

## Cap on income tax reliefs

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### Who is likely to be affected?

Individuals who use currently unlimited reliefs to reduce the amount of total income liable to tax.

### General description of the measure

This measure will introduce a cap on certain currently unlimited income tax reliefs that may be deducted from income under section 24 of the Income Tax Act 2007 (ITA). The cap will be set at £50,000 or 25 per cent of income, whichever is greater. The primary reliefs affected will be trade and property loss reliefs that can be relieved against general income and qualifying loan interest relief. A small number of other reliefs will also be affected.

### Policy objective

This measure supports the Government's objective of promoting fairness in the tax system by introducing a limit on currently uncapped income tax reliefs from April 2013.

### Background to the measure

The Government announced this measure at Budget 2012. A consultation on delivery, *Delivering a cap on income tax relief: a technical consultation*, was published on 13 July 2012 and ran for a period of 12 weeks. A summary of responses was published on 11 December 2012.

## Detailed proposal

### Operative date

The measure will have effect on and after 6 April 2013.

### Current law

Section 24 of ITA details various specific reliefs that may be deducted in the calculation of income tax liability, including reliefs which can be relieved against general income. There is currently no upper limit on the amount of income tax relief claimed for the year of the claim, any other earlier year claimed, or any later year in which the relief claimed is allocated.

### Proposed revisions

Legislation will be introduced in Finance Bill 2013 to set a limit on specific income tax reliefs claimed by individuals from 6 April 2013. The limit will only apply to certain reliefs, which are currently unlimited, and will be set at the greater of £50,000 or 25 per cent of income. The limit will not apply to charitable reliefs.

The following income tax reliefs will be limited to the extent that they can be relieved by individuals against general income:

- Trade loss relief against general income – available for losses made by an individual carrying on a trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and business premises renovation allowances (BPRA);
- Early trade losses relief – available to an individual in the first four years of the trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and BPRA;

- Post-cessation trade relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the trade;
- Property loss relief against general income – available for property business losses arising from capital allowances or agricultural expenses. This will exclude relief for losses attributable to BPRA;
- Post-cessation property relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the UK property business;
- Employment loss relief – available in certain circumstances where losses or liabilities arise from employment;
- Former employees deduction for liabilities – available for payments made by former employees for which they are entitled to claim a deduction from their general income in the year in which the payment is made;
- Share loss relief on non-Enterprise Investment Schemes / Seed Enterprise Investment Schemes shares – available for capital losses on the disposal (or deemed disposal) of certain qualifying shares;
- Losses on deeply discounted securities – available only for losses on gilt strips and on listed securities held since at least 26 March 2003; and,
- Qualifying loan interest – available for interest paid on certain loans. These include loans to buy an interest in certain types of company, or to invest in a partnership.

An individual's income will be calculated for the purposes of the limit as the same for all affected individuals as their total income liable to income tax. This figure will then be adjusted to include an individual's charitable donations made via payroll giving and to exclude pension contributions, to create a level playing field between those whose deductions are made before they pay income tax, and those whose deductions are made after tax. The result, 'adjusted total income', will be the measure of income for the limit. The limit will apply to the year of the claim and any earlier or later year in which the relief claimed is allocated against total income. The limit will not apply to relief offset against profits from the same trade or property business.

### Summary of impacts

Exchequer impact (£m)	2012-13	2013-14	2014-15	2015-16	2016-17
	-	negligible	+490	+240	+300
<p>These figures were set out in Table 2.1 of Budget 2012 and have been certified by the Office for Budget Responsibility (OBR). More details can be found in the policy costings document published alongside the Budget 2012.</p> <p>In addition, excluding charitable reliefs is expected to decrease receipts by approximately £65 million per annum. These detailed figures are set out in Table 2.1 of the Autumn Statement and have been certified by the OBR. More detail can be found in the policy costings document published alongside the Autumn Statement.</p> <p>The impact of further revisions will be subject to scrutiny by the Office for Budget Responsibility, and will be set out at Budget 2013.</p>					

