Capital Gains Tax: Gains and Losses on Foreign Currency Bank Accounts held by Remittance Basis Users

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Introduction

On 16 December 2009 the Financial Secretary to the Treasury announced in a written statement to Parliament proposed changes to the capital gains tax (CGT) rules where:

- individuals who are not domiciled in the UK and who chose to pay tax on the remittance basis;
- they make a taxable remittance to the UK from a bank account in a currency other than sterling (a 'foreign currency bank account'); and
- the remittance comprises or includes an amount that is liable to tax as remitted foreign income, or that is to be taken into account in computing income, or would be taken into account for income tax but for an exemption.

The full text of the statement is annexed.

This note sets out the detail of the proposed changes, which are to come into effect in relation to remittances on or after 16 December 2009.

Background

A foreign currency bank account (FCBA) is an asset within the scope of CGT (section 252(1) of the Taxation of Chargeable Gains Act 1992 (TCGA)). A withdrawal of funds from a FCBA constitutes a disposal (or part-disposal) of the account on which a capital gain or loss arises. The consideration for the disposal is effectively equal to the sterling value of the amount withdrawn at the time of withdrawal.

There is an exception for sums in a FCBA which were acquired for personal expenditure outside the UK of the individual and their family (section 252(2) TCGA). Sums acquired for personal expenditure abroad do not give rise to chargeable gains or allowable losses. Such sums are not affected by the proposed changes.

Where:

- a non-domiciled individual is taxable on the remittance basis in respect of their foreign income and capital gains,
- the individual withdraws funds from a FCBA situated outside the UK, and
- the whole or part of the amount withdrawn represents foreign income taxable on the remittance basis,

the foreign income transferred will be liable to income tax at the time of remittance. The amount on which income tax is due is the sterling value of the income at the time it is remitted.

However the withdrawal of funds also represents consideration for disposal of the whole or part of the FCBA for CGT purposes. HMRC now accepts that section 37 TCGA applies in this situation to exclude from the calculation of the capital gain or loss arising on disposal (or part-disposal) of the FCBA the whole of, or the relevant part of, the withdrawal that is taxable as remitted income.

The exclusion of consideration from the capital gains computation under section 37 can produce an anomalous result. By way of illustration, suppose the individual paid salary in foreign currency of FC20,000 into a FCBA abroad at a time when FC1.00 = £0.50. For CGT purposes, the cost of acquiring the FCBA is £10,000. In the next tax year he transfers the whole FC20,000 to the UK at a time when FC1.00 = £0.60, receiving a credit of £12,000 in his UK sterling bank account. For income tax purposes the taxable amount is £12,000 (the value of FC20,000 at the time of remittance). For CGT purposes the computation is as follows:

Consideration for disposal of the FCBA	£12,000	
Less exclusion under section 37 TCGA	<u>£12,000</u>	nil
Acquisition cost		<u>£10,000</u>
Loss		£10,000

This loss for CGT purposes is excessive, because the individual has incurred no real loss in these circumstances. It arises because the TCGA rules adjust the consideration for the disposal of the FCBA, but there is no requirement to remove the relevant income element from the allowable cost of the FCBA. The loss is an arithmetical anomaly.

Where a remittance comprises only part of the funds in the FCBA, so there is only a part-disposal of the account, a second anomaly arises. The normal rule for apportioning the allowable cost of the asset between the part disposed of and the remainder (the familiar A/(A + B) formula in section 42 TCGA) is distorted by the exclusion of the taxable income from the consideration for the disposal (the A element of the formula). The consequence is that the cost attributable to the remainder under the A/(A + B) formula is greater than the amount that is proportionate to the size of the remainder.

By way of illustration of this second anomaly, where (say) 40% of the FCBA is remitted to the UK and that 40% is wholly taxable as a remittance of income, the consideration for the disposal is reduced by section 37 TCGA to nil, as in the example above. As the A element of the A/(A + B) formula is nil, the result is that the whole of the cost of the account is attributed to the remainder of the account, whereas under a properly proportionate formula only 60% of the total allowable cost should be attributed.

