

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 12: Accrued Income Profits

Overview

Chapter 2: Accrued income profits and losses

Section 616: Charge to tax on accrued income profits

1800. This section provides the charge to tax on accrued income profits. It is based on sections 714(2), 716(2) and (3) and 723(4) of ICTA.

Section 617: Income charged

1801. This section provides that the full amount of accrued income profits is charged to tax. It is based on sections 714(2), (2A), 716(2), (3) and (3A), 717(10) and (11) and 723(4) of ICTA.

1802. Accrued income profits are normally computed by reference to transfers of securities of the same kind where the transfer is settled in the same interest period. *Subsection (2)* provides that the profits are treated as made in the tax year in which that interest period ends.

1803. *Subsection (3)* deals with unusual cases where the settlement day for the transfer falls outside an interest period. The last interest period of securities ends with the last interest payment day. So, if securities pay their last interest before their redemption date, their last interest period will end before the securities' redemption date. But, if a transfer occurs after the last interest payment, the settlement day for the transfer will not fall in an interest period.

1804. In such cases, subsection (3) treats the profits as made in the tax year in which the settlement day falls. It applies if:

- securities are transferred with unrealised interest (see section 625 for the meaning of “unrealised interest”); or
- variable rate securities are transferred (see section 627 for the meaning of “variable rate securities”).

1805. See *Change 101* in Annex 1, by virtue of which all transfers of variable rate securities (and not just a transfer on redemption), where the settlement day for the transfer is outside an interest period, are treated alike for the purposes of subsection (3) and all other provisions applicable to such transfers.

1806. *Subsection (4)* determines the tax year in which accrued income profits are treated as made if the proceeds of the transfer could not be remitted to the United Kingdom (and

so relief from the accrued income scheme was claimed under section 668 or 669) but can be remitted subsequently (which triggers a charge by virtue of section 670).

Section 618: Person liable

1807. This section determines the person liable to income tax for the purposes of this Chapter. It is based on sections 714(2) and (2B), 716(3) and (3B) and 723(4) of ICTA. The accrued income profits that a person is treated as making may be from transfers where the person is the transferor, or from transfers where the person is the transferee, or from a mixture of such transfers.
1808. See also section 1015 (territorial scope of charges under certain provisions to which section 1016 applies). This Chapter is among the provisions listed in Part 2 of that section. But see also section 643 which in practice cuts down the extent to which a non-UK resident is chargeable to tax under this Chapter.
1809. (See Chapter 3 of Part 9 (special rates for trustees' income) for the rate that applies if trustees are the person liable. Section 482 (types of amount to be charged at special rates for trustees) is based in part on section 720(5) of ICTA.)

Section 619: Meaning of "securities" and when securities are of the same kind

1810. This section defines "securities" for the purposes of the Chapter. It is based on section 710 of ICTA.
1811. The rule in *subsection (6)*, what is meant by securities of the same kind, is important because accrued income profits and losses treated as made under section 628 are computed by reference to transfers of securities of the same kind which occur in the same interest period.

Section 620: Transactions which are transfers: general

1812. This section defines "transfer" for the purposes of the Chapter. It is based on section 710 of ICTA. "Transfers" are the transactions and events giving rise to the income tax charge (or relief) for accrued income profits (or losses).
1813. *Subsection (1)* is subject to the cases mentioned in *subsection (6)*, which exclude certain transfers from the application of the Chapter in the case of strips of gilt-edged securities, stock lending and sale and repurchase agreements.
1814. The vesting of securities in trustees is a transfer within *subsection (1)*. But where securities vest on the appointment of a new or additional trustee, and the new or additional trustees are resident in the United Kingdom, there are no net accrued income scheme consequences because the payments treated as made effectively cancel each other out. This may not be the case if the new or additional trustees are not resident in the United Kingdom.
1815. *Subsection (3)* deals with the timing of the transfer where there is an agreement for the transfer of securities. The transfer is treated as taking place when the agreement is made, even if the agreement provides for the transfer of the securities at some future date.
1816. The time at which a transfer occurs is important for a number of provisions in the accrued income scheme (see, for example, section 660(1)). The time of the transfer must be distinguished from the settlement day for the transfer, although the two dates may be the same in certain circumstances.

Section 621: Transferors and transferees

1817. This section defines who is a "transferor" or "transferee" for the purposes of the Chapter. It is based on section 710(13) and section 717(8) of ICTA.

1818. *Subsections (2) and (3)* set out who is the transferor on conversion of securities or on the redemption of variable rate securities, as these are transactions under which the securities cease to exist rather than a transfer of a holding which continues to exist. The other party to the transaction, the issuer of the securities who has converted or redeemed them, is accordingly not treated as a transferee for the purposes of the Chapter.

Section 622: Application of Chapter to different kinds of transfer

1819. This section sets out the types of transfer for which rules are provided by the Chapter. It is new (but *subsection (3)* is based on section 716(2) of ICTA). The nature of the transfer determines:

- whether payments (or profits, in the case of a transfer to which section 630 applies) are treated as made;
- if so, who is treated as making the payment (or profits); and
- the amount of the payment (or profits).

1820. **Sections 623 to 626** describe the various types of transfer. Sections 628 to 631 provide for the calculation of accrued income profits and losses and when such profits or losses arise. Sections 632 to 635 set out the payments on transfer that are needed for the application of sections 628 to 631.

1821. Securities transferred with unrealised interest may also be transferred with or without accrued interest or the securities transferred may be variable rate securities. *Subsection (3)* confirms that the transfer must be dealt with in accordance with the rules for both a transfer with unrealised interest and another type of transfer. So, in such a case, two payments may be treated as made – one which relates to the transfer being made with unrealised interest and one which relates to the transfer with or without accrued interest or the transfer of variable rate securities.

