

What a tangled web we weave...

The calculation of top-slicing relief on life assurance gains has been the source of some confusion. **Tim Good** explains the effect of the Budget proposals that should draw a line under this.

As a direct result of the taxpayer's success in *Marina Silver* (TC7103), the legislation governing the taxation of chargeable event gains will change for such events occurring on or after 11 March 2020. Readers not familiar with the *Silver* case should see the articles 'It's all gone Pete Tong' (*Taxation*, 27 September 2017, page 14) and 'Silver wins gold' (*Taxation*, 20 May 2019, page 8).

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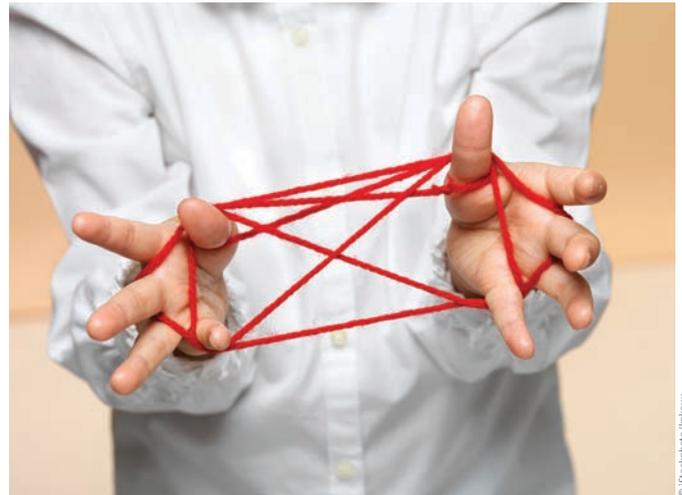
So, what has changed? The draft clauses effect two quite distinct ‘changes’.

The first change articulates the interpretation approved by the First-tier Tribunal in *Silver*. In performing the calculations required by ITTOIA 2005, s 536(1) and s 537, the individual's personal allowance, but not any other relief or allowance, is to be calculated as though the gain from the chargeable event is limited to the proportion of the gain.

The second change introduces a new rule as to how those calculations are to be made. The provisions of ITA 2007,

Key points

- The decision in *Marina Silver* went against HMRC's calculation of top slicing relief.
- Changes proposed to ITTOIA 2005, s 536 and s 537.
- Personal allowance will be calculated by reference to the limited proportion of the gain.
- ITA 2007, s 25(2) on the allocation of reliefs and allowances will not apply in calculations under ITTOIA 2005, s 536(1) and s 537.
- What will be the effect of the withdrawal of HMRC's appeal against the *Silver* decision?
- Example of the new calculation.



s 25(2), that require reliefs and allowances to be set against income in a way that results in the greatest reduction in an individual's income tax liability, do not apply in performing the calculations required by ITTOIA 2005, s 536(1) and s 537.

The *Silver* clause

The so-called ‘*Silver* clause’ is to be welcomed inasmuch as it ensures that taxpayers will no longer be overcharged by an incorrect interpretation of the legislation. It also introduces a new statutory rule that overrides the interpretation in *Silver* by limiting the application of the new clause to the individual's personal allowance under ITA 2007, s 35, but not extending it to the amount of any other relief or allowance. This latter point means, for example, that if the taxpayer has reliefs such as qualifying loan interest that are limited to the higher of £50,000 or 25% of adjusted total income, the same amount will be used in the calculation of tax on one slice as applies in the calculation on the full gain.

What about calculations on chargeable event gains arising before 11 March 2020?

I would argue that the personal allowance element of the new clause simply confirms how the legislation should always have been interpreted. This point is key to those thousands (literally) of taxpayers who have been awaiting the outcome of the *Silver* case before themselves obtaining redress from HMRC.

Until now the standard HMRC response to such claims has been, broadly speaking, that the department disagrees with the First-tier Tribunal decision and stands by the department's own interpretation.

However, it is noteworthy that the explanatory note (tinyurl.com/qs9h4wa) published on 11 March includes the following statements (emphasis added):

‘Subsections 3 and 4 *confirm* the calculation of the income tax liability on a proportion of the gain as required within the calculation of top-slicing relief in ITTOIA 2005, s 536(1) and s 537. The *clarifications* allow the individual’s personal allowance, but not any other relief or allowance, to be calculated as though the gain from the chargeable event is limited to the proportion of the gain.

Background note

‘Top-slicing relief is designed to mitigate the impact of individuals being charged to tax at a higher rate due to the inclusion of a life insurance policy gain, or gains, in income for the year.

‘This clause will *put beyond doubt* the calculation of top-slicing relief by setting out the basis of the personal allowance available and specifying how allowances and reliefs can be set against life insurance policy gains.

This ensures a fair outcome for those taxpayers eligible for top-slicing relief, in line with the original policy intent, and prevents excessive relief.’

It seems to me that the use of words and phrases such as ‘confirms’, ‘clarifications’, ‘put beyond doubt’, ‘ensures a fair outcome’ and ‘original policy intent’ all point towards acceptance by HMRC that the interpretation approved by the First-tier Tribunal was indeed right all along.