Proposed changes to the TCGA rules

For disposals on or after 16 December 2009, where the disposal is a withdrawal of funds from a FCBA that comprises in whole or in part an amount that is liable to tax as remitted income, the gain or loss arising will be calculated using the following steps:

- Identify the part of the withdrawal that is taxable as remitted income and, accordingly, excluded from the consideration for the disposal by virtue of section 37 TCGA (‘the section 37 amount’).
- Then proceed under A or B below, depending on whether the amount remitted is wholly or partially the section 37 amount.

A – Remittance is wholly the section 37 amount

a. Where the section 37 amount is the whole of the balance on the account, so there is a full disposal of the account, the loss arising on the disposal will not be an allowable loss for CGT purposes.
b. Where the section 37 amount is only part of the account, so there is a part-disposal of the account, disapply the normal part-disposal formula in section 42 TCGA.
    - Instead, apportion the allowable cost of the account between the part disposed of and the remainder in proportion to the amounts withdrawn and retained, and compute the loss on the part disposed of accordingly (so that section 37 reduces the consideration to Nil but the proportionate cost is deducted).
    - The loss arising on the disposal will not be an allowable loss for CGT purposes.

B – Remittance is partially the section 37 amount

a. Treat the disposal as, in effect, two disposals, one comprising the section 37 amount and the other comprising the rest of the remittance.
b. Where the two disposals are of the whole of the balance on the account, so there is altogether a full disposal of the account:
    - Apportion the allowable cost of the account between the two disposals in proportion to the sums comprised in each disposal (disregarding the exclusion of the section 37 amount from the consideration for one of the disposals) and compute the gain or loss on each disposal accordingly.
    - The loss arising on the disposal related to the section 37 amount will not be an allowable loss for CGT purposes (this is bound to be a loss because the effect of section 37 is to reduce the consideration to Nil but the proportionate cost is deducted).
    - The gain or loss arising on the other disposal will be chargeable or allowable in the normal way.
c. Where the two disposals together comprise only part of the account, so that there is a part-disposal of the account:
    - Disapply the normal part-disposal formula in section 42 TCGA.
    - Instead, apportion the allowable cost of the account between the two disposals and the remainder in proportion to the sums comprised in each disposal (disregarding the exclusion of the section 37 amount from the consideration for one of the disposals) and the balance remaining in the account and compute the gain or loss on each disposal accordingly.
    - The loss arising on the disposal related to the section 37 amount will not be an allowable loss for CGT purposes (this is bound to be a loss because the effect

of section 37 is to reduce the consideration to Nil but the proportionate cost is deducted).
- The gain or loss arising on the other disposal will be chargeable or allowable in the normal way.

Examples

The following examples illustrate how the new rules will work.

Example 1 – Remittance wholly income, whole account remitted (sterling depreciates)
Account contains foreign currency (FC) 20,000, cost £10,000. FC 20,000 is remitted at a time when its value is £12,000. The entire remittance is chargeable to income tax.

There is no split between a section 37 amount and another amount because section 37 applies to the whole remittance.

Gross consideration	£12,000
Less section 37 adjustment	£12,000
Net consideration	Nil
Allowable expenditure	£10,000
Loss	(£10,000)

Loss of £10,000 is not an allowable loss.

Example 2 – Remittance partly income, whole account remitted (sterling depreciates)
Account contains FC 20,000, cost £10,000. FC 20,000 is remitted at a time when its value is £12,000. FC 12,000 of the remittance, with a value of £7,200, is chargeable to income tax.

The section 37 amount is £7,200 (representing FC 12,000). The non-section 37 amount is £4,800 (representing FC 8,000).

Expenditure is allocated pro-rata:

To the section 37 amount, 12/20 x £10,000	= £6,000
To non-section 37 amount, 8/20 x £10,000	= £4,000

The section 37 amount computation:

Gross consideration	£7,200
Less section 37 adjustment	£7,200
Net consideration	Nil
Expenditure	£6,000
Loss	(£6,000)

Loss of £6,000 is not an allowable loss.