Section 623: Transfers with accrued interest

1822. This section explains when securities are transferred “with accrued interest”. It is based on section 711 of ICTA.

1823. Generally, a transfer is with accrued interest when the right to interest payable at the next payment date is given to the transferee, regardless of when in the interest period the transfer took place. The transferor gets a higher price for the securities to reflect the interest accrued to the transfer which is not received by the transferor. Certain transfers are deemed to be with accrued interest.

1824. *Subsection (5)* makes the section subject to section 626, which provides that variable rate securities are not treated as transferred with accrued interest. Rather the special rules in sections 630, 631 and 635 apply (see the commentary on section 626 for further information on variable rate securities).

Section 624: Transfers without accrued interest

1825. This section explains when securities are transferred “without accrued interest”. It is based on section 711(5) and (6) of ICTA.

1826. Generally, a transfer is without accrued interest when the right to interest payable at the next payment date is kept by the transferor, regardless of when in the interest period the transfer took place. The transferor gets a lower price for the securities to reflect the interest accruing after the transfer which is not received by the transferee. Certain transfers are deemed to be without accrued interest.

1827. Similarly to section 623, *subsection (5)* makes the section subject to section 626, which provides that variable rate securities are not treated as transferred without accrued interest.

Section 625: Transfers with unrealised interest

1828. This section explains what is meant by a transfer “with unrealised interest”. It is based on section 716(1) of ICTA.
1829. It applies if securities are transferred together with interest which is ripe for payment because the due and payable date has passed, but the holder of the securities has not called for payment of the interest. This will most commonly arise in the case of bearer securities with separate coupons for each interest instalment. But it does not follow that there could not be other circumstances where securities are transferred with unrealised interest.

Section 626: Transfers of variable rate securities

1830. This section provides that a transfer of variable rate securities is not treated as a transfer with or without accrued interest, regardless of whether it would otherwise be such a transfer. It is new.
1831. By excluding transfers of variable rate securities from the normal rules for transfers with accrued interest, the special rules which apply to transfers of variable rate securities then apply directly without first treating them as transfers with accrued interest, and without having to modify the normal rules. See in particular sections 630, 631 and 635.
1832. See *Change 102* in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

Section 627: Meaning of “variable rate securities”

1833. This section defines “variable rate securities” for the purposes of the accrued income scheme. It is based on sections 717(1) to (3) and 726A(2), (7) and (8) of ICTA. They are all securities other than fixed rate securities and securities for which the interest rate is tied to a base rate or a recognised prices index. Variable rate securities may, for example, have periods for which no interest is payable or periods in which sharply different rates of interest are payable. The rules for transfers with and without interest work on the premise that interest accrues evenly, which is not the case with variable rate securities.
1834. *Subsection (4)* applies the test for qualifying as variable rate securities in a special way if securities are issued in tranches (“new securities”) and section 649 applies.

Section 628: Making accrued income profits and losses: general rules

1835. This section determines if accrued income profits or accrued income losses are made when (as is normally the case) the settlement day for the transfer in question falls within an interest period. It is based on section 714 of ICTA.
1836. The accrued income scheme applies predominantly:
- where securities are transferred with accrued interest and
 - where they are transferred without accrued interest.
1837. The aim in both cases is to ensure that the accruing interest is taxed as income of the person who is the owner of the securities over the period in which the interest accrued. The approach taken by this section is to treat the parties as though a payment is made from one to the other as a result of the transfer.
1838. Where securities are transferred with accrued interest, the transferee is treated as making a payment to the transferor. And, where securities are transferred without accrued interest, the transferor is treated as making a payment to the transferee (see sections 632 and 633). This approach reflects the reality of these transactions, as the purchase price

on a sale of securities is increased or reduced according to whether interest which has accrued or will accrue goes to the transferor or transferee.

1839. The calculation in section 628 is made by comparing the total amount of the payments treated as made *by* a person to the total amount of the payments treated as made *to* that person for each kind of security transferred in each interest period.
1840. *Subsection (2)* provides that section 630 applies instead if the settlement day falls outside an interest period (this can only be the case in relation to some transfers of variable rate securities or a transfer with unrealised interest).

Section 629: Calculating accrued income profits and losses where section 628 applies

1841. This section determines the amount of the accrued income profit (*subsection (1)*) or the accrued income loss (*subsection (2)*) as the case may be. It is based on sections 714 and 716 of ICTA.

Section 630: Making accrued income profits: settlement day outside interest period

1842. This section provides that accrued income profits are made where the settlement day for the transfer involved occurs after the end of the securities' last interest period (and so does not fall in an interest period). It is based on sections 716(3), 717(10) and (11) of ICTA.
1843. A transfer of variable rate securities may also be a transfer with unrealised interest, so the section may apply doubly to a single transfer. An amount of accrued income profits will be found under both subsections (1) and (3) of section 631.
1844. In contrast with transfers which take place in an interest period (see section 634 and section 635), where there is a deemed payment made by the transferor (partly matching the approach in section 628 and section 629), no such deemed payment is introduced here. The section deems the transferor to have made accrued income profits by virtue of the circumstances set out in *subsection (1)*. And without any deemed payments, an accrued income loss cannot arise in the case of the transfers to which this section applies.
1845. See *Change 101* in Annex 1 which treats other transfers of variable rate securities where the settlement day is outside an interest period as redemption of such securities. And see *Change 102* in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

Section 631: Amount of accrued income profits where section 630 applies

1846. This section quantifies the amount of the accrued income profits for transfers within section 630. It is based on sections 716(3) and 717(9) of ICTA.

