

**Statement of Practice
[SP7]
Income Tax Self Assessment
Tax Credits - 1989/90**

A copy of Statement of Practice SP7 is attached.

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Background

A Statement of Practice concerning the treatment of tax credits for 1988/89 was issued in October 1988. This Statement identified what was considered to be the most accurate method ("the preferred method") for calculating tax credits and the one least likely to produce underpayments of tax. Its use was not insisted upon, however.

Experience has shown that the use of different methods for calculating credits is giving rise to confusion and, except where the preferred method was used, underpayments of tax are arising which necessitate the issuing of Notices of Amended Assessment.

An improved Self Assessment return form has been prepared for 1989/90 in consultation with tax practitioners. Accordingly the opportunity is being taken to standardise the calculation of tax credits.

Practice for 1989/90

The redesigned Return of Income Form 11 is now being issued. The VSA computation form, which is now part of the Form 11, shows the standard method of credit calculation and the accompanying notes on the Form 11 include a practical example. In addition, letters are being issued to tax practitioners for any of their Self Assessment clients who have PAYE income. Each letter shows the amount of the client's 1989/90 tax-free allowances set against PAYE income and the applicable PAYE Table Rate. The information in the letter will

enable the appropriate PAYE credit for 1989/90 to be calculated easily for payment and VSA purposes.

Accordingly, in computing tax liabilities for 1989/90, please use only the following standard treatment of tax credits. Other methods are likely to lead to differences between the computations and the computer output.

1. Credits in respect of Schedule F Dividends

Until such time as the correct "actual" income figure is known, the amount of Schedule F income for assessment in 1989/90 is the amount of the income of the preceding year. This amount is computed by adding together the distribution and the tax credit for 1988/89.

The amount of the credit to be allowed for 1989/90 should be based on a rate of 28%. [For 1988/89 it was 32%]. The appropriate tax credit for 1989/90 in the case of dividends which do not attract Export Sales Relief or Manufacturing Relief is therefore 28/32nds of the 1988/89 tax credit used in computing the preceding year's income.

The credit for the unrelieved part of Export Sales Relieved dividends may also be arrived at by taking 28/32nds of the 1988/89 tax credit. The credit for the relieved part of such dividends remains unchanged.

The credit for Manufacturing Relieved dividends is unaltered and remains at 1/18th of the dividend (i.e. 1/19, or 5.264%, of the Schedule F income). [Note: In certain circumstances, part of the income arising from Manufacturing Relieved dividends is not taxable. However, the tax credit appropriate to the non-taxable part of the income is deductible in arriving at tax liability.]

2. PAYE Tax

Until the correct "actual" figures of income and tax are known, the preceding year's income figure should be used. The appropriate credit for PAYE tax should be arrived at by computing the amount of PAYE tax which would be deducted in 1989/90 if the income being used in the computation were the income in 1989/90. In other words, the appropriate calculation is on the basis that the PAYE income for 1989/90 will be the same as for 1988/89, but the tax on that amount is calculated in accordance with the 1989/90 allowances and reliefs actually assigned in the 1989/90 Notice of Tax Free Allowances.

3. Retention Tax on Deposit Interest

For 1989/90, until the correct "actual" income is known, the "net" interest arising for 1988/89 plus the tax deducted for 1988/89 (35/65ths of the net interest) is to be used. The tax credit for 1989/90 is 32% of the sum of the 1988/89 amounts.

4. Professional Services Withholding Tax

As this income will generally be charged on the preceding year basis, the appropriate credit is the amount of Withholding Tax deducted in the basis period for 1989/90, less any tax repaid.