also be promoted for investment in:

- Social housing
- School infrastructure
- Infrastructure for the NHS
- Transport infrastructure
- Regions e.g., mayoralties, or areas such as the Southwest, Yorkshire or East Anglia.
- UK member states i.e., Scotland, Wales and Northern Ireland.

It is thought that this would increase the appeal of these accounts.

Fundraising potential

Approximately £70 billion per annum is saved in ISA accounts. Admittedly, part of this represents the recycling of old ISA account balances into new ISA arrangements, but this would continue under the new proposed structure, meaning that it will be entirely reasonable to expect that this level of funding would be secured by these new ISA arrangements each year for some time to come. This would then provide a pool of capital for new investment in the UK economy.

Given the overall aggregate level of savings in recent years, there is no reason to think that significant funds would need to be retained for liquidity purposes. If, however, that was the case, the government would always available to supply liquidity to any saving arrangement of this sort if that was required.

Taxation impact

There are two major taxation impacts to consider from this proposal.

The first is that the current tax cost of this arrangement that provides little or no economic return for the economy as a whole might be saved. If this was the case, then it is reasonable to suggest that £3.7 billion of tax subsidiy, at least, might be put to better use as a consequence.

The second, and more important, impact relates to the positive economic use that would now be made of the funds saved in ISA accounts. If these were used as capital to be

invested in new green and social infrastructure that will provide benefit to the people of the UK and beyond then a tax return would come in at least four ways.

Firstly, expenditure on these investments would, in itself, generate new tax revenue. Between 35 and 40% of all such expenditure is likely to be returned to the Exchequer by way of tax paid. If £70 billion was invested, this would give a £28 billion return, straight away.

Secondly, those in receipt of this spending because they were working on the investment programmes funded by ISA accounts would then spend their earnings. The additional spending that they might then generate would increase the income of those that they spent their money with. This would then have the consequences that those people would have higher incomes, meaning that they too would pay more tax. Given that £40 billion or so of additional spending might happen in this way, it is entirely plausible that more than £15 billion might be generated in extra tax as a result of this secondary effect.

Third, this cycle then repeats. It is not impossible that most, if not all, of the £70 billion spent could be recovered by way of tax paid as a consequence, in turn providing the means to guarantee repayment of the balances held on ISA accounts. This cycle is referred to as the multiplier effect.

Fourthly, if appropriate investments are chosen, then they too are likely to generate a return. So, for example, the impact of investment in hospitals is very significant in economic terms because this increases the health of the country's workforce, and tends to significantly increase its productivity, meaning that most employees can contribute more when at work, which increases incomes and taxes paid.

Better housing provides an alternative return. It creates stability, enhances well-being, ensures better outcomes for children and their education, and tends to significantly cut the cost of support to families who were previously in either poor quality or insecure accommodation. This then creates a return for the government by reducing spending.

Of all these options the only one included in the taxation revenue estimate for this proposal is the avoidance of money wasted on the existing ISA scheme that delivers little economic return. No claim is made for the upside of the new alternative investments that ISAs could fund. Instead, it is presumed that the £3.7 billion previously invested without return is now invested with a return sufficient to cover any tax relief provided, and this provides the estimate of the tax revenue impact used in this note.