HM Revenue
& Customs

Deduction of income tax from savings income: implementation of the Personal Savings Allowance

Consultation document
Publication date: 15 July 2015
Closing date for comments: 18 September 2015

Subject of this consultation:	Deduction of income tax from interest and other types of savings income following introduction of the Personal Savings Allowance (PSA).
Scope of this consultation:	At the March 2015 budget, the government announced that the PSA will be introduced from 6 April 2016; from the same date, banks and building societies will no longer deduct tax from payments of interest to their depositors. This consultation invites views on whether changes are also required to tax deduction arrangements currently in place for other savings income.
Who should read this:	Financial institutions and other businesses that pay interest and similar amounts, recipients of interest and other savings income, representative bodies and tax professionals.
Duration:	15 July to 18 September 2015.
Lead official:	The lead official is Andy Stewardson.
How to respond to or enquire about this consultation:	Enquiries should be addressed to Andy Stewardson on 03000 586085. Responses should be sent by email to: psa.consultation@hmrc.gsi.gov.uk or by post to: Andy Stewardson HM Revenue and Customs Room 3C/06 100 Parliament Street London SW1A 2BQ
Additional ways to be involved:	HM Revenue and Customs (HMRC) welcomes discussions with interested parties. In particular, alongside this consultation, HMRC invites dialogue with members and representatives of savings industry sectors for which the introduction of the PSA may have particular implications.
After the consultation:	Options will be reviewed in the light of representations received. The government expects to publish its response to the consultation by the end of 2015, and to include legislation where necessary in Finance Bill 2016.
Getting to this stage and previous engagement	This consultation arises from the announcement made at the March 2015 Budget on the introduction of the PSA. There has been no previous consultation on the implications of this for deduction of income tax from savings income.

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1. Introduction

1.1 The government announced in the Budget on 18 March 2015 that a new Personal Savings Allowance (PSA) would be introduced with effect from 6 April 2016. The PSA will apply a new 0% rate for up to £1000 of savings income received by a basic rate (20%) taxpayer, or up to £500 of savings income received by a higher rate (40%) taxpayer. The PSA will not apply to savings income received by 45% additional rate taxpayers.

1.2 The PSA will apply to ‘savings income’ as defined in section 18 of the Income Tax Act 2007 (ITA 2007). This includes interest, income from certain purchased life annuities, profits from deeply discounted securities, accrued income profits, and gains from certain life insurance contracts.

1.3 Banks and building societies currently deduct tax from interest they pay on deposits of individuals, partnerships and trusts under an arrangement known as the Tax Deduction Scheme for Interest (TDSI). This deduction arrangement will cease, so that from 6 April 2016 such interest will be paid without deduction of tax. This reflects the fact that following the introduction of the PSA, around 95 per cent of savers are expected to be no longer liable for tax on this interest.

1.4 The introduction of the PSA and the ending of tax deduction under TDSI raise a number of broader issues in relation to the current arrangements for other types of (non-TDSI) interest, and savings income other than interest. No decision has been taken on whether changes are needed to the rules on deduction of income tax at source for non-TDSI income following introduction of the PSA. The following chapters summarise the issues arising, and invite comments on options for changes to current legislation.

1.5 Chapter 4 sets out a number of options, including continuing with the current rules and abolishing them altogether, as well a number of possibilities which seek to take a more targeted approach. The government is interested in establishing which of these options will best balance:

- making it as easy as possible for recipients to pay the right tax;
- risks to the Exchequer if the right tax is not paid;
- administrative burdens and costs for payers of interest and other amounts; and
- costs to HMRC of operating and policing the tax system.

1.6 This consultation will be of particular interest to financial institutions and other businesses that pay interest or other savings income. However, HMRC would also like to receive comments on how recipients of savings income might be affected by the various options, and in particular those who receive amounts in excess of the PSA and so will have tax to pay on their savings income after 5 April 2016.

1.7 Introduction of the PSA may have specific implications for providers of savings products in some particular sectors of the savings industry. The government is keen to engage with relevant industry sectors to identify and understand any such issues. Representations on such matters may be made in response to this consultation. In addition HMRC welcomes direct discussions with relevant representative bodies and other stakeholders alongside the consultation.

1.8 There are particular issues, not directly related to introduction of the PSA, affecting deduction of tax at source in the peer to peer (P2P) lending sector. The government is consulting separately on those alongside this wider consultation. A consultation document on the P2P issues is being published today[1].

1.9 Chapter 6 contains specific questions to which responses are invited.

[1] The consultation document '*Deduction of income tax from interest: peer to peer lending'* can be found on the GOV.UK website

2. Savings income, deduction of income tax and reporting requirements

Overview

2.1 This chapter outlines the types of income to which the PSA will, and will not, apply. It sets out the current rules on deduction of income tax from such income and explains the obligation to report payments of these types of income to HMRC.

What kind of income will be covered by the PSA?

2.2 The PSA will apply to all types of 'savings income'. 'Savings income' takes its meaning from section 18 ITA 2007, and the phrase is used in that sense in this consultation document. It includes the following types of taxable income:

- interest;
- income from certain purchased life annuities;
- profits from deeply discounted securities;
- profits under the accrued income scheme; and
- gains from certain life insurance contracts.

