Third-party data reporting: the interest income jigsaw

Management of taxes Personal tax

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HMRC's consultation on the better use of new and improved third party data raises key areas for reform.

HMRC released a new consultation on third party data on Spring Statement day, which aims to reform the approach to third party data acquired under HMRC's bulk data powers (see tinyurl.com/yck89ymw). This came as excellent news to me, as it followed a report from the Office of Tax Simplification in 2021 (and indeed this consultation is kind enough to reference the OTS work). Responses to the consultation close on 21 May, which is presumably to allow time for the team to draft legislation for release later in the year.

The importance of the consultation is shown by the foreword from the Exchequer Secretary to the Treasury, James Murray MP, who says that making better use of third party data has the potential to contribute to all three of his objectives for HMRC: to improve customer service; to close the tax gap; and to modernise and reform the tax system.

As many will recognise, the UK tax system is almost entirely operated by businesses, which collect tax as employers, as suppliers for VAT and other indirect taxes or by bearing a tax directly, such as corporation tax. This means that only 30% of individual taxpayers need to submit a tax return, since for the majority their tax affairs are managed by the PAYE system, including adjustments through their tax code. Plugging the current data gap has the potential to further reduce the number of personal tax returns.

The key areas for reform

The consultation is based around three main areas:

- Updating the legislative framework for bulk data: For specified categories of data, HMRC would no longer need to issue an annual notice and there would be a standing requirement on financial providers to collect and pass information to HMRC.
- Improving financial account information: This would include bank and building society interest (BBSI) and other interest.
- Receiving greater amounts of card sales data: This would be shared by providers of card acquiring services, such as merchant acquirers. It would not include information on individuals spending money on cards but would cover receipts by sellers.

The consultation also seeks early feedback regarding collecting new data from financial institutions on dividend income and other income from investments.

HMRC already collects interest data from banks and building societies, as well as data on card sales. However, the changes put forward are intended to collect that data in a more useful way.

Practical applications

When the personal savings allowance was introduced in 2016, the expected benefit was that about 300,000 people no longer paid tax on interest income and 18 million people saw a tax reduction. However, the fixed personal savings allowance and higher interest rates compared to 2016 have meant that more people are liable to income tax on interest income. The document notes recent estimates that 'an additional 2.5 million taxpayers will have to pay tax on their savings by 2028 to 2029 (compared with 2022 to 2023)'. Collecting tax on relatively small amounts is costly for HMRC – and no doubt inconvenient for taxpayers to work out how best to let HMRC know how much interest they have received.

The result of getting better data should mean that many more tax codes can be changed in-year, so that people pay the right amount of tax, and the number of post-year adjustments is reduced. It could also permit pre-population for those within self assessment; again, helping to get the tax right at the same time as making it easier for taxpayers.

The consultation discusses the timing and frequency of reporting by banks and other financial institutions. It points out that millions of individuals have already submitted their self assessment tax returns by the time that the interest data is currently received by HMRC.

Receiving data after the end of the tax year means that HMRC is faced with collecting tax some time after the income has been received by individuals. The consultation suggests that monthly reporting during the tax year is the government's preferred option, which aligns with the forthcoming monthly reporting for ISAs. The question of reporting after the tax year is also raised; again, a three-month lag as currently would simply not deliver the desired benefits. The consultation asks how rapidly data can be delivered and it notes the desire to build information about interest income into the Making Tax Digital for Income Tax process.

The final pieces of the interest income jigsaw cover a new requirement for banks to collect tax references to support better data matching. Tax references must be collected by banks under the common reporting standard and extending that requirement to domestic payments is an obvious step to improve data accuracy. HMRC notes that it is currently unable to match about 20% of bank accounts to individuals. HMRC also suggests using a single reporting template, where a modified template from the CRS would appear easiest.

This is a major step in data reporting, which should both make reporting simpler for individuals, as well as collecting some tax which is currently unpaid.