<p><b>Economic impact</b></p>	<p>The measure is expected to have no significant macroeconomic impacts.</p> <p>The cap will restrict trade loss relief set against general income, however offset of losses against income from the same trade will remain unlimited. In many cases carry-back of losses against the same trade will still provide immediate relief; failing this losses will be carried forward. Delaying loss relief reduces the net present value of investment projects and therefore may impact on investment decisions and start-ups. However as the minimum cap is set at £50,000, for most businesses this is likely to allow losses to be relieved without delay and therefore without significant impact on investment decisions.</p> <p>There may be some behavioural change as individuals rearrange their affairs to limit the effect of the relief cap.</p>
<p><b>Impact on individuals and households</b></p>	<p>The cap on unlimited tax relief will only affect individuals with incomes over £50,000 in a tax year, claiming specified reliefs for that year totalling in excess of £50,000. It is estimated that around 8,000 individuals each year will be affected due to use of unlimited tax relief in excess of both £50,000 and 25 per cent of their income.</p> <p>Those impacted are likely to have high incomes, with over 90 per cent of the static yield attributable to individuals with incomes over £150,000, with a median loss of £20,000 per person. Some individuals with very high gross incomes will be impacted significantly more.</p> <p>Those affected are within the Self Assessment population. The relief cap will be operated via automated calculations using information already reported as part of the Self Assessment process. Where relief is claimed against an earlier year a manual calculation will apply as now. This should not significantly increase the administrative or compliance burden on individuals.</p> <p>Some individuals making charitable donations through payroll giving (and wishing for these to be taken into account when calculating their adjusted income for the purpose of the cap) will need to add up their annual contributions from their payslips, as this figure is not reported on the annual certificate of pay and tax, P60. This will be voluntary, but will increase the level of relief available to an individual.</p>
<p><b>Equalities impacts</b></p>	<p>Analysis of Self Assessment data does not support detailed equality analysis but HMRC has been able to extract some distribution of those impacted:</p> <ul style="list-style-type: none"> <li>• Around 90 per cent of those expected to be impacted are male.</li> <li>• Approximately 70 per cent are aged between 40 and 65.</li> </ul> <p>The available Self Assessment data does not allow the total number of individuals affected to be broken down by ethnicity, disability, religion, belief or sexual orientation. However, it is not expected that the policy would adversely or disproportionately impact on any of these groups.</p>
<p><b>Impact on business including civil society organisations</b></p>	<p>This measure is expected to have a negligible impact on businesses and civil society organisations. The relief cap will be operated via automated calculations using information already reported as part of Self Assessment. Some businesses will incur a negligible one-off cost due to familiarisation with the policy, and a negligible additional on-going administrative burden due to the requirement for more complex calculations.</p>

<b>Operational impact (£m) (HMRC or other)</b>	Implementation will require changes to HMRC's Self-Assessment system and processes. The costs of these are currently estimated to be £500,000.
<b>Other impacts</b>	<p><u>Small firms impact test:</u> the cap is likely to have some limited impacts on small businesses, as it will restrict relief for losses against other income of the same year. However, losses can still be offset against profits of the same trade to an unlimited extent; therefore in most cases the losses can still be eventually relieved.</p> <p>Other impacts have been considered and none have been identified.</p>

### **Monitoring and evaluation**

A key aim of this measure is to ensure that wealthy individuals make fairer income tax contributions and HMRC and HM Treasury will seek to assess the effects of cap in the context of other relevant tax changes.

The measure will be kept under review through regular communication with the relevant business sector and where it sees evidence of any abuse emerging, including artificially constructed ways to circumvent the cap specific and targeted action will be taken.

### **Further advice**

If you have any questions about this change, please contact Carolyn Howes on 020 7147 3508 (email: carolyn.howes@hmrc.gsi.gov.uk).

**1 Limit on income tax reliefs**

Schedule 1 contains provision limiting the deductions which may be made at Step 2 of the calculation in section 23 of ITA 2007 (calculation of income tax liability).