Section 632: Payment on transfer with accrued interest

1847. This section sets out the payments treated as made when securities are transferred with accrued interest. It is based on section 713 of ICTA.
1848. *Subsection (1)* sets out the payment treated as made by the transferee to the transferor. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is:
- to charge the transferor to income tax on the interest accruing on a day-by-day basis to the settlement day, that is, the transferor makes an accrued income profit in accordance with section 628 which is taxed by section 616, and
 - to give the transferee equivalent relief when the transferee is taxed (e.g. under Chapter 2 of Part 4 of ITTOIA) on the interest arising at the next interest payment

*These notes refer to the Income Tax Act 2007 (c.3)
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date, that is, the transferee makes an accrued income loss in accordance with section 628 which is relieved under section 679.

1849. Subsection (1) also indicates that the payment is treated as made in the interest period in which the settlement day for the transfer falls. This also determines the interest period in which the profit arises and therefore the tax year in which the profit is taxed.
1850. *Subsections (2) and (3)* quantify the amount of the payment where the interest which has accrued to the settlement day is separately accounted for to the transferor by the transferee (as it is for many transactions within the financial markets, with a corresponding adjustment in the consideration for the transfer of the security). The amount of the payment is the amount of interest accounted for.
1851. If subsections (2) and (3) do not apply and the settlement day is coincidentally an interest payment day, *subsection (4)* quantifies the amount of the payment as the amount of the interest payable on that day.
1852. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest accruing to the settlement of the transfer. The formula applies regardless of whether the interest period in question would be (but for section 673 (meaning of “interest period”)) greater than 12 months.
1853. *Subsections (7) and (8)* modify the operation of subsection (1) if the transfer in point is one for which there is either no transferor or no transferee because of the rules applying in the sections mentioned.

Section 633: Payment on transfer without accrued interest

1854. This section sets out the payments treated as made when securities are transferred without accrued interest. It is based on section 713 of ICTA.
1855. In this case the transferor retains entitlement to all the interest due at the interest payment date falling after the transfer date although the transferor will not be the holder of the security at that time. This will commonly occur where the security in question has gone “ex-dividend” when the transfer is agreed (that is, interest will be paid on the next interest date to whoever is the registered holder when the books for the security are closed until after the interest payment date). *Subsection (1)* explains that, where securities are transferred without accrued interest, a payment is treated as made by the transferor to the transferee – the reverse of section 632(1).
1856. The right to the interest is retained by the transferor, who will be taxable on the interest arising at the next interest payment. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is to charge the transferee to income tax on the interest accruing on a day-by-day basis *after* the settlement of the transfer, the accrued income profit, and to give the transferor equivalent relief when the transferor is taxed on the interest arising at the next interest payment date, the accrued income loss.
1857. Subsection (1) also provides that the payment is treated as made in the interest period in which the settlement day for the transfer falls.
1858. As in section 632, *subsections (2) and (3)* deal with transfers where the interest which will accrue from the settlement day to the next interest payment day is separately accounted for. The amount of the payment is the amount of the gross interest accounted for.
1859. If subsection (2) does not apply and the settlement day also happens to be an interest payment day, *subsection (4)* makes clear that the amount of the payment is nil. That reflects the fact that the interest retained by the transferor accrues wholly in the period to the settlement day (and is taxable on the transferor). The accrued income scheme is only interested in disturbing the normal tax rules, in the case of a transfer without

accrued interest, where part of the interest period falls *after* the settlement day (and an amount representing interest should be attributed to the transferee).

1860. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest which will accrue after the settlement of the transfer.
1861. *Subsections (7) and (8)* modify the operation of subsection (1) if the transfer in point is one for which there is either no transferor or no transferee.

Section 634: Payment on transfer with unrealised interest

1862. This section sets out the payment treated as made where securities are transferred with unrealised interest and where (as is normally the case) the settlement day for the transfer involved falls within an interest period. It is based on section 716 of ICTA. “Unrealised interest” is defined in section 625.
1863. A payment is treated as made to the transferor (see *subsection (1)*) but *subsection (4)* makes clear that no one is treated as making the payment. *Subsection (5)* therefore confirms that the deemed payment does not form part of any accrued income profit or loss calculation for the transferee.
1864. *Subsection (2)* provides that the amount of the payment is the amount of the unrealised interest. The effect of this section is that the transferor is charged to income tax on the amount of the unrealised interest.
1865. *Subsection (6)* signposts section 681 which, notwithstanding the rules in subsection (4) and (5), grants the transferee exemption from tax on the interest (when realised) if certain conditions are satisfied. That exemption is equivalent to the exemption given in section 679 by reference to accrued income losses.
1866. As explained in the commentary on section 622, where securities are transferred with unrealised interest they may also be transferred with or without accrued interest, and a payment may also arise under section 632 or 633.

Section 635: Payment on transfer of variable rate securities

1867. This section sets out the payment treated as made where variable rate securities are transferred and the settlement day for the transfer falls within an interest period. It is based on section 717 of ICTA. Section 627 gives the meaning of “variable rate securities”.
1868. *Subsection (1)* provides that a payment is treated as made to the transferor. But no one is treated as making the payment (see *subsection (3)*), nor does the payment enter the calculation of any accrued income profit or loss of the transferee (see *subsection (4)*).
1869. This is an anti-avoidance provision. The interest on a security could be structured so as to circumvent the intended effects of the accrued income scheme (for example, by using wide variations in the rate of interest payable at various times over the lifetime of the security). Where this happens, a time apportionment formula, which assumes that interest accrues at an even rate, would not produce an amount consistent with the value of the accruing interest. Instead, *subsection (2)* simply provides that the amount of the payment treated as made should be “just and reasonable” (and the transferor should make a self-assessment for the relevant tax year accordingly).
1870. No provision is made in this case for any exemption for interest received by the transferee.

Section 636: Exception where there is a transfer to a legatee

1871. This section disapplies rules which treat a payment (or profits) as made if personal representatives transfer securities to a legatee. It is based on section 721 of ICTA.

