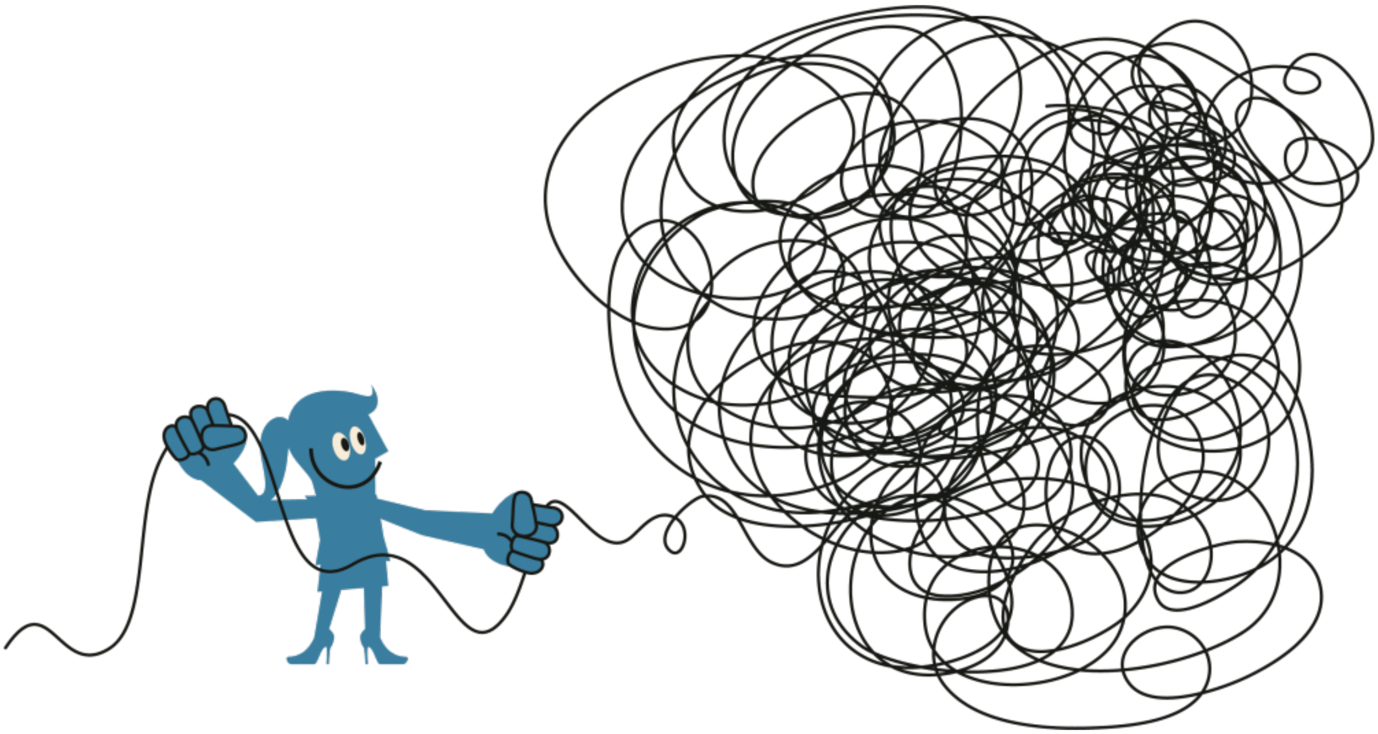
How to use third-party data

Management of taxes



05 February 2021

Bill Dodwell considers who is best placed to supply information to HMRC

Key Points

What is the issue?

The fundamental point about the PAYE system is that it is designed to collect the right amount of tax from most taxpayers – without them needing to file an annual tax return.

What does it mean for me?

The Office of Tax Simplification has launched a review that will look at smarter ways to use third party data. The purpose of the review is not to find additional data for

HMRC; rather it is to ask who would be best placed to provide existing data to HMRC.

What can I take away?

Please consider responding to our online survey for individual taxpayers and call for evidence, which can be found on the OTS home page.

In 1944, the Pay As You Earn system was introduced and about 12 million adults started to find their employer deducting tax from their salaries and wages. The system was introduced due to government and Inland Revenue concern that the old system of payment in arrears did not work well for the much larger working population now subject to income tax. There was a particular issue that the high wartime wages would be reduced after the war – and taxpayers might not have put money aside to pay their taxes.

An evolving system

That landmark decision set the path for the UK tax system that we have today. In 1975, national insurance was added to the PAYE system. In 2009, HMRC moved to a single National Insurance and PAYE System (NPS) where records are maintained on an individual employee basis, in place of the regional employer-based systems. The next big step was the introduction in April 2013 of real time information (RTI) for PAYE, where employers submit accurate data on each employee every pay period (instead of only at year-end). Finally, in 2017, HMRC completed the migration of the system to a new private cloud, involving the migration of 99 million accounts.

David Gauke, as Exchequer Secretary, noted in 2011 when writing about the introduction of RTI (see bit.ly/3oo258f):

> ‘PAYE is essentially an opaque system which tries to get it right for the taxpayer with minimal taxpayer involvement… We still have the age-old problem of a 60 year old culture that shields most taxpayers from having to think about their tax, but perversely wants them to understand what is going on when it does not reconcile. So PAYE improvement does not stop here.
>
> ‘I believe that HMRC need to think about how they can better communicate and get better understanding with taxpayers so they can

help HMRC to get it right.'

