Deduction of income tax from savings income: implementation of the personal savings allowance

Management of taxes

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CIOT comments on the HMRC consultation

HMRC's consultation document, Deduction of income tax from savings income: implementation of the Personal Savings Allowance (PSA), invited views on whether changes are required to tax deduction arrangements currently in place for interest (other than most interest paid by banks and building societies) and particular other savings income. It followed the government's recent announcement that a PSA will be introduced from 6 April 2016 and that banks and building societies will no longer deduct tax from most payments of interest to their depositors under the tax deduction scheme for interest (TDSI).

The CIOT, ATT and LITRG responded. In general, all three bodies welcome the cessation of the TDSI in relation to interest paid by banks and building societies on deposits of individuals, partnerships and trusts. This will be a big simplification and we expect that in most cases the right result, in tax terms, will be achieved.

However, in some cases the ending of TDSI will cause problems that will need to be addressed by HMRC so that taxpayers pay the right amount of tax on their interest income if their interest income is in excess of the PSA. The changes will lead to some basic rate and higher rate taxpayers who are not issued with a notice requiring a tax return being required to notify HMRC about savings income. HMRC need to carry out work to raise awareness of taxpayer duties in relation to tax on interest income.

HMRC have yet to announce how the PSA will work – will it be a tax-free allowance or will it operate within the basic rate and higher rate bands like the new 'dividend allowance'? Ideally this consultation would have followed the details being made

public.
However it is intended that it will operate, it will clearly be essential that clear guidance (including tools such as calculators) is produced by HMRC so that taxpayers can understand:

- whether they are eligible for the PSA, whether £1,000 or £500;
- what type of income is eligible for the PSA;
- how much of their savings income falls within the PSA and how much is liable to tax;
- how much tax they have already paid on their savings income and how to calculate any additional tax liability;
- how to pay more tax if necessary; and
- how to claim a tax refund.

In addition, it is essential that the guidance and tools explain clearly how the PSA interacts with the new 'dividend allowance', the various tax bands and the starting rate for savings.

The consultation document put forward six options for changes. On balance, the CIOT favours option 2: 'remove the obligation to deduct income tax from all non-TDSI interest' (or option 3: 'remove the obligation to deduct income tax from non-TDSI interest paid to individuals only' – if the non-TDSI interest payers know whether the taxpayer is an individual). This option fits in with the broad principles behind the introduction of the PSA.

However, option 2 and option 3 will present a clear risk to the Exchequer unless HMRC receive relevant information of amounts of non-TDSI interest. Unless payers of non-TDSI interest are required both to notify HMRC of payments made and provide them with enough information to allocate the payment to the correct taxpayer, the CIOT argues they should be required to deduct tax at source and would therefore favour option 1: retain the current rules for deduction of tax from non-TDSI interest. Otherwise, non-compliance, accidental and deliberate, is likely to be quite common.

The ATT favours option 2 for its ability to keep the tax system simple and easy for taxpayers to understand. While recognising HMRC's concerns about potential non-compliance and tax loss resulting from option 2, the ATT believes that non-compliance could also stem from a lack of uncertainty over one's obligations. If some types of interest were received gross while others were received net this could

lead to significant confusion for taxpayers, particularly those who may never have had to deal with HMRC thus far. The ATT does not see how option 3 changes the requirement of individuals to report to HMRC or change the risk to HMRC of non-compliance from individuals. All this option seems to do is to impose further burdens on the payers to assess the status of the recipient before they make payment.

LITRG favours option 3, on the basis that there would be less opportunity for confusion among taxpayers and the taxpayer education would be straightforward, with the same treatment as for TDSI interest. LITRG has a concern that, if deductions at sources continue, low income taxpayers may lose out because they may not claim repayments to which they are entitled – either through lack of awareness or because they find the process too daunting.

The full text of the CIOT's submission can be found on the CIOT website.

The ATT's submission can be found on the ATT website.

LITRG's submission can be found on the LITRG website.

HMRC's consultation document can be found on GOV.UK.