1872. Under *subsection (2)*, if the personal representatives of a deceased person transfer securities to a legatee in the interest period in which the individual died, neither the personal representatives nor the legatee are treated as making or receiving payments. So, in these circumstances no accrued income profit or accrued income loss can arise. But, because the transfer itself is not excluded, section 681 (exemption for unrealised interest received after a transfer within Chapter 2) may still be in point.
1873. *Subsection (3)* deals with certain transfers of variable rate securities. It treats accrued income profits as not arising, rather than a payment as not being made, in line with the approach taken in sections 630 and 631. It applies to all variable rate securities (see *Change 101* in Annex 1 which extends the treatment of transfers of variable rate securities on redemption which was provided under section 717(11) of ICTA to other transfers of variable rate securities where the settlement day is outside an interest period).
1874. If the transfer does not take place in the interest period in which the individual died, then the accrued income scheme applies to that transfer as normal.
1875. “Personal representatives” has the meaning given by section 989. (See *Change 150* in Annex 1.)

Section 637: Accrued income losses treated as payments in next interest period

1876. This section provides for a particular treatment of an accrued income loss. It is based on section 714 of ICTA.
1877. Where a person makes accrued income losses there are two ways of relieving those losses. The most common is by exempting the interest arising at the end of the interest period to which the accrued income loss relates to the extent of the amount of the loss. This relief is given by section 679, which is signposted in *subsection (3)* together with other exemptions which may apply when the interest period ends with an interest payment day.
1878. This section deals with the far less common circumstance where the interest period does not end with an interest payment day and so interest does not arise at the end of it. (This can occur where an interest payment day is more than twelve months after the previous one. The accrued income scheme restricts all interest periods to no more than twelve months. See section 673(1)(b)).
1879. *Subsection (2)* treats the person who made the accrued income loss as making a payment in the next interest period. So losses are in effect carried forward and taken into account in computing the accrued income profit (or accrued income loss as the case may be) on securities of the same kind in the next interest period. If that interest period does not end with an interest payment date and there are still losses to carry forward, the process repeats until the losses are those of an interest period which does end with an interest payment day.

Section 638: Excluded persons: disregard of certain payments and transfers

1880. This section disregards certain payments treated as made to or by a person, if that person is an “excluded transferor” or “excluded transferee”, in calculating whether that person has made accrued income profits or losses. It is based on section 715 of ICTA.
1881. By virtue of this section, the accrued income scheme does not (or does not in full) apply to them. This is either because it is unnecessary to apply the scheme to them or because applying the scheme would be unduly burdensome for both taxpayers and HMRC. The section also explains the consequences of being excluded from the scheme.
1882. Although the section generally applies to both transferors and transferees, and operates by disregarding payments treated as made by or to a person, *subsection (3)* provides that

in determining under section 630 whether a person has made accrued income profits, no account is taken of the transfer. There is an effect only for the transferor in that case.

1883. Under these provisions it is *persons* who are excluded in relation to a transfer rather than *transactions*. This means that, in respect of the same transfer, the transferor may be excluded but not the transferee (and vice versa).

Section 639: Small holdings: individuals

1884. This section excludes individuals whose holdings are below the specified limit. It is based on section 715(1)(b) of ICTA.
1885. *Subsections (1) to (3)* set out the limit for exclusion for individuals in relation to the various types of transfer of securities and by reference to the relevant basis on which income is charged under section 617. The limit is set at a total nominal value of £5,000 of all securities held by the individual on any day in the prescribed period. An individual's holding may, however, be combined with another's (see *subsection (5)*) and, where that is the case, the limit applies to the combined holding.
1886. *Subsection (3)* adapts the rule for transfers of variable rate securities as more than one basis on which income is charged under section 617 may apply to such securities. *Change 101* in Annex 1 (which applies to other transfers of variable rate securities the treatment of transfers of such securities on redemption that was provided by section 717(11) of ICTA) applies as regards such transfers for the purposes of this and the following two sections.

Section 640: Small holdings: personal representatives

1887. This section excludes personal representatives whose holdings are below the specified limit. It is based on section 715(1)(c) and (2)(b) of ICTA.
1888. When an individual dies, securities in the deceased's estate automatically vest in the deceased's personal representatives. This vesting is not a transfer for the purposes of the accrued income scheme. However, except where section 636 applies, the transfer of securities by an individual's personal representatives is a transfer for the purposes of the accrued income scheme.
1889. *Subsections (1) to (3)* accordingly provide exclusions for personal representatives identical to those for individuals. But there is no equivalent of section 639(5) so there is no question of the personal representatives' holding being combined with another's. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)
1890. "Personal representatives" has the meaning given by section 989. (See *Change 150* in Annex 1.)

Section 641: Small holdings: trustees of a disabled person's trusts

1891. This section excludes trustees of a disabled person's trusts whose holdings are below the specified limit. This section is based on section 715(1)(e) and (2)(b) of ICTA.
1892. *Subsections (1) to (3)* provide exclusions for trustees of a disabled person's trusts identical to those for individuals and personal representatives. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)
1893. *Subsection (4)* signposts the definition of "disabled person's trusts" which applies for the purpose of this provision. Broadly, that definition includes trusts where the beneficiary may be incapacitated to a degree that interferes with their management of their affairs.

Section 642: Traders

1894. This section excludes financial traders from the accrued income scheme. It is based on sections 715(1)(a) and 715(2)(a) of ICTA.
1895. It is unnecessary for such traders to be included in the scheme as profits and losses on any securities they transfer are already included in their trading profits and losses.