2.3 'Interest' for these purposes means any interest falling within Chapter 2 of Part 4 of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA 2005). This includes interest received from any person, not only interest paid by banks and building societies. The definition of interest in Chapter 2 is specifically extended to include the following items, which are therefore covered by the PSA:

- interest in kind;
- building society dividends;
- distributions from open-ended investment companies (OEICs), authorised unit trusts and offshore funds, where the payments are treated as interest for income tax purposes;
- payments by certain co-operative societies;
- funding bonds; and
- discounts other than profits from deeply discounted securities.

2.4 In addition, Chapter 2A of Part 4 of ITTOIA 2005 taxes income from certain arrangements that are economically equivalent to interest ('disguised interest').

2.5 Savings and investment income are generally charged to income tax by Part 4 of ITTOIA 2005. The types of income covered by the PSA are subjected to income tax by various chapters of Part 4[2]. The only exception to this is profits under the accrued income scheme, which deals with interest accrued on securities when they are transferred; these are taxed under Part 12 ITA 2007. Further information on the

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[2] Chapter 2 of Part 4 of ITTOIA 2005 covers interest; Chapter 7 covers purchased life annuities; Chapter 8 covers deeply discounted securities; and Chapter 9 covers life insurance contracts.

income tax treatment of savings and investment income can be found in HMRC's Savings and Investments Manual[3].

What kind of income will not be covered by the PSA?

2.6 The types of savings and investment income taxed under Part 4 of ITTOIA 2005 do not exactly match the savings income within the PSA. Some kinds of income, while taxed as savings and investment income under Part 4, are not included in the definition of savings income in section 18 ITA 2007; so they are outside the scope of the PSA. These income types include dividends and other distributions from UK-resident and non-UK resident companies, stock dividends, loans to close company participators and certain transactions in deposit rights.

2.7 Royalties and annual payments[4] are not savings income within section 18 ITA 2007. Nor are they savings and investment income within the meaning of Part 4 of ITTOIA 2005. However, they are subject to deduction of income tax at source under similar rules to those that apply to interest.

Exempt income

2.8 There are also a number of types of income which are expressly exempted from income tax, despite falling within the definition of (otherwise taxable) savings income, or savings and investment income. These are set out in Part 6 of ITTOIA 2005, and include income from some kinds of national savings certificates, investment plans (Individual Savings Accounts – ISAs) and income from certain kinds of securities and annuities.

Deduction of income tax from savings income

2.9 Deduction of income tax at source from certain types of payment is a long-standing feature of the UK tax system. Broadly there are two regimes under which tax is currently deducted from interest and similar amounts. These are:

- the Tax Deduction Scheme for Interest (TDSI); and
- deduction of income tax from yearly interest and a number of other types of income.

The Tax Deduction Scheme for Interest (TDSI)

2.10 Under TDSI, tax is currently deducted at 20% from interest paid by deposit takers (most commonly banks) and building societies. This is the most common type of savings income within the PSA. The legislation under which TDSI currently operates is in Chapter 2 of Part 15 of ITA 2007. From 6 April 2016 tax will no longer be deducted under TDSI.

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[3] The Savings and Investment Manual can be found at http://www.hmrc.gov.uk/manuals/saimmanual/index.htm
[4] Annual payments are not defined in legislation. Broadly, they are payments made under a legal obligation extending for more than one year, which represent income rather than capital amounts in the hands of the recipient, and which are received without the recipient needing to do anything to earn them.

2.11 Individuals who do not expect to have an income tax liability on interest paid under TDSI can currently apply to the payer (by completing HMRC's form R85) to receive the interest without any deduction of tax.

Deduction of income tax from yearly interest

2.12 Interest not within TDSI will normally be subject to deduction of income tax at source under separate legislation in Chapter 3 of Part 15 of ITA 2007, specifically section 874. This requires tax to be deducted from 'yearly interest'[5], subject to a number of exceptions.

2.13 These rules impose an obligation to deduct income tax at source from yearly interest paid by a company, a local authority, a partnership of which a company is a member, and by any person, including an individual, to another person whose place of abode is outside the UK. The obligation is set out in section 874 ITA 2007 and falls on the payer or on any person through whom the payment is made.

2.14 There are a number of exceptions from the obligation in section 874. These are:

- interest paid by banks and building societies in the normal course of their business (though TDSI may nevertheless apply). This exemption does not extend to interest on borrowings relating to a bank's capital structure or used for tax avoidance; nor does it cover interest paid to an individual as part of a payment of compensation in respect of, for example, mis-selling. Interest paid in these circumstances is therefore subject to deduction of tax;

- interest paid on public revenue dividends. These are subject to separate rules in Chapter 5 of Part 15;

- interest paid on an advance made by a bank or building society;

- National Savings Bank interest;

- interest paid by a company on a quoted Eurobond;

- interest paid on a loan to buy a life annuity;

- interest which is 'relevant foreign income' – income of various types from a non-UK source;

- interest paid by certain financial dealers, recognised clearing houses, Industrial and Provident Societies; and

- statutory interest on late paid debts.

