
FINANCIAL SERVICES COMPENSATION SCHEME: PAYMENTS REPRESENTING INTEREST

Who is likely to be affected?

1. Individuals who have received or will receive compensation from the Financial Services Compensation Scheme (FSCS) because of the default of a financial institution, such as a bank, where the compensation includes a payment in respect of accrued interest.

General description of the measure

2. Compensation paid by the FSCS to the customers of defaulting financial institutions has included an amount representing accrued interest from the last date interest was paid to the customer by the financial institution to the date that the financial institution defaulted (or for a fixed term deposit to the date of maturity if this is later than the date of default).
3. Income tax payers will be charged to income tax on the amount representing accrued interest paid by the FSCS to them as part of the compensation. Legislation will be introduced in Finance Bill 2009 to ensure that the financial institution's customers are in the same position as if the accrued interest were paid by the defaulting financial institution.
4. The measure only applies for income tax purposes because for companies, the taxation of bank deposits is within the loan relationship provisions in Parts 5 and 6 of the Corporation Tax Act 2009.

Operative date

5. The measure applies to payments made by the FSCS on or after 6 October 2008.

Current law and proposed revisions

6. Part of the compensation payment is described as interest by the FSCS and calculated as if the tax deduction rules on interest apply. However, the legal nature of this part of the compensation paid by the FSCS is unclear, and without legislation treating this payment as interest for income tax purposes the normal tax rules cannot apply.

7. This measure introduces two new pieces of legislation. The first is a new section 380A of the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). This section brings payments made by the FSCS that represent accrued interest within the charge to income tax.
8. Where the FSCS has calculated the amount representing accrued interest as if it were subject to deduction of tax then the amount brought into charge is the total of the amount representing the accrued interest plus the amount calculated as if it were the tax deducted.
9. New section 380A of ITTOIA applies to payments made by the FSCS itself or payments made by HM Treasury or any other person through the FSCS.
10. The second new piece of legislation is section 979A of the Income Tax Act 2007 (ITA) which applies where the FSCS has calculated the amount representing accrued interest as if tax had been deducted from it.
11. The amount treated as if it were the tax deducted is taken into account under section 59B of the Taxes Management Act 1970 in determining the amount of income tax payable on the accrued interest. This ensures that the customer can make a repayment claim if a non-taxpayer or treat the amount of notional tax deducted as if it were basic rate tax when calculating any liability to higher rate tax on the accrued interest.
12. New section 979A of ITA also requires the FSCS to provide the customer with a statement showing the gross and net amounts paid and the tax deducted if requested to do so in writing.

Further advice

13. If you have any questions about this change, please contact Lesley Hamilton on 020 7147 2564 (email: lesley.hamilton@hmrc.gsi.gov.uk) or Mark Lafone on 020 7147 2602 (email: mark.lafone@hmrc.gsi.gov.uk). Information about Budget measures is available on the HM Revenue & Customs website at www.hmrc.gov.uk