Section 643: Non-residents

1896. This section excludes persons who are non-UK residents or are not ordinarily UK resident from the accrued income scheme. It is based on section 715(1)(f) and (2)(b) of ICTA.
1897. In practice it would be very difficult to apply the scheme to such non-residents consistently. While non-residents could take the benefit of relief for accrued income losses to get repayments of tax suffered if tax is deducted at source, it would be difficult to enforce the charge to tax on accrued income profits.
1898. *Subsections (2) to (4)* ensure that non-residents who trade in the United Kingdom through a branch or agency are not excluded from the scheme by subsection (1) if the securities are situated in the United Kingdom and are used or held for the purposes of the branch or agency (such non-residents may still be excluded by section 642).

Section 644: Individuals to whom the remittance basis applies

1899. This section excludes from the accrued income scheme individuals entitled to the benefit of the remittance basis in respect of interest on the securities transferred. It is based on section 715(1)(k) and (2)(b) of ICTA.
1900. Such individuals are taxed on the amounts of income received in the tax year and not on the amount of income arising in that year. The accrued income scheme applies the equivalent of the arising basis to the amounts it charges as accrued income profits.

Section 645: Charitable trusts etc

1901. This section excludes persons from the accrued income scheme in relation to a transfer of securities if they would be entitled to exemption from tax on the interest on the securities under section 532 or 533. It is based on section 715(1)(d) and (2)(b) of ICTA.

Section 646: Pension scheme trustees

1902. This section excludes pension scheme trustees from the accrued income scheme in relation to a transfer of securities if the trustees would be entitled to exemption from income tax on the interest on the securities under section 186 of FA 2004. It is based on section 715(1)(k) and (2)(b) of ICTA.

Section 647: Makers of manufactured payments

1903. This section excludes makers of “manufactured payments” from the accrued income scheme. It is based on section 715(6) of ICTA.
1904. Broadly, a person may “manufacture” interest by buying a security without accrued interest and then selling it with accrued interest just before the next interest payment date. The maker of the manufactured payment can deliver only an “ex-dividend” security and so “manufactures” (makes) a payment to the buyer as compensation for the buyer not receiving the interest to which the buyer is entitled. The manufactured payment is taxed as though it is actual income. Chapter 2 of Part 11 applies to manufactured payments.

1905. This section ensures that the tax charge under that Part takes priority over any possible tax charge under the accrued income scheme. It does so by treating the person who manufactures interest:
- as an excluded transferee in relation to the transfer under which the securities were acquired; and
 - as an excluded transferor in relation to the onward sale.

1906. This treatment applies only if the value of the securities sold on at least equals the value of the securities acquired (but see section 663 for the reduction made where that value is insufficient).

Section 648: Strips of gilt-edged securities

1907. This section provides special rules for exchanges of gilt-edged securities for strips of such securities (and vice versa). It is based on section 722A of ICTA.

1908. Where a gilt-edged security is “stripped”, *subsection (1)* treats the exchange as a transfer by the person who held the gilt-edged security but no one is treated as the transferee (see *subsection (2)*). The strips themselves are not within the accrued income scheme regime and any disposals of strips are dealt with under the rules relating to deeply discounted securities (see Chapter 8 of Part 4 of ITTOIA).

1909. Where strips are consolidated into a gilt-edged security (by exchanging the strips for a newly issued gilt-edged security), *subsection (3)* treats the acquisition of the gilt-edged security as a transfer to the person acquiring the single gilt-edged security but no one is treated as the transferor (see *subsection (4)*). The disposal of the strips is dealt with under the deeply discounted securities regime.

1910. For both kinds of transfer the settlement day for the transfer is the day on which the securities are transferred (see section 674(4)).

1911. The reference in *subsection (5)* to the time “after the balance has been struck for a dividend on the security” is to the time when the security goes ex-dividend in respect of the next interest payment day. Interest at the next interest payment date will go to the person registered as entitled to the security at that date, so an exchange after that date is treated as a transfer without accrued interest.

1912. Where a gilt-edged security is “stripped”, although the security itself may be cancelled part of the way through an interest period, the formulas in sections 632(5)(b) and 633(5)(b) still work because they operate by reference to interest periods of securities of that kind. The assumption is that there will always be unstripped gilt-edged securities of the same kind as the stripped security. If not, however, section 673(4) deals with the possibility of all gilt-edged securities of a particular kind being stripped.

1913. Where strips are consolidated into a gilt-edged security, the consolidated security may be issued part way through an interest period for securities of that kind. As the consolidated security is fully fungible with other securities of the same kind, that interest period is taken (by virtue of the general rule in section 673(1)) to have begun immediately after the last interest payment day before the settlement day. (See *Change 106* in Annex 1 which amends the meaning of “interest period” for the purposes of that section.) The formulas in sections 632(5) and 633(5) can work on that basis because they operate by reference to interest periods of securities of that kind.

1914. *Subsection (7)* disregards as transfers transactions between the person making the exchange and the market maker (that is, the only type of person authorised by the rules of the market to facilitate the exchanges in question). So the market maker is not a transferee for the purposes of the accrued income scheme in respect of such exchanges.

1915. The definition of “gilt-edged security” is that in section 1024.

Section 649: New securities issued with extra return

1916. This section provides a special rule where securities are issued in tranches. It treats the issue of the new securities as a transfer with accrued interest. It is based on section 726A of ICTA.
1917. See also the commentary on section 662 which explains the special rule about payments treated as made.
1918. To raise finance, debt issuers may make further issues of the same securities (“new securities”) rather than issue fresh securities. The new securities issued in each new tranche are intended to be fungible with the very first securities of that kind issued, so they have identical terms.
1919. However, where new securities are issued part way through an interest period, the interest payable on the next interest payment date would be less than the interest payable on that date for existing securities (assuming the same rate of accrual). To compensate for this and to ensure complete fungibility, the issuer will pay an extra amount of interest on these securities. The issue price of the securities in the new tranche may therefore be set to take account of this extra return.
1920. Under the accrued income scheme the extra return is treated in the same way as accruing interest.
1921. As the new securities have identical terms to the original securities they should pay the same interest on the next interest payment day. However, if they are issued part of the way through an interest period, the effective rate of interest will be different. So the securities may well fall within the definition of “variable rate securities”, in which case this provision will not apply. Section 627(4) applies the test for variable rate securities to the new securities as though the interest payable on the first interest payment day after their issue relates to the period from the last interest payment day (or, if there was no such day, the date of issue) of the original securities to that day.
1922. This section makes the equivalent provision for the accrued income scheme that section 845 makes in relation to the charge to tax on interest.