[5] Yearly interest is paid under an obligation extending, or intended to extend, over more than one year. This includes an obligation lasting less than a year but which is capable of being rolled over into one or more successive obligations whose duration could together exceed a year. Interest paid under an obligation of less than one year is known as 'short interest'. There is no requirement to deduct tax at source from payments of short interest.

In addition, separate consultation is currently taking place on a new exemption in respect of privately placed debt[6].

2.15 For convenience, this consultation document refers to interest within Chapter 3 of Part 15 (or which would be but for one of the exemptions) as ‘non-TDSI interest’.

2.16 Unlike TDSI, there is no general facility to make an application for non-TDSI interest to be paid gross where the recipient does not expect to be liable to tax on their interest.

No deduction of income tax from non-interest income within the PSA

2.17 Some other types of savings income that will be within the PSA are, unlike interest, currently paid gross. For example, there is no requirement to deduct income tax from disguised interest, gains on deeply discounted securities, accrued income profits, income from purchased life annuities, or gains from life insurance contracts.

Deduction of income tax from types of income outside the PSA

2.18 Conversely, there is an obligation to deduct income tax from certain types of financial payment which are not savings income within the scope of the PSA. These include annual payments, patent royalties, other payments connected with intellectual property and certain ‘manufactured payments’ made by companies.

Collection and reporting arrangements for income tax deducted at source

2.19 Income tax deducted from payments of interest by banks, building societies and companies, whether under TDSI or under Chapter 3 of Part 15, must be paid over to HMRC. These procedures also apply to income tax deducted under other provisions in Part 15 (such as annual payments and royalties).

2.20 In addition to deduction of income tax from interest paid, and payment to HMRC, a person paying interest must provide HMRC with information on the recipient of the interest and the tax deducted, under powers in Schedule 23 of Finance Act 2011 and the Data Gathering Powers (Relevant Data) Regulations SI 2012/847.

2.21 HMRC intends to use information provided by financial institutions to make it easier for customers to pay the tax that is due on savings income. For example, where possible, HMRC will use this information to automatically code out savings income that remains taxable through the Pay As You Earn System, or to populate digital tax accounts.

2.22 The UK is a signatory to the Convention on Mutual Administrative Assistance in Tax Matters agreed in 2014. Current work on implementing the Common Reporting

[6] Private placement is lending made by, or securities issued to, a small group of investors, as opposed to a public offering of securities by a company.

Standard (CRS) on the automatic exchange of information under the Convention will also have an impact on such reporting arrangements.

Summary of Chapter 2

2.23 ‘Savings income’ that will be within the scope of the PSA includes all types of interest paid by banks and building societies on deposits, and some other types of return received by savers and investors. However, the definition of savings income for the purposes of the PSA does not include all types of taxable ‘savings and investment income’.

2.24 ‘Interest’ for the purposes of the PSA includes all types of interest paid by any person to any person. It is not limited to interest paid by banks and building societies to retail depositors.

2.25 Deduction of income tax is currently required from some, but not all, types of income that will be within the PSA and to some, but not all, kinds of ‘savings and investment income’ that will be outside the PSA. It also applies to a range of other types of payment that are neither ‘savings income’ nor ‘savings and investment income’.

3. Deduction of income tax from savings income following the introduction of the Personal Savings Allowance

Overview

3.1 This chapter explores implications for the deduction of income tax from savings and similar types of income, following the introduction of the PSA. It outlines issues to be considered in determining whether rules on deduction of tax on savings income outside TDSI should be amended.

3.2 TDSI tax deduction arrangements will cease to apply from 6 April 2016, when the PSA is implemented. Gross payment of bank and building society interest currently within TDSI will give the correct tax result, and therefore the least compliance burden, for the great majority of people receiving such income.

3.3 However, no decision has been made on whether changes should be made to current arrangements for the deduction of tax at source from other types of savings income following the introduction of the PSA.

3.4 The government's overall aim is to strike an appropriate balance between:

- making it as easy as possible for recipients to pay the right tax;
- risks to the Exchequer if the right tax is not paid;
- administrative burdens and costs for payers of interest and other amounts; and
- costs to HMRC of operating and policing the tax system.

Interest paid to recipients who have a tax liability on their savings income

3.5 Bank and building society interest paid on savings and deposit accounts represents most of the savings income received by many individuals. Following the introduction of the PSA most individuals will have no tax liability on such interest.

3.6 However, where a taxpayer's savings income exceeds the PSA of £1000 for a basic rate taxpayer and £500 for a higher rate taxpayer, there will usually be tax to pay. In some cases this is likely to be a one-off event, where a taxpayer receives a large single payment, such as maturity of a life insurance product or compensation for financial mis-selling which includes an interest element. The savings income involved may of course consist of both bank or building society interest (to be paid from April 2016 without deduction of tax) and non-TDSI income (which if current rules continue would be subject to deduction). In such circumstances it would be difficult to predict a taxpayer's tax liability and the extent to which any tax deducted at source might match it.

