

*These notes refer to the Income Tax (Trading and Other Income) Act 2005 (c.5) which received Royal Assent on 24 March 2005*

# **INCOME TAX (TRADING AND OTHER INCOME) ACT 2005**

---

## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### **Part 5: Miscellaneous income**

##### **Overview**

2235. This Part contains the rules relating to miscellaneous income. It consists of income that is charged under Schedule D Cases III, IV, V and VI and non-schedular charges in the source legislation.

2236. There is a separate Chapter for each category of income arranged as follows:

- receipts from intellectual property (Chapter 2);
- films and sound recordings: non-trade businesses (Chapter 3);
- certain telecommunication rights: non-trading income (Chapter 4);
- settlements: amounts treated as income of settlor (Chapter 5);
- beneficiaries' income from estates in administration (Chapter 6);
- annual payments not otherwise charged (Chapter 7); and
- income not otherwise charged (Chapter 8).

##### **Structure of Chapters**

2237. The basic structure of each Chapter is:

- charge to tax on income;
- the amount to be charged to tax;
- the person liable for the tax charged; and
- rules specific to that income.

2238. This Part does not contain exemption provisions. Signposts to the exemptions most likely to be relevant have been placed in the charge to tax provisions.

#### **Part 5: Chapter 1: Introduction**

##### **Section 574: Overview of Part 5**

2239. This section sets out the income charged in this Part, the approach to exempt income and where to find the priority rules. It is new.

**Section 575: Provisions which must be given priority over Part 5**

2240. This section provides rules which determine which Part will take priority in the case of any overlaps in the charging provisions. It is based on sections 18 and 20 of ICTA, and section 9D of TMA.
2241. *Subsection (1)* ensures that if any amount falls within a charge in Part 5 of this Act and the charge on trade profits, Chapter 2 of Part 2 of this Act will charge that amount as a trade receipt.
2242. It also reflects the decision to give effect to the Crown Option. See *Change 66* in Annex 1.
2243. *Subsection (2)* ensures that if any amount falls within a charge in Part 5 of this Act and the charge on a UK property business, Chapter 3 of Part 3 of this Act will charge that amount as a receipt of a UK property business. This reflects the priority of Schedule A over Schedule D and is based on section 18(1)(b) of ICTA and Schedule D Cases III(a) and VI.
2244. Particular types of income which, in the source legislation, are charged to tax under Schedule D Case III have been given separate charges to tax in Parts 4 and 5 of this Act. As the general annual payments charge in Chapter 7 of Part 5 of this Act takes effect only if an amount is not otherwise charged to income tax there can be no overlap between this charge and the ex-Case III charges in Part 4 of this Act.
2245. *Subsection (3)*, therefore, provides a rule where there could potentially be an overlap between Chapters within Parts 4 and 5 of this Act. It ensures that the interest charge in Chapter 2 of Part 4 takes priority over any of the charges in Part 5 that are based on Schedule D Case VI. This maintains the priority in the source legislation of Case III over Case VI which charges amounts that do not fall under any other Case of Schedule D.
2246. It also provides the priority between Chapter 3 of Part 4 of this Act (dividends etc. from UK resident companies) and Part 5 of this Act. This rewrites the effect of section 20(2) of ICTA which provides specifically for Schedule F to take priority over the other Schedules.
2247. *Subsection (4)* ensures that if any amount falls within a charge in Part 5 and any of the charging provisions in ITEPA, ITEPA has priority. This reflects the priority of ITEPA over Schedule D and is based on section 18(1)(b) of ICTA and Schedule D Case VI.
2248. The non-schedular charges rewritten in Part 5 of this Act in Chapter 5 (Settlements: amounts treated as income of the settlor) and section 656 (Beneficiaries' income from estates in administration: Income charged: UK estates) do not have the potential to overlap with Chapter 2 of Part 2 of this Act (trade profits) or Chapter 3 of Part 3 of this Act (UK property business) or any of the charges in Part 4 of this Act or ITEPA. There is therefore no need to exclude these charges from the priority rules.