Section 650: Trading stock appropriations etc

1923. This section treats as a transfer of securities certain changes in the capacity in which securities are held by a trader. It is based on section 722 of ICTA.
1924. [Section 642](#) excludes financial traders from the accrued income scheme as profits and losses on any securities they transfer are already included in trading profits and losses. But a financial trader may hold securities as personal investments as well as in the capacity of financial trader.
1925. *Subsections (1) and (2)* deal with the case where securities are acquired in a non-trading capacity and are then appropriated as trading stock.
1926. *Subsections (3) and (4)* deal with the reverse case where securities held as trading stock are appropriated for some non-trading purpose.
1927. *Subsections (5) and (6)* deal with the case where securities are held as trading stock but the trade ceases without the securities changing ownership.
1928. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 651: Owner becoming entitled to securities as trustee

1929. This section treats the owner of securities who settles the securities on trust and becomes trustee of them (or one of the trustees of them) as transferring them. It is based on section 720 of ICTA.
1930. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 652: Securities ceasing to be held on charitable trusts

1931. This section treats trustees as transferring the securities in their capacity as charitable trustees to themselves in another capacity, if securities cease to be held on charitable trusts. It is based on section 715(3) of ICTA.
1932. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 653: Stock lending

1933. This section excludes stock lending transactions from the accrued income scheme. It is based on section 727 of ICTA.
1934. Broadly, stock lending is a mechanism by which a securities dealer makes an arrangement for an institutional investor to place some of its securities at the dealer's disposal. The dealer is therefore able to deliver securities the dealer has contracted to sell even if the dealer has been unable or unwilling to buy them in the market. (The dealer undertakes to return the securities, or equivalents, to the institution later. Although the mechanism is referred to as "lending", the securities do change ownership.)
1935. As the lending institution is entitled to the return of securities of the kind transferred under the lending arrangement, and effectively retains rights to the interest on them, the accrued income scheme disregards stock lending transfers.

Section 654: Sale and repurchase arrangements

1936. This section sets out the conditions under which section 655 applies. It also applies for the purposes of sections 656 to 658 which provide powers to modify the application of section 655. It is based on sections 727A, 730B and 737E(8) and (9) of ICTA.
1937. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos) (see sections 569, 570 and 571).
1938. See paragraphs 125 and 126 of Schedule 2 which modify the operation of this and the following section for securities in relation to which amendments to the source legislation, by FA 1995 and FA 2003 respectively, do not apply.
1939. See also [SI 1995/3220](#) (Sale and repurchase of securities (modification of enactments) Regulations 1995) which provides that in certain circumstances securities include substituted securities and the meaning of "buying back" securities is extended.

Section 655: Transfers under sale and repurchase arrangements

1940. This section excludes transfers under sale and repurchase agreements ("repos") from the accrued income scheme, if the transferor or a person connected with the transferor is required or entitled to repurchase the securities. It is based on section 727A of ICTA.
1941. Under a repo, as with stock lending, the economic benefit of the interest on the securities sold and repurchased remains with the original holder of the securities, to whom they return. The original owner is taxed on the interest under other rules so there is no need for the accrued income scheme to apply to either the sale or the repurchase.

1942. This section exempts the transfer under the sale and the transfer under the repurchase.

Section 656: Power to modify: non-standard sale and repurchase arrangements

1943. This section provides powers for regulations to modify the application of section 655 in relation to cases involving “non-standard sale and repurchase arrangements” (as defined in *subsection (2)*). It is based on section 737E of ICTA.

1944. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos). See section 612.

Section 657: Power to modify: redemption arrangements

1945. This section provides powers for regulations to modify the application of section 655 in relation to cases involving “redemption arrangements” (as defined in *subsection (2)*). It is based on section 737E of ICTA.

1946. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos). See section 613.

Section 658: Powers to modify: supplementary

1947. This section further describes the scope of the powers in sections 656 and 657 and defines terms used in those sections. It is based on section 737E of ICTA.

1948. It is broadly equivalent to section 614 in Part 11 (manufactured payments and repos).

Section 659: Transfers with or without accrued interest: interest in default

1949. This section modifies the calculation of the payments treated as made under a number of provisions if the interest is in default. It is based on section 718 of ICTA.

1950. The value of the right to receive interest may be affected if the issuer defaults or has previously defaulted on the obligation to pay interest. If this is the case, *subsection (2)* substitutes the value of the right to receive interest for the interest payable in the various calculations.

Section 660: Transfers with unrealised interest: interest in default

1951. This section deals with a transfer of securities with unrealised interest where interest is in default. It is based on section 719 of ICTA.

1952. Where securities are transferred with unrealised interest, the transferor is effectively charged to income tax on the unrealised interest (see section 630 and section 634). (The transferor may also be charged on other accrued income profits in respect of the same transfer if it is also a transfer of another of the types mentioned in section 622(2).)

1953. Where the issuer of the securities has defaulted on the obligation to pay interest, that default may affect the value of the interest coupons which are transferred (as, for example, when bearer securities are transferred with uncashed coupons attached). Where this is the case, under *subsections (2) and (3)*, when calculating the amount of the payment under section 634 or the amount of the accrued income profits under section 631, the value of the right to receive interest (“A”) is substituted for the amount of the unrealised interest.