3.7 These considerations are particularly relevant where a taxpayer's income level moves above or below the thresholds for higher or additional rates of tax because the amount of the PSA available depends on the rates at which an individual pays tax. However, they will also apply to a minority of basic rate taxpayers.

3.8 In such cases, payment of interest without deduction at source would leave taxpayers with a tax liability to be settled through self-assessment, PAYE coding adjustments, or in due course through the taxpayer's digital tax account. This would be a new requirement for basic rate taxpayers, many of whom currently have no need to contact HMRC in order to pay the tax due on their savings income because the right amount is deducted at source. Higher and additional rate taxpayers would, as now, have to declare such income to HMRC, but would have larger tax liabilities to settle if 20% were not deducted at source. For all taxpayers with a liability to tax on savings income not within TDSI, complying with tax obligations would become more onerous without deduction at source arrangements. For the Exchequer there would be an increased risk from failures, deliberate or inadvertent, to declare untaxed income.

3.9 Ending the deduction of tax under TDSI will reduce the administrative burden and costs for financial institutions and other persons paying savings income. Removing deduction obligations in respect of non-TDSI payments would be expected similarly to reduce administration and costs. Conversely, maintaining deduction arrangements for non-TDSI income after TDSI deductions cease would mean that institutions would have to deduct income tax from some amounts but not others.

3.10 Whichever of the option in Chapter 4 is ultimately adopted, recipients of such amounts will need to understand what tax has been deducted and the extent to which the income is taxable, in order to ensure that they comply with their tax obligations. Introduction of the PSA may make this more difficult for some taxpayers, who at present may receive interest from different sources, some net of tax and some gross. Under the PSA some of that income may be exempted, while some remains taxable (for instance because it exceeds the PSA), resulting in an additional complexity.

Particular types of savings and investment income

3.11 As well as the general issue outlined above which applies where any recipient of savings income exceeds the PSA, there are a number of specific issues that arise where particular types of savings and investment income are paid.

Collective investment schemes

3.12 Collective investment schemes (CIS) include arrangements such as bond and equity funds in which contributions from more than one investor are pooled and investments are managed by an asset manager.

3.13 Investors in CIS are more likely than bank or building society depositors to be higher or additional rate taxpayers, and more likely to receive amounts in excess of the PSA.

3.14 Withholding rules for CIS aim broadly to maintain parity between the taxation of investors holding assets through a fund and those owning assets directly. However, the rules vary between different types of CIS. The relevant tax rules for OEICs, authorised unit trusts and offshore funds are set out in sections 373 to 379 of ITTOIA 2005. These rules differ according to the composition of the fund. Distributions from funds holding a mixed portfolio of interest-bearing and other assets are taxed as dividends where equities account for 40% or more of the investments. They will therefore not fall within the PSA. Conversely, if interest-bearing assets exceed 60%, distributions are treated as interest and would be covered by the PSA.

3.15 The tax rules for unauthorised unit trusts (UUTs) provide different tax treatments, including different deduction at source rules, for particular categories of UUT. These are set out in regulations in Statutory Instrument 2013/2819.

3.16 Fund managers currently therefore operate a range of withholding arrangements. Ending the obligation to deduct income tax at source from non-TDSI interest would not necessarily represent a significant simplification of the administrative and compliance burdens on either the payers or the recipients of income from CIS.

Life insurance policies

3.17 Purchased life annuity payments and gains from investment life insurance policies are classed as savings income falling within the PSA. Gains from life insurance policies issued by UK insurers or UK branches of non-UK insurers are currently treated as having suffered tax at the basic rate. However, no repayment is available to non-taxpayers. Basic rate payers have nothing further to pay on these returns, while higher and additional rate payers have a further tax liability to settle.

3.18 Gains from insurance policies are typically received as one-off events, having accrued over a number of years, and commonly exceed the PSA threshold. A larger proportion of these returns are taxable at higher and additional income tax rates, than is the case with bank and building society interest.

3.19 Insurers also sometimes make payments of non-TDSI interest which are subject to deduction of tax at source. The most common example of such amounts is interest included in compensation for financial mis-selling.

Peer to peer lending

3.20 In peer to peer (P2P) lending an internet platform acts as intermediary between lenders and borrowers. Rates of interest paid to P2P lenders may be substantially higher than those offered by banks and building societies, and consequently it is more likely that the amounts received by P2P borrowers will exceed the PSA. P2P interest is not within TDSI.

3.21 Lenders and borrowers in P2P arrangements made through intermediary platforms do not usually know each other, and current rules on deduction of tax are not always straightforward to apply. Following discussions with the P2P sector, HMRC is consulting separately on specific difficulties with withholding requirements for the industry. That consultation is being conducted in parallel to this, and is concerned with issues specific to the P2P sector which are not specifically linked to the introduction of the PSA. A separate consultation document '*Deduction of income tax from interest: peer to peer lending'* is being published today.

Interest paid by companies on loans and securities

3.22 Nearly all companies carrying on a business pay interest or incur some other kind of financial expense. A wide range of withholding rules apply to such payments, which may be made variously to persons or entities which are not entitled to the PSA, or to persons whose savings income will be wholly or partly covered by the PSA.

