DRN-3456967

The complaint

Mr D complains about Interactive Investor Services Limited ("Interactive") refusing to allow him to continue to hold in his ISA an issue of American Depositary Shares ("ADSs"). He says Interactive has not been fair or customer friendly.

Mr D doesn't agree with Interactive's interpretation of the ISA rules, which Interactive says mean the ADSs can't be held in an ISA. He says Interactive didn't say the ADSs couldn't be held in an ISA when he first bought them in 2019. He seeks compensation for the tax he will have to pay on gains on the ADSs when held outside an ISA. He also seeks a refund of fees he says Interactive charged him for holding the ADSs.

What happened

In October 2021 Interactive told Mr D ISA rules didn't permit his ADSs to be held in an ISA. It said he could either sell the ADSs and leave the proceeds in his ISA or transfer the ADSs out of the ISA. It offered to do the sale free of commission. It gave Mr D just over a month to reply and said it would sell the ADSs if it didn't hear from him within that time.

Mr D complained and in response Interactive gave him around two months more to choose between the two options it was offering. It told him the ISA guidance *"states that for an ADR/ADS to be eligible both the ADS and the underlying shares used to make up the ADS must trade on an HMRC recognised exchange."* ADR means 'American Depositary Receipt'.

Interactive's complaint response stated the following as a quote from the ISA guidance:

"A depository receipt can be held in an ISA providing the underlying shares represented by the depository receipt are in the beneficial ownership of the holder and are themselves ISA qualifying. It is irrelevant for ISA purposes whether the depository receipt is listed or traded on a recognised stock exchange."

Interactive said that although Mr D's ADSs are traded on a recognised stock exchange, the underlying shares were unlisted and so didn't trade on a recognised exchange. Interactive said this meant the ADSs aren't ISA qualifying. Interactive acknowledged it had let Mr D buy the ADSs within his ISA but said it had to correct this now it had discovered the issue. On top of its existing offer to sell the ADSs within the ISA free of commission, Interactive also offered to reduce its exchange rate charge.

Interactive said if Mr D decided instead to move the ADSs from the ISA, it would do this free of charge, including transferring to a different provider. But Interactive said it would not be responsible for any tax liability arising from such a decision to move the ADSs from the ISA.

Mr D has said Interactive's view that his ADSs can't be held within an ISA, wrongly interprets his ADSs - American Depositary *Shares* - as ADRs - American Depositary *Receipts*.

Our investigator thought Interactive did understand Mr D held ADSs not ADRs. But our investigator thought these ADSs weren't ISA qualifying because although the ADSs were listed on a recognised exchange, the shares underlying them weren't. So our investigator

agreed with Interactive and also thought the options Interactive had offered Mr D, including the extra time in its complaint response letter, were fair and reasonable.

Our investigator understood Mr D had transferred his ADSs from the ISA to an overseas broker which our investigator thought supported the idea the ADSs weren't ISA eligible, as otherwise Mr D might've transferred the ADSs to another provider's ISA. Mr D has since told us that he also moved some ADSs into his pension.

Our investigator understood Mr D hadn't yet incurred the tax liability he had asked Interactive to cover. But our investigator didn't think Interactive should cover any tax liability for Mr D anyway. In reaching this view our investigator noted Mr D was better off overall as a result of having bought the ADSs, even after allowing for the tax. In other words, Mr D was better off than he would've been if he hadn't bought the ADSs at all. Also our investigator thought if Mr D had been told by Interactive the ADSs weren't ISA qualifying, he would've most likely still bought them outside the ISA. In other words, he would've held the ADSs in an account that wasn't capital gains tax free, and so would've had to pay tax on his gains anyway.

In view of all this, our investigator concluded Interactive didn't have to do anything more to put things right.

Mr D maintains that Interactive's wish to remove his ADSs from his ISA was due to it wrongly interpreting his ADSs as ADRs – that is, as *receipts* rather than *shares.* He refers to ISA guidance that says shares are ISA eligible if listed or traded on a recognised exchange. His ADSs are traded on the New York Stock exchange. He rejected our investigator's view and also said the following points hadn't been taken into account:

- The company that issued the ADSs was global with multiple subsidiaries but with only one public listing which is on a recognised stock exchange (the New York Stock Exchange listing of the ADSs).

- The ADSs aren't receipts and whether there is an underlying class A share is irrelevant – the class A shares are just an internal link from the ADSs to the various company subsidiaries. This was all in the annual report he sent us.

- Interactive had admitted an error (allowing the ADSs to be bought within the ISA) but was offering no compensation for the inconvenience of moving the ADSs and had also charged him ADR fees. That is completely unfair and consumer unfriendly.