Non-S37 amount computation:

Consideration	£4,800

Allowable expenditure	£4,000
Chargeable gain	£ 800

The chargeable gain £800 is liable to CGT in the normal way.

Example 3 – Remittance wholly income, whole account remitted (sterling appreciates)
Account contains FC 30,000, cost £30,000. FC 30,000 is remitted when its value is £27,000. The entire remittance is chargeable to income tax.

There is no split between a section 37 amount and another amount because section 37 applies to the whole remittance.

Gross consideration	£27,000
Less section 37 adjustment	£27,000
Net consideration	Nil
Expenditure	£30,000
Loss	(£30,000)

Loss of £30,000 is not an allowable loss.

Example 4 – Remittance partly income, whole account remitted (sterling appreciates)
Account contains FC 30,000, cost £30,000. FC 30,000 is remitted when its value is £27,000, of which FC 20,000, with a value of £18,000, is chargeable to income tax.

The section 37 amount is £18,000 (representing FC 20,000). Non-section 37 amount is £9,000 (representing FC 10,000).

Expenditure is allocated pro rata:

To the section 37 amount 20/30 x £30,000	= £20,000
To non-section 37 amount 10/30 x £30,000	= £10,000

The section 37 amount computation:

Gross consideration	£18,000
Less section 37 adjustment	£18,000
Net consideration	Nil
Allocated expenditure	£20,000
Loss	(£20,000)

Loss of £20,000 is not an allowable loss.

Non-section 37 amount computation:

Consideration	£ 9,000
Allowable expenditure	£10,000
Loss	(£ 1,000)

Loss of £1,000 is allowable in the normal way.

Example 5 – Remittance wholly income, part account remitted (sterling depreciates)
Account contains FC 80,000, cost £60,000. FC 30,000 is remitted when its value is £30,000. The entire remittance is chargeable to income tax.

There is no split between a section 37 amount and another amount because section 37 applies to the whole remittance.

The part-disposal A/(A+B) formula does not apply. Instead, expenditure is allocated pro-rata:

To the section 37 amount, 30/80 x £60,000	= £22,500
To the remainder, 50/80 x £60,000	= £37,500

The section 37 amount computation:

Gross consideration	£30,000
Less section 37 adjustment	£30,000
Net consideration	Nil
Expenditure	£22,500
Loss	(£22,500)

Loss of £22,500 is not an allowable loss.

The allowable expenditure remaining for the balance of the bank account is £37,500, apportioned as above.

Example 6 – Remittance wholly income, part account remitted (sterling appreciates)
Account contains FC 50,000, cost £40,000. FC 30,000 is remitted when its value is £18,000. The entire remittance is chargeable to income tax.

There is no split between a section 37 amount and another amount because section 37 applies to the whole remittance.

The part-disposal A/(A+B) formula does not apply. Instead, expenditure is allocated pro-rata:

To the section 37 amount, 30/50 x £40,000	= £24,000
To the remainder, 20/50 x £40,000	= £16,000

The section 37 amount computation:

Gross consideration	£18,000
Less section 37 adjustment	£18,000
Net consideration	Nil
Expenditure	£24,000
Loss	(£24,000)

Loss of £24,000 is not an allowable loss.

The allowable expenditure remaining for the balance of the bank account is £16,000, apportioned as above.

Example 7 – Remittance partly income, part account remitted (sterling depreciates)
Account contains FC 200,000, cost £160,000. FC 120,000 is remitted when its value is £120,000, of which FC 20,000, with a value £20,000, is chargeable to income tax.

The remittance is split between a section 37 amount of £20,000 (representing FC 20,000) and a non-section 37 amount of £100,000 (representing FC 100,000).