## SCHEDULES

### SCHEDULE 1

Section 1

#### LIMIT ON INCOME TAX RELIEFS

##### *The limit*

- 1 In Chapter 3 of Part 2 of ITA 2007 (calculation of income tax liability) after section 24 insert –

##### **“24A Limit on Step 2 deductions**

- (1) If the taxpayer is an individual, there is a limit on certain deductions which may be made for the tax year at Step 2.
- (2) The limit is determined as follows.
- (3) Amount A must not exceed amount B.
- (4) Amount A is –
  - (a) the deductions for the tax year at Step 2 for the reliefs listed in subsection (6) taken together, less
  - (b) so much of those deductions as fall within subsection (7).
- (5) Amount B is –
  - (a) £50,000, or
  - (b) if more, 25% of the taxpayer’s adjusted total income for the tax year (see subsection (8)).
- (6) The reliefs are –
  - (a) relief under section 64 (trade loss relief against general income);
  - (b) relief under section 72 (early trade losses relief);
  - (c) relief under section 96 (post-cessation trade relief);
  - (d) relief under section 120 (property loss relief against general income);
  - (e) relief under section 125 (post-cessation property relief);
  - (f) relief under section 128 (employment loss relief against general income);
  - (g) relief under Chapter 6 of Part 4 (share loss relief);
  - (h) relief under Chapter 1 of Part 8 (interest payments);
  - (i) relief under section 555 of ITEPA 2003 (deduction for liabilities relating to former employment);
  - (j) relief under section 446 of ITTOIA 2005 (strips of government securities: relief for losses);

- (k) relief under section 454(4) of ITTOIA 2005 (listed securities held since 26 March 2003: relief for losses: persons other than trustees).
- (7) The deductions falling within this subsection are –
- (a) deductions for amounts of relief so far as attributable to allowances under Part 3A of CAA 2001 (business premises renovation allowances);
  - (b) deductions for amounts of relief under a provision mentioned in subsection (6)(a) to (e) so far as made from profits of the trade or business to which the relief in question relates;
  - (c) deductions for amounts of relief under the provision mentioned in subsection (6)(a) or (b) so far as attributable to a deduction allowed under section 205 or 220 of ITTOIA 2005 (deduction for overlap profit in final tax year or on change of accounting date);
  - (d) deductions for amounts of relief under the provision mentioned in subsection (6)(g) –
    - (i) where the shares in question fall within section 131(2)(a) (qualifying shares to which EIS relief is attributable), or
    - (ii) where SEIS relief is attributable to the shares in question as determined in accordance with Part 5A (seed enterprise investment scheme).
- (8) The taxpayer’s “adjusted total income” for the tax year is calculated as follows.

*Step 1*

Take the amount of the taxpayer’s total income for the tax year.

*Step 2*

Add back the amounts of any deductions allowed under Part 12 of ITEPA 2003 (payroll giving) in calculating the taxpayer’s income which is charged to tax for the tax year.

*Step 3*

If the taxpayer is given relief in accordance with section 192 of FA 2004 (pension schemes: relief at source) in respect of any contribution paid in the tax year under a pension scheme, deduct the gross amount of the contribution.

The “gross” amount of a contribution is the amount of the contribution before deduction of tax under section 192(1) of FA 2004.

*Step 4*

If the taxpayer is entitled to a deduction for relief under section 193(4) or 194(1) of FA 2004 (pension schemes: excess relief under net payment arrangements or relief on making a claim) for the tax year, deduct the amount of the excess or contribution (as the case may be).

The result is the taxpayer’s adjusted total income for the tax year.”

*Consequential amendments*

- 2 (1) ITA 2007 is amended as follows.

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- (2) In section 23 (calculation of income tax liability) at step 2 for “section 25” substitute “sections 24A and 25”.
  - (3) In the following provisions (which explain how certain reliefs work) for “section 25(4) and (5)” substitute “sections 24A and 25(4) and (5)” –
    - (a) section 65(1),
    - (b) section 73,
    - (c) section 121(1),
    - (d) section 129(1), and
    - (e) section 133(1).

*Commencement and transitional provision*

- 3 The amendments made by this Schedule have effect for the tax year 2013-14 and subsequent tax years.
- 4 (1) The amendments also have effect for tax years before the tax year 2013-14 but subject to sub-paragraph (2) below.
  - (2) Section 24A(6) of ITA 2007 (as inserted by paragraph 1 above) has effect as if –
    - (a) in paragraphs (a), (b), (f) and (g) the references to relief were limited to relief in respect of a loss made in the tax year 2013-14 or a subsequent tax year, and
    - (b) all the other paragraphs were omitted.
- 5 In section 24A(6)(d) of ITA 2007 (as inserted by paragraph 1 above) the reference to relief does not include relief in respect of a loss made in the tax year 2012-13.