1954. However, A may be reduced where there have been successive transfers. Where this is the case, the calculation rules in section 661 apply.

1955. This section only deals with the position of the transferor. Accordingly *subsection (6)* signposts the exemption under section 681 for interest payable to the transferee. See

in particular subsections (3) to (6) of that section which deal with the situation where unrealised interest is in default.

Section 661: Successive transfers with unrealised interest in default

1956. This section modifies the application of section 660 where the securities have previously been transferred with unrealised interest in default. It is based on section 719(4) of ICTA.
1957. *Subsection (1)* applies where the transferor originally acquired the securities with unrealised interest. In that case, A (see commentary on section 660) is reduced by the value of the right to receive the interest (“B”) on the day the transferor acquired the securities (see *subsection (5)*). That is, the transferor is now given credit for the amount of consideration given for that value when the securities were acquired.
1958. But, if the transferor has received any of the interest in the meantime (or an amount on account of that interest), *subsection (4)* applies so that B is reduced by the amount of the interest received, thus increasing A. That is, to the extent the transferor has received the benefit of B, and has therefore recouped some of the consideration given for the securities, the credit given against the amount now chargeable, on the present transfer of the securities, is reduced.
1959. *Subsection (6)* makes clear that the amount of the reduction of A is itself reduced to nil where the amount of the credit found under subsection (4) or (5) exceeds the value found under subsection (1) by reference to section 660. That is, if the transferor has recouped amounts equal to or exceeding the value of the right to receive unrealised interest, at the time the securities were acquired, there is no credit to set against the value, A, which is now used in section 634(2) rather than the amount of the unrealised interest itself.
1960. **Paragraph 127** of Schedule 2 saves the transitional rule that was in section 716(6) of ICTA (as substituted by section 719(4) of ICTA). That paragraph disapplies this section if the acquisition of the securities by the transferor occurred before 28 February 1986.

Section 662: New securities issued with extra return: special rules about payments

1961. This section provides for calculating the amount of the payment treated as made where securities have been issued in tranches and the conditions in section 649 apply. It is based on section 726A of ICTA.
1962. *Subsection (1)* provides that the amount of the payment is not calculated under section 632. Instead the amount is calculated by reference to *subsection (3)* or *(4)* (which are equivalent to the calculation rules in sections 632 and 633).
1963. The amount of the payment (that is, the extra return) is therefore taken into account under section 628 in calculating whether an accrued income profit or an accrued income loss is made. The effect of this (assuming no other transfer of the same kind of security has taken place in the interest period) is that the recipient of the new securities will only be taxed on the interest which accrued during the time he or she owned the securities.

Section 663: Transfers without accrued interest to makers of manufactured payments

1964. This section reduces the amount of the payment treated as made to the maker of a manufactured payment (the transferee) under section 633 if that person is not an excluded transferee under section 647(3) because the transferee has contracted to sell fewer securities than have been transferred to the transferee. It is based on section 715(6) and (7) of ICTA.
1965. The amount of the payment is treated as reduced to the extent that the maker of the manufactured payment has already contracted to sell securities of that kind. That is, while the maker of the manufactured payment is only an “excluded transferee” in

relation to the acquisition of the securities if the securities sold on equal or exceed in amount those acquired, this section abates the amount of the payment under section 633 to the extent the acquisition and onward sale are in fact matched. This again ensures there is not a double charge to tax under Part 11 (manufactured payments and repos) and under the accrued income scheme.

Section 664: Foreign currency securities: sterling equivalent of payments on transfers

1966. This section provides for the application of the accrued income scheme if the interest on the securities is payable in a currency other than sterling. It is based on sections 713(7), (8), 716(6) and 726A(5) of ICTA.
1967. This section sets out the rules for converting amounts into sterling.

Section 665: Foreign currency securities: unrealised interest payable in foreign currency

1968. This section provides for the application of the accrued income scheme if unrealised interest on the securities is payable in a currency other than sterling. It is based on sections 713(7), (8), 716(6) and 726A(5) of ICTA.
1969. This section sets out the rules for converting amounts or values into sterling.

Section 666: Certain transfers by or to nominees or trustees treated as made by or to others

1970. This section provides for another person (or persons) to be regarded as the transferor or transferee if there is a transfer by or to trustees or nominees. It is based on section 720 of ICTA.
1971. *Subsection (1)* ensures that, where someone holds securities through a nominee, transfers of securities by or to the nominee are treated as being made by or to the person for whom the nominee acts. Consequently the charges under the accrued income scheme fall not on the nominee but on the principal.
1972. Likewise, *subsection (2)* ensures that, where securities are held on trust but the beneficiary is absolutely entitled to direct how the securities are to be dealt with, transfers of securities by or to the trustees are treated as being made by or to the beneficiary.
1973. *Subsections (3), (4) and (5)* explain what is meant by a beneficiary being “absolutely entitled” against a trustee. *Subsection (8)* provides that a lack of legal capacity is ignored in deciding whether someone is absolutely entitled against a trustee.
1974. *Subsections (6) and (7)* apply the same rules as in subsections (1) and (2) but where two or more persons effectively own the securities. As subsection (7) makes provision for the case where two or more persons are absolutely entitled against a trustee, for consistency subsection (6) spells out for the case of nominees what may otherwise be derived from the application of the Interpretation Act 1978.

Section 667: Trustees’ accrued income profits treated as settlement income

1975. This section provides for certain accrued income profits to be taken into account for the purposes of Chapter 5 of Part 5 of ITTOIA (where settlement income is taxed on the settlor). It is based on section 720(6) of ICTA.
1976. *Subsection (4)* defines the accrued income profits in question. They do not include profits in respect of a transfer with unrealised interest or profits chargeable under section 670 on the withdrawal of unremittable income relief. But they include profits in respect of transfers of variable rate securities. (See *Change 101* in Annex 1 which

treats other transfers of variable rate securities where the settlement day is outside an interest period as redemption of such securities is treated.)