The part-disposal A/(A+B) formula does not apply. Instead, expenditure is allocated pro-rata:

To the section 37 amount, 20/200 x £160,000	= £16,000
To the non-section 37 amount, 100/200 x £160,000	= £80,000
To the remainder, 80/200 x £160,000	= £64,000

The section 37 amount computation:

Gross consideration	£20,000
Less section 37 adjustment	£20,000
Net consideration	Nil
Expenditure	£16,000
Loss	(£16,000)

Loss of £16,000 is not an allowable loss.

Non-section 37 amount computation:

Consideration	£100,000
Allowable expenditure	£ 80,000
Chargeable gain	£ 20,000

Total chargeable gain £20,000.

The allowable expenditure remaining for the balance of the bank account is £64,000, apportioned as above.

Example 8 – Remittance partly income, part account remitted (sterling appreciates)
Account contains FC 50,000, cost £35,000. FC 15,000 is remitted when its value is £9,000, of which FC 5,000, with a value of £3,000, is chargeable to income tax.

The remittance is split between a section 37 amount of £3,000 (representing FC 5,000) and a non-section 37 amount of £6,000 (representing FC 10,000).

The part-disposal A/(A+B) formula does not apply. Instead, expenditure is allocated pro-rata:

To the section 37 amount 5/50 x £35,000	= £ 3,500
To the non-section 37 amount 10/50 x £35,000	= £ 7,000

To the remainder 35/50 x £35,000	= £24,500

The section 37 amount computation:

Gross consideration	£3,000
Less section 37 adjustment	£3,000
Net consideration	Nil
Expenditure	£3,500
Loss	(£ 500)

Loss of £500 is not an allowable loss.

Non-section 37 amount computation:

Consideration	£6,000
Allowable expenditure	£7,000
Loss	(£1,000)

Loss of £1,000 is allowable in the normal way.

The allowable expenditure remaining for the balance of the bank account is £24,500, apportioned as above.

Annex: Text of the Written Ministerial Statement on 16 December 2009

The Remittance Basis

The Financial Secretary to the Treasury (Mr. Stephen Timms): I am announcing today the Government's intention to present to Parliament proposed changes to the capital gains tax rules which will be legislated as part of Finance Bill 2010. These changes prevent the creation of capital gains tax losses which arise in certain circumstances from transactions of foreign currency bank accounts and will be effective from 16 December 2009. HM Revenue and Customs will publish on their website at: www.hmrc.gov.uk, precise details of the changes as soon as possible.

The changes affect individuals who are liable to tax on their foreign income and gains on the remittance basis. These individuals are liable to income tax on the sterling value of the amount remitted at the time of remittance. If the remittance takes the form of a transfer from a bank account in a foreign currency, they will simultaneously dispose of a corresponding part of that account and a capital gain or loss might arise as a consequence.

Associated with this change, I can confirm that HM Revenue and Customs accept that an existing capital gains tax rule in section 37 of the Taxation of Chargeable Gains Act 1992 removes any element of double tax charge in this situation. The income remitted is fully taxable (subject to any exemption which might apply), but a double charge to tax is avoided by this rule which excludes the income amount from the disposal proceeds used to calculate the capital gain or loss.

It is now clear that the rule goes beyond preventing a charge to capital gains tax and does not produce a fair outcome. Where the remittance is all treated as income, the rule creates capital gains tax losses that are far in excess of any real loss which the individual incurs. Where the remittance is partly income, the rule either creates an excessively large loss or reduces the taxable gain below the real level of gain.

The proposed legislative change will correct this defect in the current rules. Where a remittance comprises wholly income, the change will eliminate the loss arising under the current rule. Where a remittance comprises only partly income, the loss attributable to the income element of the remittance will again be eliminated. In addition, the allowable cost attributable to the non-income element of the remittance will be adjusted to ensure it corresponds to the amount of that part of the remittance. Where necessary, the allowable cost of the bank account will also be adjusted to ensure it corresponds to the amount remaining in the bank account after the remittance.

The result of these changes will be that a double tax charge will be avoided and no relief will be given where no actual loss has been incurred.