Regarding inconvenience suffered by Mr D due to Interactive allowing him to buy the ADSs within his ISA, Interactive has said no redress is due for this because, in brief summary:

- Interactive offered Mr D cost-free options to resolve the issue and it can't be responsible for what he chose to do instead. His disappointment and inconvenience stems from his own choices, delay and decision to pursue and escalate his complaint. He had made a very large gain on the ADSs at the time of the dispute. Any capital gains tax he pays is applicable as the right position would've been for the ADSs to be bought outside an ISA. The result of Interactive's error was Mr D avoided paying tax. It's possible he will face no tax at his overseas broker. He has been repaid many times over by benefiting from Interactive's administrative position.

Mr D considers he should be compensated for the service he has received. He also points out that Interactive acted on its own interpretation of the ISA rules rather than being told to act by the relevant tax authority (HM Revenue and Customs - HMRC).

As the complaint couldn't be resolved informally it has been passed to me for a decision.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Having done so, I've decided to uphold Mr D's complaint in part. I'll explain why.

Mr D's ADSs represent a certain number of class A ordinary shares of the company that issued and listed the ADSs. This is apparent from the annual report Mr D sent us, which refers to the ADSs as *"American Depository Shares, each of which represents one of our Class A ordinary shares…"* His contract notes for the ADSs also reiterated this, saying: "EACH REP ONE CLASS A ORD SHS".

So the ADSs aren't shares of the company but depositary shares representing those shares.

I note in passing that the memorandum of association on the company's website says the share capital of the company is made up of class A and class B shares. It doesn't include the ADSs in that description, only the class A shares that the ADSs represent.

The ISA guidance Mr D has referred to contains a section on shares, but it also has one that covers both ADRs and ADSs specifically. That section includes the following:

"If the investor holds an American depositary shares or American depositary receipt that is traded on a US stock exchange the underlying investment is the shares represented by the American depositary shares or American depositary receipt. If these shares are officially listed on a recognised stock exchange, the American depositary shares or American depositary receipt will be a qualifying investment for stocks and shares ISA."

The reference to *"If these shares are officially listed"* refers, for both ADRs and ADSs, to *"the shares represented"* by the ADRs or ADSs – meaning *"the underlying investment"* rather than the ADRs or ADSs themselves. In this case that means the company's class A ordinary shares. If those underlying shares represented by the ADSs are not officially listed, the ADSs would not be ISA eligible according to this guidance. This part of the section makes no distinction between ADRs and ADSs.

Neither Mr D nor Interactive have suggested that the ordinary shares the ADSs represent are listed or traded on a recognised exchange. Mr D says the company's only public listing is for the ADSs, listed on the New York Stock Exchange. The annual report he refers to gives information on the history of the company and refers to an initial public offering for the ADSs but doesn't refer to the company's ordinary shares being listed on any recognised exchange.

So the ADSs are depositary shares and the shares they represent aren't listed or traded on any recognised exchange. As the shares the ADSs represent aren't listed or traded on a recognised exchange, the ADSs aren't ISA eligible under the guidance referred to above. With this in mind, I don't think Interactive did anything wrong when it wrote to Mr D offering him the options it did. Based on its understanding of the ADSs and its interpretation of the guidance, Interactive took the view that the ADSs had to be removed from the ISA. It acted on this in line with its duty to run the ISA in accordance with the relevant rules and guidance. It doesn't matter that it wasn't acting under a specific instruction from HMRC.

In reaching my conclusion above, I don't overlook that the company that issued the ADSs is global with many subsidiaries or that it has only listed its ADSs and not its ordinary shares or that the ADSs are depositary shares rather than depositary receipts (although I note that the guidance to which Mr D refers says these two terms are often used interchangeably). I don't agree that the significance of the company's class A shares is as a link between the listed

instrument and the company's subsidiaries. The significance of the class A shares is that they are the company's shares - the ADSs are instruments representing those shares.

Mr D has said Interactive charged custody or ADR fees for holding the ADSs. I gather he is referring to the sort of fees or costs that arise due to the custody of shares underlying an ADR issue. Mr D's ADSs likewise involve depository or custodian services - ordinary A shares are deposited with a custodian – so fees or expenses can arise in a similar way. Fees or expenses like this may be outlined in regulatory filings or prospectuses. What Mr D has told us, and the fact he held ADSs rather than ADRs, doesn't persuade me he has incurred expenses or been charged fees at Interactive that he shouldn't have incurred relating to his holding of the ADSs or the custody of the shares underlying his ADSs.