Why does all this matter? Well, at 5pm on 17 March (coincidentally the deadline for the delivery of HMRC’s skeleton argument) the department submitted to the Upper Tribunal notice of withdrawal of its appeal in the *Silver* case. On 19 March, Judge Richards consented to withdrawal of the appeal with HMRC to pay reasonable costs.

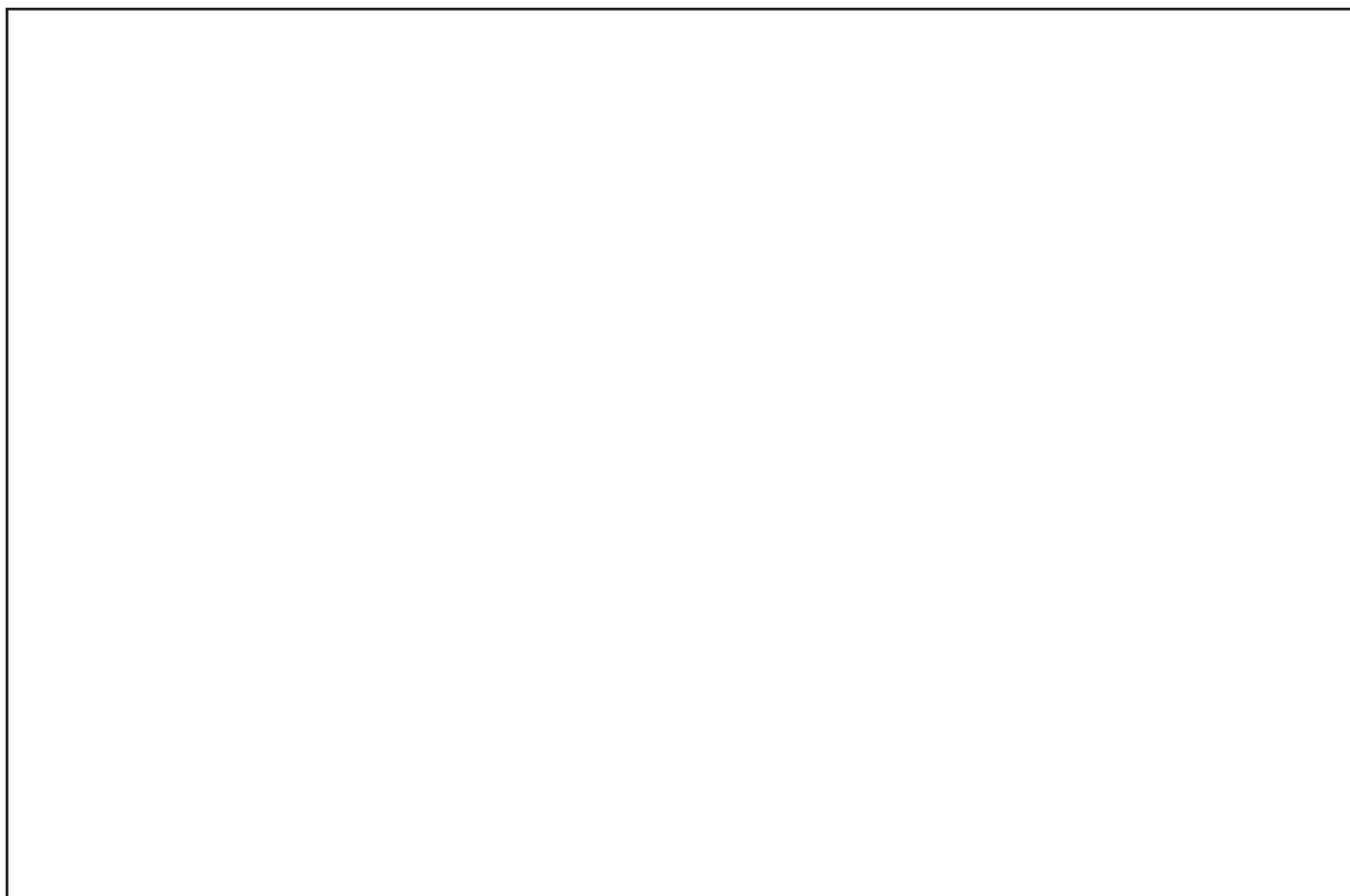
It is well known that decisions of the First-tier Tribunal, while of persuasive value, are not binding in other proceedings. I had asked the Upper Tribunal to dismiss HMRC’s appeal rather than to allow withdrawal, anticipating that withdrawal could leave us in a very tiresome situation: HMRC might continue to reject claims by other taxpayers and we would need a further First-tier Tribunal decision to take us back to the Upper Tribunal. I hope we will very soon know where we stand on this.

The allocation clause

The second limb of the new legislation addresses the way in which allowances and reliefs are to be allocated in the calculations of top slicing relief. Coincidentally, I assume, I had sent HMRC the following example of a case where the department’s 2019-20 calculator is undercalculating top slicing relief even though the personal allowance issue did not arise.

