

REGULATORY IMPACT ASSESSMENT

Abolition of Withholding Tax on Bond Interest and Extension of Routine Information

Powers on Savings Income

1. Purpose and intended effect

The UK Government strongly believes that routine information reporting to tax authorities is the best way to tackle tax evasion on savings income. This includes information on cross-border savings income. The Government believes that effective exchange of information on cross-border savings income is the right way to collect the right amount of tax in the right country.

To further this aim the Government introduced a package of measures in the Finance Act 2000, and taking effect from April 2001, to obtain information on the income of both UK residents and non-residents. This will allow the Government to ensure effective compliance domestically and to co-operate with tax authorities in other countries to combat international tax evasion and avoidance. At the same time the Government will abolish the Paying and Collecting Agent (PACA) schemes for withholding and collecting tax on bond interest and foreign dividends, which are not geared to providing information on the income of UK or non-UK residents.

2. Options.

To ensure effective compliance domestically and effective exchange of information with other tax authorities, the Government needs to obtain information on the savings income of residents and non-residents. The level of information needed will vary depending on the nature and tax treatment of the investment. As a minimum it will be necessary to provide details of the payee's name, address and the amount paid or received in the year. In certain cases confirmation of the identity and residential address of the person beneficially entitled to the interest will be required - in general this will only be where the payer is already required to hold that information. It is recognised that the more detailed the information required, or the more those requirements depart from what financial institutions already need for their own purposes, the greater the cost to the payer.

Options available to achieve these aims were either to build on the existing reporting requirements in sections 17 & 18 TMA 70, or to develop a completely new system of information supply. In order to minimise the impact on financial institutions it was decided to build on the existing requirements. This had the advantage that many financial institutions were already familiar with these information requirements as of course were the Revenue and it would be possible in many cases for the expanded requirements to be added to existing systems. In order to ensure an orderly introduction of the new arrangements, it was also decided that the extension of current arrangements for reporting on interest to cover foreign dividends and redemption

proceeds of discounted securities would not be applied at least for the first year of the new arrangements. Further enhancements of the information reporting arrangements to be applied from April 2001 will be considered for future years.

The Government believes it is important that exchange of information on savings income should take place on a wide international basis, to ensure a level playing field for individuals and business. However, it is recognised that not all countries are yet in or approaching a position to provide this level of information to the UK in return. Because of this, and in order to keep administrative costs to a minimum, it is proposed that the information reporting should be adapted so as to allow unnecessary reporting to be eliminated.

To cope with the need to eliminate unnecessary reporting, without compromising the effectiveness of the reporting arrangements in ensuring domestic and cross-border tax compliance, it was decided that the Inland Revenue should make administrative arrangements with those persons required to make returns of payments and receipts allowing for details relating to addresses in certain "Non-Fully Reportable" ("NFR") countries to be excluded. For 2001-02, the list of Fully Reportable ("FR") countries will be confined to EU Member States, the Crown Dependencies and certain UK Overseas Territories, and a number of other countries with whom the UK expects to exchange information reciprocally.

3. Benefits.

Abolition of the PACA schemes will provide operational cost savings for all those who currently have to operate them. The City has been pressing for some time for the schemes to be abolished and it has widely welcomed the Government's decision to do so.

Abolition of the PACA rules from 1 April 2001 will mean:

- they are no longer required to deduct and account for UK tax on most payments passing through their hands. This will also remove the associated activities such as making repayment claims and preparing returns
- they no longer need to obtain and maintain declarations from those entitled to be paid gross
- they will no longer be subject to the current audit regime which tests compliance with the schemes together with associated penalties for non-compliance.

Those affected:

There are currently about 500 participants in the PACA schemes ranging from the major banks handling £billions to companies handling just a few £hundreds (the amount they handle does not necessarily reflect the size of the organisation, e.g. a major company may be only a small participant in the PACA schemes but it is

unlikely that the reverse would be true). The current average annual costs of operating PACA range from about £25,000 to £125,000 for each participant. All will benefit from its abolition.

4. Costs.

Taking new powers to obtain adequate information will impose a changed compliance burden on financial institutions. This will:

- require those who pay or collect interest in the tax year 2001-02 to make annual information returns including details of payments to or amounts received on behalf of resident and non-resident individuals (except those in NFR countries).
- remove the option for non-resident individuals investing in bank and building society deposit accounts to have their names and income withheld from the annual returns which banks and building societies already make to the Revenue. But information will not need to be reported for individuals in NFR countries.

Those affected:

- Banks and building societies currently provide information on interest payments made to UK residents but individuals who are not ordinarily resident (NOR) have the right to have their details withheld from the returns (there are estimated to be about 1 million such accounts). Not having to separate out payments to NOR individuals will make the returns easier for some banks and building societies though this will be offset by the exclusion of information relating to NFR countries. Most major UK banks will also benefit from the abolition of the PACA schemes.
- Other institutions within the PACA schemes. The current arrangements of quarterly aggregate returns of tax deducted together with the related deduction and accounting mechanisms will be replaced by the need to provide annual information returns with details of payments of interest and foreign dividends to resident and non-resident individuals.
- CGO members handling UK gilt interest. Many of these will also benefit from the abolition of the PACA schemes, although there are others who have little or no involvement in the current PACA arrangements.
- Alongside the introduction of the new information provisions, the Inland Revenue propose to make greater use of existing information powers in some cases where these are not generally applied at present. The main group affected will be fund managers of UK collective investment vehicles (AUTs and OEICs), who in future will be required to make returns of interest distributions made to UK resident and non-resident recipients.