Mr D has asked for compensation for a capital gains tax liability. He's told me he has not yet sold any of the ADSs and hasn't yet received any tax bill for his gains. But I think there's still a chance that Mr D will face tax on gains he makes on the ADSs (usually gains are taxed at the point when an asset is disposed of, such as upon sale). Mr D claims compensation for this future tax on the basis that he wished to continue to hold the ADSs within the ISA and if he'd been permitted to do so he wouldn't have had to pay tax on any gains. But in light of all I've said above already, I'm not persuaded that Mr D was entitled to hold the ADSs within an ISA and entitled to escape tax on his gains in that way.

Also I'm not persuaded that if Mr D hadn't been allowed to buy the ADSs within the ISA, the way he most likely would've bought the ADSs would've allowed him to avoid tax on gains. He hasn't told us of a way he might've manged this and I'm mindful that what Mr D might've done differently should be assessed without using hindsight. Mr D has told me he transferred some ADSs to his pension and transferred some offshore, but I've seen no suggestion from him that he would've bought the ADSs offshore or within his pension to start with if he hadn't been able to use his ISA. The size of the ADSs' price rise, and so the extent of a potential tax liability outside an ISA, of course wasn't known when Mr D first bought the ADSs.

With what I've said above in mind, if Mr D had decided to buy the ADSs even though he couldn't use his ISA, what I have doesn't make me think he would've most likely done so in a way that would've avoided tax on the gains. For this reason my conclusion is that Interactive shouldn't compensate or indemnify Mr D against tax arising on gains he might make or have made on the ADSs, as that would put him in a position he could not have found himself in even if Interactive had not done anything wrong.

Interactive has told us the ADSs *"should never have been purchased within an ISA for that error we sincerely apologise"*. So it accepts it was at fault. Mr D thinks Interactive should offer redress for its customer service in the light of this. Interactive has told us it doesn't consider that a payment for this would be appropriate. I've considered all this carefully.

I agree that having spotted the issue Interactive did act fairly in offering Mr D options to put the situation right in ways that would cause him only limited inconvenience and cost. The transfer from the ISA was cost free and the offer to sell his holdings within his ISA involved a currency exchange at a reduced fee rate. That cost may have been outweighed by potential benefits from the situation – a larger sum within the ISA for reinvestment than might have been achieved with a qualifying investment, for example. Perhaps there were other benefits too, but I won't explore that more here given that Mr D didn't wish to sell his ADSs and so didn't take up this offer.

Interactive says its offer would've allowed Mr D to benefit from the proceeds of its error. At the very least I've seen nothing to suggest Mr D was likely to be disadvantaged materially by the options Interactive offered – bearing in mind that if Interactive hadn't made its error he would've likely still had to pay tax on his gains. Also accepting the options Interactive offered

Mr D would've settled matters with a minimum of inconvenience to him. So if Mr D chose to do something that was more time consuming and inconvenient, I agree with Interactive that this isn't inconvenience that Interactive should necessarily compensate Mr D for.

Engaging in financial business involves some inconvenience. Also errors do happen from time to time and complaints sometimes need to be made. None of these things on their own mean compensation should be paid necessarily. But in this instance Interactive's error did cause Mr D significant disappointment in my view and some unavoidable inconvenience.

I say this bearing in mind that when Interactive spotted and contacted Mr D to address the error, Mr D had held his ADSs in his ISA for two years and wasn't expecting any problem like this. Also by that time any alteration of the tax situation of his ADSs was complicated by a sizable gain (on paper) which brought with it the prospect of a significant tax loss if the way it was crystallised involved it being taxed. So Interactive's update was surprising, disappointing and not at all trivial for Mr D given the large sums involved. I think it understandable in that context that Mr D wished to explore and give everything careful consideration before acting.

Also I don't agree that because Mr D had a large (paper) gain when Interactive spotted the issue, the impact of the error was of no consequence for him. There may have been ways for him to take advantage of the situation or to resolve it at minimal cost, but there were also clearly routes that could potentially lead to significantly negative results. It was not a small matter.

With all I've said above in mind, taking everything into account I think it fair and reasonable that Interactive pays Mr D £250 for the inconvenience and disappointment its error caused him – and I uphold his complaint in part. But bearing in mind the options Interactive went on to offer Mr D, which I think were reasonable, I don't think Interactive need do more than this.

Putting things right

To put things right Interactive Investor Services Limited should pay Mr D £250 for the disappointment and inconvenience caused by its error.

My final decision

For the reasons given, I uphold Mr D's complaint. Interactive Investor Services Limited should put things right by doing what I've said above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr D to accept or reject my decision before 29 December 2022.

Richard Sheridan
Ombudsman