

## The complaint

Mrs W complains that Nationwide Building Society ("Nationwide") wrongly deducted income tax from a compensatory interest payment it made to her in relation to a potential higher rate of interest she could've earned on an ISA product it had on offer. Mrs W says any interest payments relating to her ISA needed to be paid within the ISA framework and are tax free and so it was wrong of Nationwide to deduct tax from the payment.

## What happened

Mrs W held two ISA's with Nationwide the first opening in 1999 and the second 2008. Nationwide received information that Mrs W no longer lived at the address it held on file for her and so suspended all communications and wrote to Mrs W asking to confirm her address. Confirmation of this was received on 23 August 2023 and communications resumed.

Due to the suspension of communications Mrs W missed out on receiving some marketing communications including making her aware of new accounts that may have had a higher interest rate. Though throughout this period Mrs W continued to be paid the interest rate that was applicable to her accounts on the balances held in line with the terms and conditions of the accounts.

Because there was a possibility Mrs W may have switched her accounts to products offering a higher interest rate if she'd received the marketing material, Nationwide decided to pay Mrs W the highest interest rates available for each type of account she held. This equated to a total of £3,769.63 (net) and being a compensatory interest payment – as it wasn't interest Mrs W was entitled to but rather interest she could've earned had she chosen to open the accounts marketed – it was subject to income tax.

In the letter sent to Mrs W regarding this compensatory payment Nationwide explained:

*"we've taken off basic rate income tax from the amount we paid you. We'll pay this to HMRC for you. Not everyone has to pay income tax on interest though - while other people may need to pay more income tax. If this is the case for you, please contact HMRC to either arrange a refund of the amount paid, or to make the extra payment needed."*

Nationwide also confirmed the payment would be sent to Mrs W by cheque. Nationwide have further explained that it is required by law that the tax for these types of payments is withheld as required under section 874(5)(A) Income Tax Act 2007.

Mrs W called Nationwide to query this payment on 5 October 2023 and to ask why tax had been deducted. Mrs W was unhappy with this as she believed this payment should've been made within her ISA's and so shouldn't have been subject to tax and raised a complaint with Nationwide about this. Nationwide informed Mrs W that she could reclaim the tax through the HMRC but the advisor shouldn't have said this as they wouldn't have known Mrs W's income tax liabilities.

Mrs W spoke to Nationwide again about this on 9 October and was correctly informed that as the payment was compensatory it was tax deductible but wrongly told the matter wasn't linked to interest when it was a compensatory sum in relation to interest that could've been earned. It is important to remember however that this wasn't a payment of interest that was due in-line with the ISA products Mrs W held within the ISA tax wrapper, but rather a compensatory payment regarding accounts she did not hold but may have and this is where the differentiation in tax deductibility comes in.

Nationwide responded to Mrs W's complaint on 24 October. It accepted it had provided Mrs W with incorrect information during her calls with it regarding the compensatory payment and offered £50 by way of apology for any confusion this caused and informed Mrs W of the correct information surrounding compensatory payments of interest. Nationwide further confirmed to Mrs W on 19 December that compensatory interest is tax deductible and that this wouldn't be able to be paid directly into her ISA as it would count towards her ISA allowance. Mrs W was dissatisfied with this and brought her complaint to this service.

One of our investigators looked into Mrs W's concerns but didn't agree Nationwide was wrong to deduct tax from the compensatory interest provided to her as this wasn't interest earned within a product – in particular the ISA's Mrs W held with Nationwide – and as such were subject to tax in-line with law and regulations.

They noted the compensatory payment wasn't something Nationwide were required to pay and that they'd seen no evidence that would indicate Mrs W was wishing to switch products or unable to do so had she been unhappy with the interest rate she was receiving on her ISA's and so they didn't think Nationwide had done anything wrong.

Furthermore, they didn't think it was wrong for Nationwide to make the payment by cheque rather than into Mrs W's ISA as it would be Mrs W's choice to deposit into her ISA and would affect her annual allowance. Overall, they thought the £50 by way of apology for the misinformation was fair as this had been corrected and the appropriate information given.

Mrs W disagreed. She says as the payment was made for missing interest or otherwise that she could've received on her ISA accounts it needed to be paid within the framework of the ISA which is tax free and so tax shouldn't have been deducted. Mrs W has asked for an ombudsman's decision on the matter.

### **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.

It might help if I explain here my role is to look at the problems Mrs W has experienced and see if Nationwide has done anything wrong or treated her unfairly. If it has, I would seek – if possible - to put Mrs W back in the position she would've been in if the mistakes hadn't happened. And I may award compensation that I think is fair and reasonable.

Mrs W's main complaint point is that Nationwide were wrong to deduct tax from the compensatory payment it made to her as it was in relation to an ISA which is tax free. But I don't agree. It is true Mrs W holds two ISA's with Nationwide the funds of which are held within the ISA tax wrapper and interest paid on these funds are tax free. But the payments made to Mrs W – and the subject of this complaint – are completely separate from the ISA's Mrs W holds.

The payment made to Mrs W is in regard to a potential missed opportunity in that had Mrs W received the marketing communications regarding the products on offer paying a higher

interest rate, Mrs W might have opened one of these and switched the ISA products she held over.

There is no evidence to suggest Mrs W would've switched accounts or wanted to had she received these marketing communications - indeed records show Mrs W had held the same accounts for a long period of time. But even so Nationwide decided to make a compensatory payment to Mrs W for the higher interest rate she might have received if she'd opened such a product.

And as Mrs W didn't open the product in question the compensatory interest payment made wasn't interest due on her ISA products and so wasn't paid within the ISA wrapper and therefore was subject to income tax. And so I can't say Nationwide did anything wrong in deducting income tax from the payment as this was in-line with its obligations.

It might well be that Mrs W is able to get a refund of tax on this or indeed she may have a further tax liability. But Mrs W's tax affairs are outside this services remit and this is something for Mrs W to follow up with the relevant authorities.

Furthermore, I don't think Nationwide did anything wrong in making this payment by cheque to Mrs W, as it wasn't under any obligation by law to make this payment and it's not up to Nationwide to decide where Mrs W should invest the money. If Mrs W wishes to invest this in an ISA she is free to do so if she wishes.

Finally, although I don't think Nationwide has treated Mrs W unfairly or made an error in deducting tax from what I consider a compensatory interest payment outside of the ISA wrapper, I do acknowledge that Mrs W was provided with misinformation when querying this. But as I'm not aware of her suffering any financial detriment because of this and she has now been provided with the correct information I agree that the £50 Nationwide paid Mrs W by way of apology is fair and reasonable in the circumstances.

### **My final decision**

For the reasons I've explained I've decided not to uphold Mrs W's complaint.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mrs W to accept or reject my decision before 4 October 2024.

Caroline Davies  
**Ombudsman**