Estimated costs to businesses in the UK (including UK branches of foreign concerns)

Estimates provided indicate that the average annual costs to each institution of operating the new information requirements will be in the region of £20k -100k. In general, for those institutions affected, there will be a reduction of approximately 20% in the average annual costs of operating the new information requirements compared to the current annual costs of operating PACA. Annual savings for each institution will be in the region of £5k to £25k. In addition to the annual costs there will be one-off systems build costs which will vary considerably from institution to institution. These will generally be in the order of 2 to 4 times the annual costs, though some institutions have estimated the initial costs at up to 10 times annual costs.

Further annual costs will arise in dealing with any follow up enquiries generated from the information exchanged. Some enquiries may be simply to confirm the details already supplied. Others (which in appropriate cases would be subject to the formal procedures of Section 20 TMA 1970) may relate to information on residential addresses, confirmation of the person beneficially entitled to the interest, or details of transactions other than the payment or receipt of interest. In addition to the direct costs involved there is an indirect cash flow benefit currently enjoyed by institutions subject to the PACA schemes from holding tax balances before they are paid over to the Revenue. In future that benefit will arise to the payee who will receive the income gross. Overall there is little net change but if anything, the effect on UK business compliance costs is a saving.

5. Other costs/benefits

The administration of the PACA schemes is conducted by the Inland Revenue's Financial Intermediaries and Claims Office. Staff employed on the administration of the PACA schemes will be re-deployed on audit, compliance and customer service related duties, including in connection with the new information returns. Automatic exchanges of information are conducted by the Inland Revenue's Taxes Information Distribution Office (TIDO). It is estimated that the new information reporting arrangements will lead to between 10-30 million further items of information being received annually. However it is thought that the increased volume of information to be passed to treaty partners can be managed without any significant increase in staff resources.

Other costs - UK resident individuals may face having to pay a UK tax bill in respect of their foreign income rather than having had the tax deducted at source. However, it is fair to assume that most would have had to complete a tax return in any case. The cash flow benefit should outweigh any costs they incur. UK companies will have to include such income in their returns as now and once quarterly accounting comes fully on stream will account for the tax at broadly the same time as at present.

Non-resident individuals and companies and UK resident charities and exempt institutions will also benefit in the sense that they will not need to complete declarations of eligibility in order to receive income through the PACA schemes

without deduction of tax. Nor will they need to submit a repayment claim to recover UK tax deducted in the absence of such a declaration.

There should be no greater cost to IR of processing returns from taxpayers since we assume that most UK resident individuals and all UK resident companies investing overseas will already be required to file a return.

6. Consultation

The representative bodies of financial institutions affected have fully participated in consultation on drawing up the detailed rules relating to the changes and have assisted in providing estimates of the benefits and costs of the proposals for the purposes of this RIA.

7. Summary

The adoption of an effective regime for exchanging information about savings income will enable the UK to play an effective role in combating international tax evasion. At the same time the abolition of the PACA rules will remove burdensome tax deduction schemes which act as a hindrance to the financial markets.

The Inland Revenue has taken soundings of the financial institutions affected by these changes and consider that overall the savings arising from the abolition of the PACA schemes will broadly offset, or maybe outweigh, the costs of providing information.

8. Enforcement, Sanctions and Review

The Inland Revenue will offer support and guidance to enable companies to comply with the Regulations.

Inland Revenue Audit Unit will carry out a risk based audit programme covering all S17/18 information returns relating to the tax year 2001-2002 onwards to check completeness and accuracy of the returns. The audit will be arranged on similar lines to other audits carried out by the Audit Unit. Where appropriate, and by agreement, the audit of the return will be combined with other audits, for example for Deposit Takers combined with the Tax Deduction Scheme for Interest (TDSI) audit.

The audit test will include

- a walkthrough of systems
- a check that all interest payments and transactions are reflected on the return
- a check that entries on the return reflect the position in the institutions books and records in relation to interest/dividends and ownership.

Penalties for incomplete or incorrect returns will be based on the existing penalty regime in S98 TMA.

There will no longer be a statutory facility to opt for Independent Audit for TDSI purposes. However the Inland Revenue will be willing to reach administrative arrangements with persons within the information reporting and/or TDSI regimes allowing for independent auditors to conduct audit of NFR accounts.

9. Post implementation review

The Inland Revenue will continuously monitor the operation of the new system through the audit review.

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Or visit our website www.inlandrevenue.gov.uk which contains the detailed guidance notes on s.17/18 reporting