

Bill 7: New clause in Chapter 2 of Part 2

Introduction

1. This paper presents a draft clause for inclusion in Chapter 2 of Part 2 of Bill 7 (double taxation relief by way of credit) rewriting section 796(3) of ICTA as proposed to be in force following correction by order under section 1029 of ITA.

2. The paper contains:

- the draft clause, with origins;
- an explanatory note.
- a proposed change in the law

3. The proposed change gives statutory effect to the practice of taking the donor's income tax and capital gains tax liabilities together in applying the limit set by section 796(3) of ICTA. The change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.

Questions for the committee

4. We would be grateful for any comments you may have on these draft clauses and the proposed change in the law.

Closing date for comments

5. We would welcome any comments as soon as possible and in any event by 11 December 2009. If possible, they should be sent by e-mail to:

jackie.bartlett@hmrc.gsi.gov.uk

Written comments should be sent to:

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7. Please note that the names of respondents may be published unless they ask for their comments to be treated in confidence.

12 October 2009

Limit on total credit against income tax and capital gains tax

40A Amount of limit [jctr036]

- (1) In subsection (2) “the total credit” means –

$$F + G$$

where –

F is the total credit, under all tax-relief arrangements, allowed under section 18(2) against a person’s income tax for any tax year, and

G is the total credit, under all tax-relief arrangements, allowed under section 18(2) against the person’s capital gains tax for that tax year.

Origin: ICTA s.796(3); TCGA 1992 s.277(1).

- (2) The total credit is not to be more than –

$$I + C - A$$

where –

I is the total income tax payable by the person for the tax year,

C is the total capital gains tax payable by the person for the tax year, and

A is the total amount of the tax treated under section 414 of ITA 2007 (gift aid) as deducted from gifts made by the person in the tax year.

Origin: ICTA s.796(3), TCGA 1992 s.277(1); Annex 1, change 789.

- (3) In calculating I and C for the purposes of subsection (2), no reduction is to be made for credit under section 18(2).

Origin: Drafting.

- (4) Subsection (2) applies in addition to sections 36 and 40.

Origin: ICTA s.796(3), TCGA 1992 s.277(1).

- (5) For the purposes of subsection (1) the following are “tax-relief arrangements” –

(a) double taxation arrangements, and

(b) unilateral relief arrangements for a territory outside the United Kingdom.

Origin: ICTA s.790(3), s.796(3).

Taxation (International and Other Provisions) Bill
Chapter 2 of Part 2: Double taxation relief by way of credit
Clause 40A: Amount of limit

1. This clause restricts the total credit which may be allowed against income tax and capital gains tax. It is based on sections 790(3) and 796(3) of ICTA and section 277(1) of TCGA.
2. In applying the limit, *subsection (2)* takes the person's income tax and capital gains tax liabilities together. This minor change brings the law into line with practice. See *Change 789* in Annex 1.
3. The reference to section 414 of ITA (gift aid) in the definition of "A" in subsection (2) includes by implication a reference to section 426 of that Act (election by donor: gift treated as made in previous tax year).
4. Section 796(3) of ICTA refers to "total income tax" and, as applied by section 277(1) of TCGA, to "total capital gains tax". Attempting to spell out the meaning of these expressions could change their scope, with repercussions which could be difficult to predict. Accordingly, subsection (2) retains these expressions.
5. Also, persons other than individuals cannot make gift aid donations falling within section 414 of ITA. But the scope of "total income tax" and "total capital gains tax" in subsection (2) is not entirely clear. Accordingly, this clause follows the source legislation in using "person" rather than "individual", to preserve the possibility that, in a case involving a person other than an individual, this clause may set a limit on the amount of credit that is allowed in addition to the limits on credit that are set by clauses 36 and 40.

ANNEX 1

Change 789: Double taxation relief: limit on total credit against income tax and capital gains tax: interaction with gift aid: section 40A

This change relates to section 796(3) of ICTA, which restricts DTR by way of credit relief in order to ensure that tax refunded to charities on gift aid donations is covered by tax paid by the donor. The change gives statutory effect to the practice of taking the donor's income tax and capital gains tax liabilities together in applying the limit set by section 796(3).

Before ITA, section 796(3) of ICTA read:

Without prejudice to subsections (1) and (2) above, the total credit for foreign tax to be allowed to a person against income tax for any year of assessment under all arrangements having effect by virtue of section 788 shall not exceed the total income tax payable by him for that year of assessment, less any income tax which he is entitled to charge against any other person.

Section 796(3) of ICTA was initially repealed by ITA, without being rewritten, on the basis that its effect was replicated in Chapter 3 of Part 2 of ITA (calculation of income tax liability).

It was then realised that section 796(3) of ICTA, as applied for capital gains tax purposes by section 277(1) of TCGA, should not have been repealed. Accordingly, section 796(3) of

ICTA was restored (without break in continuity) for capital gains tax purposes by article 3(5) and (6) of the Income Tax Act 2007 (Amendment) (No. 3) Order 2007 (SI 2007/3506). The wording restored was unchanged from the pre-ITA wording, so the final phrase of the restored section 796(3) continued to refer to charges on income (despite their having become deductions in the income tax calculation). Prior to ITA, that final phrase had been extended by section 25(6)(b) and (7)(b) of FA 1990 so as to include a reference to tax treated as deducted from gift aid donations. Section 25 of FA 1990 was also repealed by ITA, and SI 2007/3506 did not restore the effect of section 25(6)(b) and (7)(b) of FA 1990.