1977. *Subsection (1)* ensures that qualifying accrued income profits treated as received by trustees of a settlement are treated as arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA. The income is then chargeable on the settlor. The settlor may be eligible under section 680 for exemption in respect of interest on the securities, if the interest is also chargeable under that Chapter, by reference to accrued income losses arising to the trustees under section 628.
1978. *Subsections (2) and (3)* ensure that trustees who are non-UK resident or domiciled outside the United Kingdom are treated as receiving, for the purposes of the same Chapter, the amount of accrued income profits they would have been treated as receiving if they had been UK resident or domiciled in the United Kingdom. That is, by virtue of their actual residence status, the trustees are likely to be excluded transferors or transferees under section 643 in which case accrued income profits to which subsection (1) applies will not arise to them. By virtue of subsection (3), the same results follow as under subsection (1).

Section 668: Relief for unremittable transfer proceeds: general

1979. This section provides relief from the accrued income scheme charge if transfer proceeds cannot be remitted to the United Kingdom. It is based on section 723 of ICTA.
1980. It is equivalent to the relief provided by Chapter 4 of Part 8 of ITTOIA (unremittable income) for other foreign income.
1981. The section applies if a person is chargeable to income tax on accrued income profits arising from the transfer or transfers of “foreign securities” (defined in *subsection (4)*) and those proceeds are unremittable.
1982. *Subsection (1)* applies to all transfers and includes transfers of securities with unrealised interest. See *Change 103* in Annex 1 which extends the relief to such transfers.
1983. *Subsection (2)* indicates that a claim must be made for the relief to apply. Subsection (2) also explains that the accrued income profits are either reduced to nil or reduced by the amount of the relevant payments.
1984. *Subsection (5)* defines when proceeds are unremittable. Any one of the three reasons given is sufficient for proceeds to be unremittable. See *Change 104* in Annex 1 which broadens one condition in the source legislation for the relief and removes another.
1985. *Subsection (7)* explains that the claim must be made on or before the fifth anniversary of 31 January following the end of the tax year for which the profits would be chargeable were it not for the relief. See *Change 105* in Annex 1 which substitutes this time limit for claiming relief in respect of accrued income profits if the proceeds of the transfer of foreign securities are unremittable for the time limit in the source legislation.

Section 669: Relief for unremittable transfer proceeds: section 630 profits

1986. This section provides the same relief as section 668 but in respect of section 630 profits (cases where the settlement day is outside the interest period). It is based on section 723 of ICTA.
1987. See also *Change 101*, *Change 103* and *Change 105* in Annex 1.

Section 670: Withdrawal of relief

1988. This section treats the claimant of relief under section 668 or section 669 as making accrued income profits if relief has been granted and the proceeds of the transfer cease to be unremittable. It is based on section 723(4) of ICTA.

Section 671: Meaning of “interest”

1989. This section defines “interest” for the purposes of this Chapter. It is based on section 711(9) of ICTA.
1990. This section expands the meaning of “interest” beyond its normal meaning to take account of the meaning of “security” for the purposes of the accrued income scheme. The return on a gilt-edged security may be referred to as “dividend” (hence references to sales of securities “cum-dividend” or “ex-dividend”) even though the return is in fact in the form of interest.

Section 672: Meaning of “interest payment day”

1991. This section defines “interest payment day” for the purposes of this Chapter. It is based on section 711(2) of ICTA.

Section 673: Meaning of “interest period”

1992. This section defines “interest period” for the purposes of this Chapter. It is based on section 711(3) of ICTA.
1993. If the period between interest payment days exceeds twelve months, it is not an interest period. Instead, the first twelve months of the period, each succeeding period of twelve months within that period, and any rump period, is an interest period. This ensures that charges under the accrued income scheme cannot be deferred by having long intervals between interest payment days.
1994. *Subsection (1)* defines when an interest period begins and when an interest period ends (which includes when twelve months has expired). This is subject to special rules in some cases – see *subsections (3) to (6)*.
1995. See *Change 106* in Annex 1 which amends the meaning of “interest period” in relation to this section.

Section 674: Meaning of “the settlement day”

1996. This section defines the “settlement day” in relation to any particular transaction for the purposes of this Chapter. It is based on section 712 of ICTA.
1997. The main rule is set out in *subsection (1)* and applies where securities are transferred under the rules of a recognised market (such as a stock exchange). Three other rules are set out in *subsections (3), (4) and (6)*, which apply where a transfer is not made under the rules of a recognised stock exchange.

Section 675: The holding of securities

1998. This section sets out when someone is regarded as holding securities for the purposes of the Chapter. It is based on section 710(7), (8) and (10) of ICTA.
1999. This definition is needed for the “small holdings” tests in sections 639 to 641.
2000. *Subsection (3)* ensures that in Scotland, as elsewhere in the United Kingdom, transfers of securities involving partnerships are treated as though they were carried out by the individual partners and securities held by partnerships are treated as held by the individual partners. (In contrast to the rest of the United Kingdom, where a partnership has no separate legal personality, a partnership under Scots law is a legal person distinct from the partners it comprises.)

Section 676: Nominal value of securities: general

2001. This section determines the nominal value for the purposes of the Chapter. It is based on section 710(11) of ICTA.

*These notes refer to the Income Tax Act 2007 (c.3)
which received Royal Assent on 20 March 2007*

2002. *Subsection (2)* deals with relatively rare cases where interest on the securities is not expressed to be payable by reference to a given value.

Section 677: Nominal value: foreign currency securities

2003. This section determines the nominal value of securities where that nominal value is expressed in a foreign currency. It is based on section 710(12) of ICTA.