Exclusion 80 – Income Tax Treated as Paid

The Self Assessment Calculator, and software based on it, has not been producing accurate tax calculations in certain circumstances related to the amount of income tax treated as paid on chargeable event gains. This is because some of a chargeable event gain may be charged at 0% due to the Starting Rate for Savings and Personal Savings Allowance, while the amount of income tax treated as paid is calculated as 20% of the gain.

Life insurance policies, life annuity contracts and capital redemption policies are only charged to tax in certain circumstances, called chargeable events. Generally, an individual who is liable for tax under the chargeable event regime is treated as having paid tax at the basic rate on the amount of the gain. Tax at the basic rate is not treated as having been paid on certain chargeable event gains. These are usually where the insurer that issued the policy is not taxed on the investment return accruing for the benefit of the policyholders under the I minus E system, or similar systems within the European Economic Area.

This notional tax is not repayable in any circumstances and the gain is not grossed up to take account of the tax treated as paid. For example, if an individual has a gain of £1,000, they are treated as having paid tax on the gain of £200 already.

If we take an example of an individual who had a chargeable event gain of £50,000, of which £20,000 is taxed at 20% and the remainder at 40%. They would be liable to tax of £16,000, less the amount of tax treated as paid at the basic rate of £10,000, resulting in tax due of £6,000.

With the introduction of the Starting Rate for Savings and the Personal Savings Allowance, there are now instances where some of the gain will be charged at 0%. An example would be with a gain of £20,000, with £5,000 at the Starting Rate, £1,000 at the Nil Rate and the remaining £14,000 at the basic rate, resulting in tax due of £2,800. The amount of tax treated as paid at the basic rate is £4,000.

When the amount treated as paid is more than the amount due on the gain, and the only tax that would have been due was any amount on the gain, then no tax is repaid. However, when there is tax due on other income, the SA Calculator can currently repay some of this. An example of this would be an individual in 2016-17 with £20,000 of employment income and a chargeable event gain of £20,000. There would be tax due on the employment income of £1,800, and £3,800 on the gain. The income tax treated as paid is £4,000. The SA Calculator currently works out the amount of tax due as £1,600, and as such has refunded £200 of the tax due on the employment income. HMRC's view is that this is incorrect and that the notional credit for the income tax treated as paid should be limited to the amount of tax calculated as due on the gain.

The income tax treated as paid is not a relief that can give a tax reduction against total income under s26 Income Tax Act 2007, and it is not a tax credit. It is self-contained in Chapter 9 of the Income Tax (Trading and Other Income) Act 2005, so should not have any effect on the tax due on other income.

We have introduced Exclusion 80 on version 9.0 of the e-filing exclusions list for 2016-17. This means that for 2016-17, customers may receive a correction calculation from HMRC. We were unable to make changes for 2017-18, but we are working closely with software developers, the agent community and other stakeholders to determine how we can best support our customers from April. We will be issuing correspondence in due course.

Thank you for your patience and ongoing support.