3.23 Interest paid by a company to a bank, to another UK-resident company or on a listed security will normally be paid gross because of the special exceptions from the requirement to deduct tax mentioned in paragraph2.14. But interest paid on an unlisted bond is currently subject to deduction at source, as is interest paid by a close company to a shareholder or director.

3.24 As noted in paragraph 2.14, the government is consulting with a view to introducing an exemption from deduction in respect of private placements, which are a particular form of unlisted debt.

3.25 Given the range of circumstances in relation to interest paid by companies other than financial institutions, ending the deduction of tax from this interest will not necessarily reduce compliance and administrative burdens for all payers and recipients of such interest.

Interest paid to non-residents

3.26 Savings and investment income arising to a non-UK resident is chargeable to UK income tax under Part 4 of ITTOIA 2005 if it is from a source in the UK. However, UK taxing rights over UK source interest are often over-ridden where the recipient is in a territory with a double taxation agreement with the UK. Such agreements generally allocate taxing rights to the territory where the recipient of the income is resident.

3.27 Nevertheless, deduction of tax from interest paid overseas is an important safeguard against leakage of tax where the recipient is not entitled to the benefit of relief under a double taxation treaty.

Royalties and annual payments

3.28 Royalties and annual payments are not savings income and will not therefore come within the scope of the PSA. They are nonetheless subject to deduction of income tax at source, under rules in Part 15 ITA 2007, similar to those applying to yearly interest.

3.29 Annual payments are payments of a recurring nature made under a legal obligation, and which provide 'pure income profit'. There is an extensive body of case law on annual payments, which cover a wide range of types of financial payment. Some payments made by banks and building societies, such as certain kinds of reward payment for opening and holding an account, and some payments by collective investment schemes, are annual payments.   Following the end of deductions under TDSI, banks and building societies will therefore, if current rules continue, have to deduct tax from annual payments associated with savings and deposit accounts. This may be confusing for customers and burdensome for payers in cases where tax is deducted from annual payments to an account but not from interest on sums held in that account.

Summary of Chapter 3

3.30 Ending TDSI deduction arrangements alongside the introduction of the PSA will achieve an appropriate outcome for the majority of individuals in receipt of interest on bank and building society interest. However, the position may not be so straightforward for non-TDSI deduction arrangements covering other forms of savings income, for example savings income arising from more complex financial arrangements. In these cases there are a range of issues and factors to be balanced, with a view to:

- making it as easy as possible for recipients to pay the right tax;
- minimising risks to the Exchequer if the right tax is not paid;
- minimising administrative burdens and costs for payers of interest and other amounts; and
- minimising costs to HMRC of operating and policing the tax system.

4. Options for change

Overview

4.1 This chapter sets out options in relation to the deduction of income tax from non-TDSI interest (and in the case of Option 6, other types of income to which withholding currently applies). As set out in paragraph 3.4, the government's aim is to achieve the most appropriate balance between a number of potentially competing considerations for payers, recipients and HMRC. It would be helpful for respondents to the consultation to frame their representations with these in mind.

4.2 The options presented are not necessarily mutually exclusive, and any legislative changes made in this area might include elements from more than one option. The government is also open to considering other possibilities which may be put forward in the consultation.

- Option 1: retain the current rules for deduction of tax from non-TDSI interest.
- Option 2: remove the obligation to deduct income tax from all non-TDSI interest.
- Option 3: remove the obligation to deduct income tax from non-TDSI interest paid to individuals only.
- Option 4: remove the obligation to deduct income tax from non-TDSI interest below a specified amount.
- Option 5: allow individuals to elect to receive interest with or without deduction of tax.
- Option 6: modify the obligation to deduct income tax from non-TDSI income, as part of wider changes to deduction of tax obligations in Part 15 ITA 2007.

Option 1: retain the current rules for non-TDSI interest

4.3 Under this option, payers of non-TDSI interest, and of other amounts subject to deduction of tax would continue to deduct income tax from all yearly interest, except where one of the exceptions in Chapter 3 of Part 15 ITA 2007 applies. This would include interest included in compensation paid by banks and building societies.

4.4 The current deduction of basic rate income tax at source achieves an appropriate outcome for the majority of basic rate taxpayers receiving savings income of any kind. In most cases they need no further contact with HMRC to make sure the correct tax is paid. Higher rate or additional rate taxpayers need to declare the income to HMRC in order to pay the difference between the 20% tax deducted at source, and their marginal rate of tax. People with no tax liability need to reclaim the basic rate tax deducted or, in the case of interest paid by a bank or building society, they can apply for the interest to be paid gross.

4.5 Bank and building society interest accounts for most of the interest received by individuals eligible for the PSA. In the majority of cases payment of this interest without deduction of tax will achieve the right outcome after the PSA is implemented on 6 April 2016, and accordingly the government has announced that TDSI deduction arrangements will cease from that date.