Employment income	£55,000
Chargeable event gain (six years term)	£10,000

The HMRC calculator allocates the £12,500 personal allowance as follows:



Calculation 1

Tax on full gain pre-11 March 2020 rules

	£	Personal Allowance £	Savings rate band £	PSA £	Basic rate £	Higher rate £	Tax £
Employment income	55,000	11,333	5,000		37,500	6,167	9,967
Chargeable event gain	10,000	1,167		500		8,333	3,333
Total	65,000	12,500	5,000	500	37,500	14,500	13,300

Calculation 2

Tax on sliced gain pre-11 March 2020 rules

	£	Personal Allowance £	Savings rate band £	PSA £	Basic rate £	Higher rate £	Tax £
Employment income	55,000	11,333	5,000		37,500	6,167	9,967
Sliced gain	1,667	1,167		500			
Total	56,667	12,500	5,000	500	37,500	6,167	9,967

Calculation 3

Top slicing relief and tax calculation pre-11 March 2020 rules

	£	£	£
ITTOIA 2005, s 535(3) – Tax liability on full gain		3,333	
ITTOIA 2005, s 535(3) – Basic rate on full gain less allowances		1,767	
ITTOIA 2005, s 535(1)(a)		<u>1,567</u>	
ITTOIA 2005, s 536(1) – Tax liability on sliced gain	0		
ITTOIA 2005, s 536(1) – Basic rate on sliced gain less allowances	<u>0</u>		
ITTOIA 2005, s 536(1) – Step 3		<u>0</u>	
Top slicing relief		<u>1,567</u>	
Tax liability			13,300
Less: Top slicing relief		1,567	
Less: Notional basic rate liability on gain		<u>1,767</u>	3,334
Net liability			<u>9,966</u>

Employment income £12,500
Chargeable event gain £nil

This allocation arrives at the tax liability of £10,300 as shown in *Calculation 6*.

I would allocate the £12,500 personal allowance in accordance with ITA 2007, s 25(2) as follows.

Employment income £11,333
Chargeable event gain £1,167

My use of the allowances arrive at a liability of £9,966 as shown in *Calculation 3*.

The new allocation clause will, from 11 March 2020, require the HMRC allocation above rather than mine.

The detailed calculations

For those interested in the detailed calculations of how the above liabilities were arrived at, calculations 1 to 3 show the income tax computations for a chargeable event gain arising before 11 March 2020 and calculations 4 to 6 show the corresponding calculations for gains arising on or after 11 March 2020.

As it happens, my own liability calculator arrives at tax of £9,500 rather than £9,967 under the pre-11 March 2020 rules.

The reason for this is because I would allocate the whole of the personal allowance of £12,500 to the employment income in both the actual calculation of tax under ITA 2007, s 23 and the hypothetical calculation on the full gain under ITTOIA 2005, s 535(3). However,

Calculation 4

Tax on full gain post-11 March 2020 rules

	£	Personal Allowance £	Savings rate band £	PSA £	Basic rate £	Higher rate £	Tax £
Employment income	55,000	12,500	5,000		37,500	5,000	9,500
Chargeable event gain	10,000			500		9,500	3,800
Total	65,000	12,500	5,000	500	37,500	14,500	13,300

Calculation 5

Tax on sliced gain post-11 March 2020 rules

	£	Personal Allowance £	Savings rate band £	PSA £	Basic rate £	Higher rate £	Tax £
Employment income	55,000	12,500	5,000		37,500	5,000	9,500
Sliced gain	1,667			500		1,167	467
Total	56,667	12,500	5,000	500	37,500	6,167	9,967

Calculation 6

Top slicing relief and tax calculation post-11 March 2020 rules

	£	£	£
ITTOIA 2005, s 535(3) – Tax liability on full gain		3,800	
ITTOIA 2005, s 535(3) – Basic rate on full gain less allowances		2,000	
ITTOIA 2005, s 535(1)(a)		<u>1,800</u>	
ITTOIA 2005, s 536(1) – Tax on sliced gain	467		
ITTOIA 2005, s 536(1) – Basic rate on sliced gain less allowances	333		
ITTOIA 2005, s 536(1) – Step 3	<u>133</u>	800	
Top slicing relief		<u>1,000</u>	
Tax liability			13,300
Less: Top slicing relief		1,000	
Less: Notional basic rate liability on gain		2,000	3,000
Net liability			<u>10,300</u>

I would allocate £11,333 to the employment income and £1,167 to the sliced gain in the hypothetical calculation under ITTOIA 2005, s 536(1).

I think that recent HMRC statements and the analysis of the legislation in the *Silver* case would make it very hard for HMRC to resist a claim that the top slicing relief in this case should be £1,800 and the notional basic rate liability £2,000. ●

Planning point

Advisers who have clients that have gains from chargeable events will want to check the effect that HMRC's withdrawal of its appeal in the *Marina Silver* case may have on their top slicing relief calculations

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- Silver wins gold (repayment claims for top slicing relief): tinyurl.com/stcsexf
- It's all gone Pete Tong (calculating top-slicing relief): tinyurl.com/y3so5dvy
- Investment bonds tax planning: tinyurl.com/stfzprg