Savings income issues, including bank accounts paying ‘rewards’

Personal tax

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Accounts that pay rewards can cause confusion for taxpayers. The LITRG website explains further.

The mis-named ‘personal savings allowance’ (in reality, a 0% rate of tax) can cause confusion for taxpayers. Particularly for lower income clients, it is worth noting that both savings and dividend income still form part of tax credits claimants’ income calculations. Enquirers to the Low Incomes Tax Reform Group (LITRG) website have been confused by this point, having mistakenly thought that savings and dividend income is now ‘tax free’ and therefore also not income for tax credits purposes.

Another area of confusion drawn to LITRG’s attention is that of bank accounts paying ‘rewards’ which may not fall within the definition of savings income. Does the personal savings allowance (PSA) apply to them? The following extract from LITRG’s website guidance helps explain:

> *‘The PSA applies only to savings income as defined by law. What this means is, that even if you receive income that you think of as savings income, if it is not within the definition, it is not eligible for the PSA. Equally, it is not eligible for the 0% starting rate of savings.'*

The situation can be very confusing in relation to certain types of ‘reward’ accounts which many banks offer. If you receive any interest (whether on the reward account or on a different account), you should now receive that gross and it will be eligible for the PSA. The treatment of ‘rewards’ however depends on the nature of the reward. It is very possible that you will receive the reward net of 20% tax; in addition, the reward may not be eligible for the PSA. There is often limited guidance available from the bank, and the nature of the reward can vary from account to account.

(Please note that we are talking about regular cash rewards here as opposed to cash incentives for people switching their accounts or cashback on certain types of spend, which are not taxable as they are considered a ‘discount’ rather than a reward.)

If you have a reward account, to check the tax position, you need to find out the following information:

- The type of reward;
- Whether the bank pays you the reward gross or net of tax (and if net, how much tax is deducted at source);
- Whether the reward is taxable income;
- Whether the reward is potentially eligible for the PSA, depending on your circumstances.

There are three main possible tax treatments, depending on the type of reward:

- If the reward takes the form of interest (that is a rate based on the account balance), it is savings income and eligible for the PSA. Banks should pay this to you gross without deducting 20% tax at source, but it is still taxable income.

- If the reward takes the form of a cash reward (not related to the account balance), for say depositing a certain amount per month, this is not savings income, but is probably an ‘annual payment’ (applicable even if reward is paid monthly). Banks must deduct tax at 20% before paying you the cash reward, and the gross amount of the cash reward is taxable. Since annual payments are not savings income, these types of reward are not eligible for the PSA (or the 0% starting rate for savings). If you are not liable to tax, you can reclaim any tax deducted by completing an R40 form or on your self-assessment tax return. If you are a higher-rate taxpayer you would need to pay the extra amount via a PAYE coding adjustment or through your tax return.
- If the reward takes the form of a cash reward (not related to the account balance) AND there is a fee for the account, the reward does not meet the conditions for an annual payment. It is still taxable however as ‘miscellaneous payment’. Banks do not have to deduct tax before paying you the cash reward, so you receive these rewards gross and the gross amount is taxable. These types of reward are not savings income, so they are not eligible for the PSA (or the 0% starting rate for savings). If you are a basic or higher-rate taxpayer you would need to pay any tax due to HMRC via a PAYE coding adjustment or through your tax return.’

This and other guidance can be found on the LITRG website.