4.6 However, individuals with large investments, perhaps from multiple sources, or who receive large one-off investment returns, may receive savings income above their PSA. In many such cases this will be because an individual has received non-TDSI interest. Without deduction at source from this non-TDSI interest, these individuals will need to contact HMRC to pay the tax that is due. At present interest rates are low, so savings income in excess of the PSA is likely to arise only to people with substantial investments. However, as interest rates rise from their present levels over time, more individuals will find themselves in this position.

4.7 Retaining deduction from non-TDSI interest while bank and building society interest is paid gross would mean that some people might receive interest from different sources both with and without tax deducted. This may make their obligations to notify income to HMRC less clear.

4.8 Deduction of tax at source also plays an important role in minimising the tax gap from non-compliance by individuals who receive savings income. In particular, deduction of tax at source is the primary means by which the UK's taxing rights over UK source interest is enforced, in cases where the payment does not qualify for exemption under a double taxation treaty.

4.9 Continuation of the current rules in Chapter 3 of Part 15 of ITA 2007 for non-TDSI income would minimise the risk of non-compliance in cases where the income exceeds the recipient's PSA or where the PSA does not apply. It would give the correct outcome for most basic rate taxpayers. Higher and additional rate taxpayers would as now, have a tax liability to settle through their self assessment or, in future, digital tax account. Those with no tax liability would, as now, have to reclaim tax overpaid.

Option 2: remove the obligation to deduct income tax from all non-TDSI interest

4.10 Allowing all non-TDSI interest to be paid gross, without deduction of income tax at source, would represent a simplification for all businesses that pay interest.

4.11 Everyone with liability to tax, at any rate, on savings income would have to declare it to HMRC to ensure the right tax is paid. This would be a new obligation for most basic rate taxpayers. It would not be a new obligation for those taxable at the higher and additional rates, but they would have more tax to pay. Those with no tax liability would no longer have to reclaim overpaid tax.

4.12 Gross payment of non-TDSI interest to persons not within the PSA would increase the risk of non-compliance, and payments to non-UK resident persons would present a particular risk.

Option 3: remove the obligation to deduct income tax from non-TDSI interest paid to individuals only

4.13 The PSA will apply only to taxpayers who are individuals, and not therefore to any company, group, trust or other entity. Removing the requirement to deduct income tax from non-TDSI interest only in respect of payments to individuals may therefore provide a more appropriate outcome than complete abolition of the duty in section 874 ITA 2007.

4.14 Such an approach may present practical problems for payers of interest who would need to ascertain whether or not the recipient is an individual.

4.15 As with Option 2, all individuals with liability to tax on savings income would have to declare it to HMRC, while individuals with no tax liability would no longer need to claim repayment of tax deducted.

Option 4: remove the obligation to deduct income tax from non-TDSI interest below a specified amount

4.16 The obligation to deduct income tax from non-TDSI interest could apply only to amounts paid above a certain limit, which might be aligned to the annual amount of the PSA for basic rate taxpayers (£1,000).

4.17 This might give the correct result for most basic rate taxpayers, but as with Options 2 and 3 those with residual liability to tax would have to declare such income to HMRC. It would be less likely to achieve an appropriate outcome where a taxpayer receives interest from multiple sources. It would be more difficult for taxpayers to determine to what extent their liability was satisfied by tax deducted at source, and therefore to comply with their tax obligations.

4.18 A requirement to deduct income tax from payments of non-TDSI interest greater than, say, £1000 to the same person in the same year might be more straightforward for payers of interest than the approach under Option 3, which would require the payer to distinguish between individuals and other recipients. However, payers would need to be able to establish reliably when they were making multiple payments to the same recipient.

Option 5: allow individuals to opt to receive interest with or without tax deducted

4.19 Under current TDSI rules, an individual who does not expect to have to pay tax on the interest they receive from a bank or building society can complete and provide to the payer a form R85, which allows the interest to be paid without tax deducted. This procedure only applies to TDSI interest, and will therefore cease alongside TDSI deduction arrangements from 6 April 2016. However, a similar approach could be adopted to cover non-TDSI savings income paid after the PSA is introduced.

4.20 Alternatively, if the obligation to deduct tax at source from non-TDSI interest were withdrawn, it might be possible to introduce a procedure which would allow an individual expecting to be liable to tax on the interest to opt into deduction at source and receive payments net rather than gross. This would allow many basic rate taxpayers to satisfy their liabilities without the need for further action. Higher and additional rate taxpayers would still need to return the income to HMRC, and anyone electing for net payments, whose liability was less than the tax deducted would have to claim repayment. The payer would, as now, be required to pay over any tax deducted to HMRC.

4.21 This option would provide an element of flexibility to taxpayers, but conversely might leave some unsure as to their best course of action. Further, the circumstances of some taxpayers are likely to change over time, so net payment may be appropriate for some years, but not others. It may be more difficult and costly for payers to operate than a blanket treatment for all recipients and, like other options which curtail the existing scope of tax deduction at source, is likely also to increase the risk of tax leakage for the Exchequer.