Subsequently, the Income Tax Act 2007 (Amendment) (No. 2) Order 2009 (SI 2009/xxxx) has caused section 796(3) of ICTA to be restored as if it had never been repealed by ITA but as if ITA had from the outset amended the final phrase so as to rewrite the effect of section 25(6)(b) and (7)(b) of FA 1990. It is this restored version of section 796(3) of ICTA that is now rewritten in clause 40A. This order also amends section 424 of ITA to restore the effect for capital gains tax purposes of section 25(9)(d)(ii) and (iii) of FA 1990 (which, like section 796(3) of ICTA, concern DTR).

Section 796(3) of ICTA provides that the total credit for foreign tax allowed against a person's income tax for a year of assessment is given by –

- the amount of the person's total income tax for the year, less
- the amount of tax (i.e. income tax at basic rate) treated as deducted under section 414 of ITA from gift aid donations made by the person in the year.

This rule operates without prejudice to (i.e. in addition to) the rules in section 796(1) and (2) about the amount of credit against income tax on income from individual sources.

Section 796(3) of ICTA also has effect for capital gains tax purposes as applied by section 277(1) of TCGA. Section 277(1) of TCGA operates on Chapters 1 and 2 of Part 18 of ICTA (DTR) by, in particular, turning references to income tax into references to capital gains tax. Under section 796(3) as so applied, the starting point for the total credit for foreign tax allowed against a person's capital gains tax for a year of assessment is the total amount of the person's capital gains tax for the year. Section 796(3) suggests that although the total amount of capital gains tax for the year is the starting point for the limit on credit, the actual limit is given by reducing that total amount by tax treated as deducted under section 414 of ITA from gift aid donations.

The application of section 277(1) of TCGA to the reference to the tax treated as deducted under section 414 of ITA is not completely straightforward. In particular, the deemed deduction under section 414 of ITA is treated as a deduction of income tax at the basic rate. Given that the deemed deduction is of income tax, it might be thought that it makes no sense for that reference to income tax to be converted by section 277(1) of TCGA so as to become a reference to capital gains tax treated as deducted under section 414 of ITA. After all, section 414 of ITA makes no provision for capital gains tax to be treated as deducted.

In practice, it will rarely be the case that a person's entitlement to DTR will be affected by whether the person's capital gains tax liability is, or is not, reduced by tax treated as deducted under section 414 of ITA from gift aid donations made by the person. Yet the result of

leaving the final phrase as a reference to the income tax treated as deducted under section 414 means that, in a case where a person has foreign income and foreign capital gains, the amount of the person's entitlement to DTR by way of credit is reduced by up to twice the amount of the deemed deduction under section 414 of ITA. This clearly goes beyond the purpose of the deemed deduction, which is to ensure that tax reclaimed by a charity under the gift aid scheme is covered by tax paid by donors.

Despite that, reading the final phrase as an unconverted reference to the income tax treated as deducted under section 414 of ITA does mean that the words of the final phrase are given some effect. This is a strong argument for reading the phrase in this way.

Alternatively, it could be said that, to avoid the double reduction of entitlement to credit relief, it must have been intended that the final phrase of section 796(3) of ICTA should be omitted in its application for capital gains tax purposes. Or again, it could be said that there is no reason why section 277(1) of TCGA should not convert the reference to income tax treated as deducted under section 414 of ITA into a reference to capital gains tax treated as deducted under section 414 of ITA, despite that conversion having the result that the final phrase of section 796(3) of ICTA would have no effect for capital gains tax purposes.

The difficulty with these alternative approaches, which for capital gains tax purposes in effect strip out the final phrase of section 796(3) of ICTA, is their arbitrariness. If the gift aid tax reclaim by a charity is to be covered by income tax on the donor's foreign income, that income tax (so far as needed to cover the reclaim) cannot be reduced by DTR. Yet under these approaches, if the reclaim is to be covered by capital gains tax on the donor's foreign capital gains, there would be nothing to stop that capital gains tax being reduced or wiped out by credit relief for foreign tax on the gains. This would run counter to the clear intention behind gift aid relief, which is that gift aid tax reclaims by charities are to be covered by income tax and capital gains tax paid by donors.

In practice, section 796(3) of ICTA is applied as if it provided for total credit relief against a person's income tax and capital gains tax for a tax year to be –

- the person's total income tax and capital gains tax for the year, less
- the total of the tax treated as deducted under section 414 of ITA on gift aid donations made by the person in the year.

Section 796(3) of ICTA is being rewritten, in clause 40A, in a way which gives effect to this practice. In the light of the discussion above, this is a change in the law. Of course, this single disallowance of the amount treated as deducted under section 414 of ITA is clearly more advantageous for taxpayers than the double disallowance of that amount that could arise under what appears to be the most likely reading of section 796(3) of ICTA. But clause 40A could also be to the taxpayer's disadvantage, as it will prevent the taxpayer arguing that credit for foreign tax charged on capital gains should be allowed against any part of the taxpayer's capital gains tax liability which covers tax reclaims by charities on gift aid donations made by the taxpayer.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with generally accepted practice.