**EXPLANATORY NOTE**

**LIMIT ON INCOME TAX RELIEFS**

**SUMMARY**

1. This clause and Schedule provide for a limit on the amount of income tax relief that an individual may deduct at step 2 of their income tax calculation for a tax year in relation to certain prescribed reliefs. The limit is the greater of £50,000 or 25 per cent of the individual's adjusted total income for the tax year. The limit has effect for the tax year 2013-14 and subsequent tax years.

**DETAILS OF THE SCHEDULE**

*The limit*

2. Paragraph 1 inserts new section 24A after section 24 of Chapter 3 of Part 2 of Income Tax Act 2007 (ITA). New section 24(A)(1) provides for a limit on the amount of relief that may be deducted at step 2 of the income tax calculation for those reliefs listed in new section 24A(6). The reliefs are:
  - Trade Loss Relief against general income– available for losses made by an individual carrying on a trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and Business Premises Renovation Allowances (BPRA);
  - Early Trade Losses Relief – available to an individual in the first four years of the trade, profession or vocation. This will exclude relief for losses attributable to overlap relief and BPRA;
  - Post-cessation Trade Relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the trade;
  - Property Loss Relief against general income – available for property business losses arising from capital allowances or agricultural expenses. This will exclude relief for losses attributable to BPRA;
  - Post-cessation Property Relief – available for qualifying payments or qualifying events within seven years of the permanent cessation of the UK property business;
  - Employment Loss Relief against general income– available in certain circumstances where losses or liabilities arise from employment;
  - Former Employees Deduction for Liabilities – available for payments made by former employees for which they are entitled to claim a deduction from their general income in the year in which the payment is made;
  - Share Loss Relief on non-EIS/SEIS shares – available for capital losses on the disposal (or deemed disposal) of certain qualifying shares;

## FINANCE BILL

- Losses on Deeply Discounted Securities – available only for losses on gilt strips and on listed securities held since at least 26 March 2003; and,
  - Qualifying Loan Interest – available for interest paid on certain loans. These include loans to buy an interest in certain types of company, or to invest in a partnership.
3. New sections 24A(3) to (5) set out the method of computing the limit.
  4. New section 24A(7) lists deductions for amounts of relief that are specifically excluded from the limit.
  5. New section 24A(8) explains how to calculate “adjusted total income” for the purposes of the limit.

### *Consequential Amendments*

6. Paragraph 2 provides consequential amendments to step 2 of the income tax calculation in section 23 ITA, and in specific relief provisions.

### *Commencement and transitional provision*

8. Paragraph 3 provides for the limit to take effect for tax year 2013-14 and subsequent tax years.
9. Paragraph 4 provides that the limit will also apply where loss relief is claimed for a tax year before 2013-14 in relation to losses made in 2013-14 or a later year.
10. Paragraph 5 ensures that the limit will not apply to property loss relief arising from a loss made in 2012-13 where the loss is claimed for relief against general income in tax year 2013-14.

## BACKGROUND

11. In his Budget Statement of 21 March 2012, the Chancellor announced a limit on previously uncapped income tax reliefs with effect from 6 April 2013. The limit is to ensure that those on higher incomes cannot use reliefs excessively. The limit is set at £50,000 or 25 per cent of an individual’s adjusted total income, whichever is the greater.
12. This measure is about fairness: the Government is committed to supporting investment and entrepreneurship – but considers that its support should not be without limit.
13. This measure is not being introduced to address tax avoidance; it will however reduce the scope for exploiting these reliefs for tax avoidance purposes.
14. Following engagement with the charity sector the Government decided to specifically exclude charitable reliefs from the cap. The Government consulted on the delivery of the cap between 13 July and 5 October 2012.

## **FINANCE BILL**

15. If you have any questions about this change, or comments on the legislation, please contact Carolyn Howes on 020 7147 3508 (email: [carolyn.howes@hmrc.gsi.gov.uk](mailto:carolyn.howes@hmrc.gsi.gov.uk)).