Option 6: modify the obligation to deduct income tax from non-TDSI income, as part of wider changes to deduction obligations in Part 15 ITA 2007

4.22 As noted above, Part 15 of ITA 2007 imposes obligations to deduct tax at source from a wider range of payments than simply interest, including for instance royalties and annual payments. Withdrawal of the TDSI tax deduction arrangements could provide an opportunity for wider changes to the withholding obligations in Part 15. This may also be facilitated in due course by the introduction of digital tax accounts for individuals, which will remove the need for annual tax returns.

4.23 At present, Part 15 contains a number of exemptions from the obligation to deduct income tax from interest, royalties and annual payments. For instance, payments by companies to other companies and certain other persons may be made gross where the payer has a reasonable belief that the payment is an ‘excepted payment’. Similarly, some royalties may be paid gross to recipients outside the UK where the payer has a reasonable belief that the recipient is entitled to relief under double taxation arrangements.

4.24 In addition, there are a number of provisions that require certain payers of interest (not just yearly interest) to report those payments, and the tax deducted, to HMRC. Detailed obligations in respect of such payments are set out in the Data Gathering Powers (Relevant Data) Regulations SI 2012/847.

4.25 These reporting rules have recently been supplemented by the International Tax Compliance Regulations 2015 (SI 2015/878), which require information to be provided in respect of certain financial payments, under international agreements[7].

4.26 It may be possible to build on these existing rules, extending them to cover yearly interest under section 874, or indeed income subject to deduction by Part 15 more generally. Alternatively, they might be adapted for certain particular situations, such as payments made to non-UK residents. So, for example, the obligation under section 874 to deduct income tax from yearly interest could be removed where the payer has a reasonable belief that the recipient is entitled to relief under a double taxation treaty, and has provided information to HMRC in compliance with reporting requirements. An alternative to the 'reasonable belief test' might be a procedure by which the recipient certifies to the payer that she is entitled to treaty relief.

4.27 Such an approach, if applied more widely, may permit a rationalisation of a number of the existing exemptions in Part 15, potentially reducing the administrative burden on financial institutions and other persons paying interest. An appropriate combination of gross payment and reporting requirements could limit compliance risks to the Exchequer, such as that relating to payments to non-residents of UK source interest. However, an outcome which required payers to establish a reasonable belief regarding the recipient's status may give rise to administrative costs for payers and uncertainty as to what constitutes a reasonable belief. If applied to payments to offshore residents, this approach would permit gross payment in appropriate cases, but would require recipients to demonstrate their status to payers, perhaps by way of a certificate.

Summary of Chapter 4

4.28 Options 1 and 2 both seek to address the issues set out in chapter 3 by way of a blanket approach – complete retention or complete abolition of the current obligation to deduct tax from yearly non-TDSI interest. These are likely to be the simplest options for payers to implement and for recipients to understand. Options 3 to 5 offer more nuanced and targeted alternatives, which seek to match tax deducted at source more closely to actual liability to tax for as many recipients as possible; they seek to do this by limiting the circumstances in which the current rules apply. They are likely to achieve a more appropriate result for many recipients, but would not remove the need to make further payments or reclaim over-deducted tax in certain cases. These options would probably be more difficult for payers to operate. Option 6 differs from the other options in that it would involve consideration of the Part 15 deduction rules more generally.

4.29 Some amendments to legislation in Chapter 3 of Part 15 are likely to be needed regardless of which option or combination of options is adopted, to ensure that deduction of tax rules in relation to non-TDSI interest apply correctly.

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[7] These agreements are: (i) EU Council Directive 2011/16/EU on enhanced administrative co-operation in the field of direct taxation; (ii) the Multilateral Competent Authority Agreement on the Automatic Exchange of Financial Account Information signed on 29 October 2014 ('the Common Reporting Standard', referred to in paragraph 2.22 of this document); (iii) the agreement between the UK and the USA on international tax compliance signed on 12 September 2012 ('the FATCA agreement').

4.30 Subject to responses to this consultation it is currently expected that any necessary legislative changes would be made in Finance Bill 2016. However, if the more extensive changes suggested in Option 6 were adopted, it is likely that further consultation may be needed. In that case, at least some additional legislation would be likely to appear in a later bill.

5. Assessment of Impacts

Overview

5.1 Potential impacts of the options proposed will be assessed in the light of this consultation.

5.2 The discussion of the issues and options outlined in this consultation document are aimed at identifying an approach to deduction of income tax from non-TDSI interest (and perhaps some other types of income) which will strike an appropriate balance between the administrative burden on payers, the compliance burden on the recipient, HMRC's operational costs and compliance risk.

5.3 The questions set out in Chapter 6 of this consultation document are intended to help HMRC assess administrative burdens and compliance costs arising from the various options.

Summary of impacts

Exchequer impact

5.4 None of the options proposed have any effect on the amount of tax due on savings income. However, removing or limiting the obligation to deduct income tax at source could involve potential loss to the Exchequer due to deliberate or inadvertent non-compliance by taxpayers who remain liable to tax on savings income.

Economic impact

5.5 No impact on the UK economy generally is anticipated.

Impact on individuals and households

5.6 The impact of these changes for individuals depends upon the option chosen, and will also vary according to the amount of savings income received, the amount of other income and the rates at which an individual is liable to pay income tax. These circumstances may vary from year to year for any particular individual.

