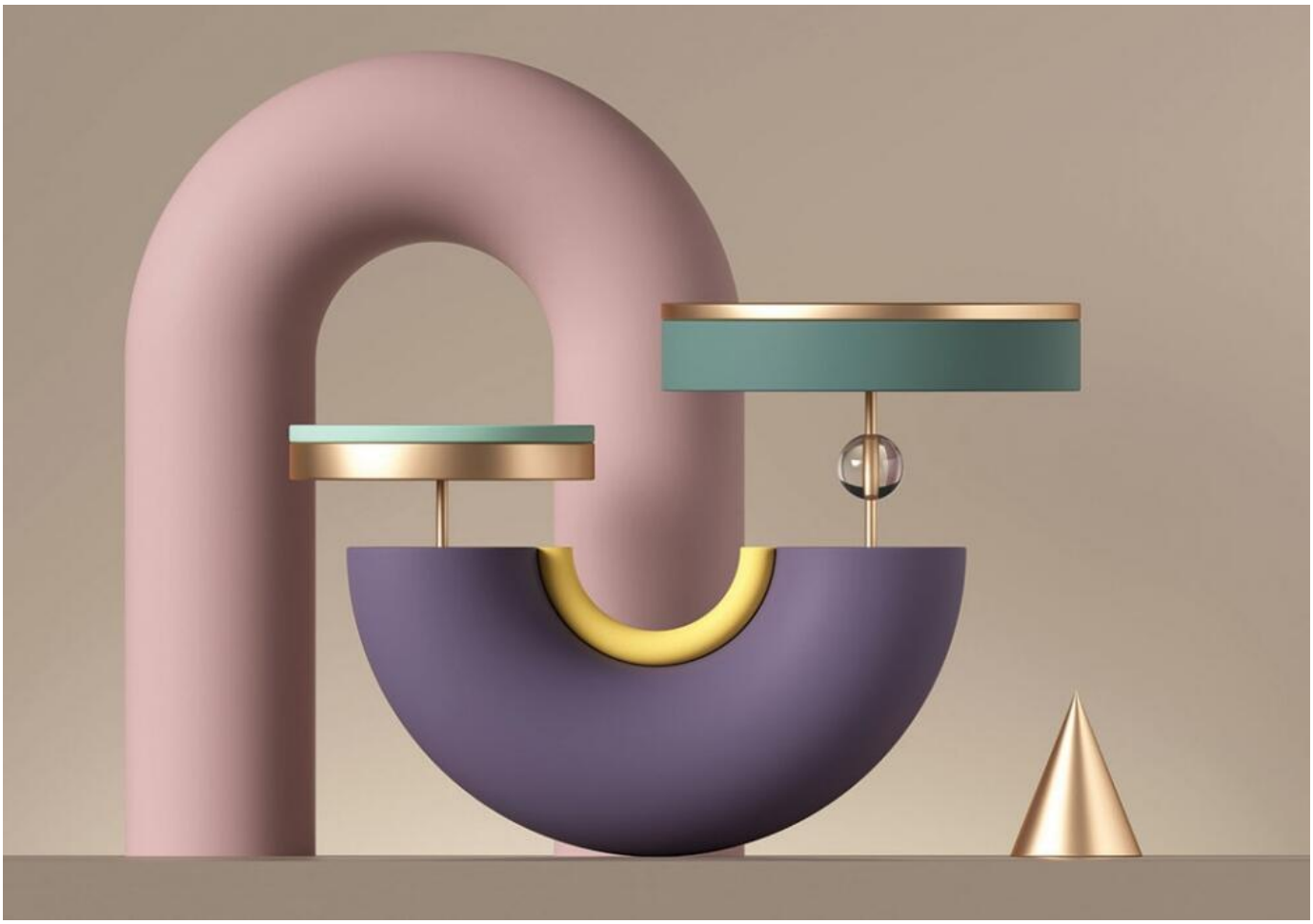
Asymmetric information

International Tax | Management of taxes



01 July 2020

Bill Dodwell considers how third-party data can be utilised to increase compliance and reduce the tax gap

One of the key topics for tax administrations concerns what academics might call asymmetric information. What this means is that taxpayers should know what their taxable income and gains are – but that tax authorities don't have this data. They need to get it from taxpayers or from others. The key bridge for tax authorities is through accessing third-party data. The most obvious source of UK third-party data is of course PAYE data, supplied every month by over 2 million employers.

The US Internal Revenue Service, like HMRC, analyses the tax gap. This is the difference between the tax due under the law and the tax ultimately collected. In the UK, much of the analysis focuses on behaviours and on taxpayer groups. However, the US produces analysis which looks at the tax gap based on whether or not third parties supply the tax authority with data.

The IRS estimates that there is a tax gap of just 1.2% on wages and salaries, due to both reporting and withholding (see Tax Gap Map for Tax Year 2001). Items subject to substantial information reporting (but no withholding), such as interest and dividend income, have a 4.5% tax gap. The gap is nearly doubled to 8.6% where there is just some information reporting. However, where there is little or no information reporting, the tax gap jumps to 53.9%. The main US income in this category is self-employment and farm income, rents and royalties.

Making tax compliance easier

The Office of Tax Simplification (OTS) has done some recent work in this area. Of course, the OTS's focus was on making tax compliance easier for individuals, who often find it hard to understand how and when they should report to HMRC.

The OTS Tax reporting and payments review recommended that HMRC should invest in improving the personal tax account and making the business tax account part of it (see OTS Tax reporting and payment arrangements review). Having two accounts can mean that taxpayers don't understand the difference between the two. The income reported under each one isn't joined up and there's no easy mechanism for taxpayers to upload expense data, get a mid-year tax calculation, or pay tax earlier if they wish.

The second recommendation was that work should be done on those sectors where there is a third party, or intermediary, involved in the chain. Where most of a sector does involve third parties, there is a much stronger case for requiring reporting by those third parties. However, where third party involvement is not significant, or those third parties do not have sales information, reporting is not easily possible. One sector with lots of intermediary involvement is taxis, mini-cabs and private hire. If those intermediaries uploaded monthly data to HMRC, it could be presented to taxpayers on a monthly basis for validation – and for the taxpayers to add expense information, whether by Making Tax Digital or otherwise. In that way, HMRC, taxpayers and their agents could stay on top of monthly net income and potential

tax liabilities.

Platform operators

The OECD is also working in this area. This initiative is limited to the OECD and not the wider BEPS Inclusive Framework. In February this year, the OECD's Working Party 10 released for comment draft model rules for reporting by platform operators with respect to sellers in the sharing and gig economy (see Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy).

The issue here is that exchange of information between countries will almost certainly be needed, as platform operators are unlikely to have a physical presence in every country where they offer services. Without that physical presence, enforcement of information requirements will rely upon exchange of information under double tax treaties or global conventions. Platform operators will need some global agreement on the data fields which they should collect and provide; it would be unduly burdensome for there to be significantly different requirements for every country. Operators currently do not gather tax identification numbers; they will need notice so that they can set up the systems to do this and ensure that the data provided can be properly and easily matched with individual taxpayers.

Ultimately what is needed is a fixed set of data fields, both internationally and nationally, so that data can be collected relatively easily, passed to the tax authority and then be transferred as seamlessly as possible into the taxpayer records. In the UK, we would want data to appear every month in the Personal Tax Account, for example. Today, banks and building societies pass interest received data to HMRC; however, it then takes some time for it to appear in the individual taxpayer records, probably because there is no tax identification number attached (such as the NI number).

Updating systems to deal with this type of issue will take some time – but the prize of accurate and up to date taxpayer accounts is well worth the effort.