The fundamental point about the PAYE system is that it is designed to collect the right amount of tax from most taxpayers – without them needing to file an annual tax return. About 47 million adults receive some taxable income and about 30-31 million pay income tax. For 2019/20, HMRC reported that 11.7 million returns were due (see bit.ly/36i97Fb) and it also received 363,000 unsolicited returns. This meant that about 25% of adults (or just under 40% of income tax payers) completed a return. HMRC has long expressed the ambition that it would be possible to reduce the number required to complete a tax return.

Alongside the PAYE system have been approaches to the taxation of savings income designed to remove further tax liabilities from basic rate taxpayers, and the need for them to make returns. For many years, basic rate income tax was deducted at source (or deemed to be deducted) from bank interest. Dividends came with a basic rate tax credit. When these credits and deductions were abolished, most basic rate taxpayers were still protected from paying additional tax by special allowances.

Smarter use of data

With this background – that we have a tax system in the UK that is designed to minimise the number of tax returns required – the Office of Tax Simplification has launched its latest review, which will look at smarter ways to use third party data (see bit.ly/2NAcjW9). The purpose of the review is not to find additional data for HMRC; rather it is to ask who would be best placed to provide existing data to HMRC.

The OTS will explore the opportunities set out in the government and HMRC's ten-year Tax Administration Strategy (see bit.ly/3a6nVb7) for 'smarter use of data on taxpayers and their activities – pre-population of tax returns, including with data from third-parties – to reduce the need for taxpayers and agents to submit additional information that HMRC either already holds or could verify itself'.

The review will look at the principles that should apply in relation to third-party data and taxpayers generally. It will also consider sources of third-party data that it could be helpful to individuals for HMRC to receive, and how this can best be embedded into the next stage of HMRC's work on the single digital account and system design more generally. This is not a review about HMRC's auditing activities; rather, it is about pre-population of tax returns and digital tax accounts.

The review will include the key considerations, impacts and priorities that HMRC should focus on; any stages in which work might best proceed; and what realistic timescales would be.

Third-party data

The OTS has previously considered the potential for third party data in relation to self-employment and rental income in its Tax Reporting and Payments review (see bit.ly/3cefgWM). This review will focus on personal tax data, potentially including:

- bank and building society interest (building on the information already available);
- dividends from UK companies and distributions from authorised unit trusts; distributions from UK and overseas open-ended investment companies;
- pension contributions;
- gift aid payments to charities;
- data from investment and wealth managers, including information about chargeable gains, excess reportable income, interest, dividends and equalisation payments;
- insurance bond chargeable events; and
- royalties.

The objective of third party data reporting should be to relieve individuals of the burden of having to report information individually. Pension company PensionBee reported that over 80% of higher rate taxpayers were not claiming higher rate relief on their pension contributions (see bit.ly/3a5ieKB), thereby collectively missing out on over £800 million in tax relief.

If pension companies could notify HMRC of contributions made every month – and HMRC could process that information into the personal tax account – adjustments could be made to tax codes or in self assessment returns to give the correct relief. It could also be worth considering whether HMRC could advise pension companies when the individual was subject to the money purchase annual allowance restriction. This could mean that the individual could be advised not to make contributions over that limit, rather than HMRC needing to recover excess relief later.

Similar benefits could come in relation to Gift Aid and higher rate relief. Charities reclaiming Gift Aid need to notify HMRC of the name, address and amounts from each donor (subject to exceptions for small cash gifts). By adding a unique tax reference (such as the national insurance number), the information could be routed to the personal tax account and higher rate relief given. It might even be possible to find a way of optionally giving that additional tax relief as a further gift to the charity, as some have suggested.

Issues for consideration

There are a range of important areas to consider. Perhaps the first place to start is how individual data is to be reported to HMRC in a way that it can be immediately loaded into the digital tax account. A unique identifier will be needed, rather than attempting matching using name and address.

The national insurance number (NINO) has the best credentials for this. It is issued automatically to everyone at age 16 and almost everyone has one. It is used in our tax affairs already. However, there would need to be better processes for issuing NINOs to those arriving in the UK and it would need to move away from its current connection to national insurance contributions and benefits to become a generic tax reference.

There are a series of questions about trust and errors. HMRC needs to be able to trust data given to the Department by third parties. Individuals need to have trust that HMRC will process the data correctly and quickly. There would also need to be an easy process for correcting errors and thought given to how to deal with possible liabilities where something goes wrong.

There are also questions over whether third parties should be required to provide data, or should do so on a voluntary basis, authorised by the taxpayer. It is likely that if any new system goes ahead, reporting should be standardised across an industry sector. However, it is worth exploring the scope for voluntary reporting.

Wealth management is an interesting area where managers already report income information to their customers. Some may report capital gains information too, but not everyone has all the information to cover capital gains calculations. There are also a wide range of systems used, typically tailored to each manager. Yet anyone who has looked at statements will find it confusing to work out how to report each source for tax purposes – and to understand terms such as equalisation and excess reportable income. Managers might be able to report data to HMRC as well as to their clients and take away the burden of complexity that different sources bring.

The most obvious beneficiaries of third party reporting would be higher rate taxpayers and individuals who receive more than average amounts of savings income, such as pensioners.

In conclusion

Any new system of third party reporting will take some time to establish, as HMRC and data providers will need to agree a technical framework for the tagging and submission of data. Companies will need time to modify their systems and HMRC will need to ensure its systems have the functionality to receive data and process it quickly into self assessment and digital tax accounts. It is important that we start to consider these issues now to see whether and how they could improve tax reporting in coming years.

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