5.7 In general, if the current non-TDSI deduction arrangements are retained, we expect the impact upon higher and additional rate taxpayers, and basic rate taxpayers with savings income above the PSA threshold to be insignificant. Non-taxpayers and savers whose savings income is entirely within their PSA would however need to claim repayment of any tax deducted from HMRC.

5.8 By contrast, if tax were no longer deducted at source from any savings income, higher and additional rate taxpayers would, as now, have to contact HMRC to pay the tax due on this income. However, payments needed to satisfy their liability would be greater than would be the case if 20% tax had been deducted at source. Basic rate taxpayers with savings income in excess of the PSA threshold would have a new obligation to contact HMRC to pay tax, which would not be necessary if deduction of tax at 20% had continued. Non-taxpayers and savers whose savings income is entirely within their PSA would not need to contact HMRC claim repayment of any tax deducted.

Equalities impacts

5.9 No impact on any particular equality group is anticipated.

Impact on businesses and Civil Society Organisations

5.10 The impact of these changes for businesses and civil society organisations depends upon the option chosen, and will also vary according to the savings income received. Maintaining the current obligations to deduct income tax at source from interest may represent the least impact for most businesses. However, banks and building societies will no longer have to operate TDSI from April 2016, so there may be some operational complexity for them in applying deduction arrangements for some amounts paid to retail customers but not others. However, this is likely to be outweighed by the overall reduction of administration and costs following the cessation of TDSI. Many other businesses already operate deduction of tax from some payments but not others, and would see no change in their administrative burden.

5.11 Removal of the obligation to make deductions from interest payments, and to report and pay income tax to HMRC would represent a reduction in the compliance burden all payers of non-TDSI yearly interest, including businesses.

Impact on HMRC or other public sector delivery organisations

5.12 The impact on HMRC depends on the option chosen. Once the PSA comes into effect, retaining the current deduction rules for non-TDSI income would see an increase in the number of claims for repayment of tax from basic rate taxpayers, with some impact on HMRC's operational costs. Removing deduction requirements would see a reduction in the cost of handling repayment claims, but this could be outweighed by an increase in costs arising from the need to operate alternative collection arrangements where there is liability to tax on savings income.

Other impacts

5.13 No other impacts are anticipated.

6. Consultation Questions

6.1 This chapter sets out specific consultation questions. In addition, as noted above, HMRC welcomes representations from savings industry sectors on any sector specific issues.

Question 1

6.2 Other than the issues identified in this consultation, are there other key issues that need to be considered in relation to the interaction of the PSA and rules on deduction of income tax from interest and other savings income?

Question 2

6.3 Which of the issues identified in this consultation do you consider most important, and why? Comments on implications for particular kinds of non-TDSI income, or particular categories of payer or recipient are welcome. Please provide quantitative evidence where available.

Question 3

6.4 Chapter 4 sets out options for change. Which of those options do you think is likely to provide the best balance between:

- making it as easy as possible for recipients to pay the right tax;
- risks to the Exchequer if the right tax is not paid;
- administrative burdens and costs for payers of interest and other amounts; and
- costs to HMRC of operating and policing the tax system?

Please explain the reasons for your view.

Question 4

6.5 Of the options set out in Chapter 4, which is your preferred option or combination of options? Please explain why.

Question 5

6.6 Are there are other options that should be considered? If so, please say what they are and why they should be considered.

Question 6

6.7 Chapter 5 considers potential impacts on payers and recipients of savings income, and on government. Do you have any comments on the assessment of impacts, either generally or in relation to the specific options set out?

7. The Consultation Process

This consultation is being conducted in line with the Tax Consultation Framework. There are 5 stages to tax policy development:

Stage 1 Setting out objectives and identifying options.

Stage 2 Determining the best option and developing a framework for implementation including detailed policy design.

Stage 3 Drafting legislation to effect the proposed change.

Stage 4 Implementing and monitoring the change.

Stage 5 Reviewing and evaluating the change.

This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on policy design and any suitable possible alternatives.

How to respond

Specific questions asked in the consultation are set out in Chapter 6.

Responses should be sent by 18 September 2015, by e-mail to:

psa.consultation@hmrc.gsi.gov.uk

or by post to:

Andy Stewardson
HM Revenue and Customs
Room 3C/06
100 Parliament Street
London
SW1A 2BQ

Paper copies of this document or copies in Welsh and alternative formats (large print, audio and Braille) may be obtained free of charge from the above address. This document can also be accessed from HMRC's GOV.UK pages. All responses will be acknowledged, but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes.

These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentially can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HMRC.

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

Consultation Principles

This consultation is being run in accordance with the government's Consultation Principles. HMRC welcomes direct discussions on issues that impact on particular financial institutions or sectors.

The Consultation Principles are available on the Cabinet Office website: http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance

If you have any comments or complaints about the consultation process please contact:

Oliver Toop, Consultation Coordinator, Budget Team, HM Revenue & Customs, 100 Parliament Street, London, SW1A 2BQ.

Email: hmrc-consultation.co-ordinator@hmrc.gsi.gov.uk

Please do not send responses to the consultation to this address.