**Section 576: Priority between Chapters within Part 5**

2249. This section provides rules which determine which Chapter will take priority in the case of any overlaps in the charging provisions within Part 5 of this Act. It is new.
2250. Usually, by their nature, the particular amounts charged in Part 5 of this Act can fall only within one Chapter so there is no need to make any special provision. In addition, as the general annual payments charge in Chapter 7 of Part 5 of this Act takes effect only if an amount is not otherwise charged to income tax there can be no overlap between this charge and the ex-Case III charges in Part 5 of this Act.
2251. This section provides the one priority rule required for this Part. Where amounts fall within Chapter 2 (receipts from intellectual property) and Chapter 3 (films and sound recordings: non-trade businesses), Chapter 3 has priority. Although both charges are based on Schedule D Case VI, priority has been given to Chapter 3 to ensure that these

amounts continue to benefit from the special deductions rules set out in sections 612 and 613 of that Chapter.

### ***Section 577: Territorial scope of Part 5 charges***

2252. This section provides that income within Part 5 of this Act is only charged to tax if it is from a source in the United Kingdom or, if from a source outside the United Kingdom, it arises to a UK resident.
2253. It is based on section 18(1) of ICTA.
2254. The comments made in the commentary on section 368 of this Act on the absence of a charge to tax on income from outside the United Kingdom arising to non-residents apply here also. See in particular the specific comments on subsections (1), (2) and (3) of that section, the use of the term “source” and how it is proposed to include within that section income without a source.
2255. *Subsection (4)* serves to exclude, for example, section 587 (charge to tax on income from sales of patent rights) from the scope of this rule since that section has its own rules on territorial scope.

### ***Chapter 2: Receipts from intellectual property***

#### **Overview**

2256. This Chapter incorporates three charges to income tax in respect of intellectual property. The Chapter includes a charge to income tax on royalties and other receipts from intellectual property arising both within and outside the United Kingdom. In this context, intellectual property includes patents, trade marks, registered designs and design rights, copyright, performer’s rights or plant breeder’s rights. The Chapter also charges to income tax capital sums arising from the disposal of know-how in certain circumstances and capital sums from the sale of patent rights.
2257. The following are excluded from the scope of this Chapter:
- royalties or other receipts from intellectual property which form part of the profits of a trade (dealt with in Part 2 of this Act);
  - capital sums from the disposal of know-how which are treated either as trading receipts or as a payment for goodwill (dealt with in Part 2 of this Act or in TCGA); or
  - balancing charges for certain forms of intellectual property included in CAA.
2258. **Sections 536** (taxation of royalties where owner abroad), **537** (public lending right) and **537B** (taxation of design royalties where owner abroad) of ICTA are not rewritten. These provisions all relate to deduction of tax at source under section 349(1) of ICTA.

### ***Section 578: Contents of Chapter***

2259. This introductory section sets out the three income tax charges imposed by the Chapter. It is new.
2260. *Subsection (2)* contains a signpost to section 727 of this Act which provides for a limited exemption from income tax for annual payments made by individuals. So payments of royalties which are made by individuals and arise in the United Kingdom will be outside the scope of this section if the conditions in section 727 are met. This subsection also contains a signpost to section 758 of this Act which contains another exemption for certain interest and royalty payments.

**Section 579: Charge to tax on royalties and other income from intellectual property**

2261. This section charges to tax royalties and other income from intellectual property. It is based on section 18 of ICTA.
2262. The section sets out a new provision creating a specific charge to tax on royalties and other income from intellectual property. The source legislation uses general principles to tax such income. In the source legislation, income from intellectual property is charged:
- as annual payments under Schedule D Case III;
  - as profits of a trade under Schedule D Case I;
  - as annual profits or gains under Schedule D Case VI; or
  - as income arising from possessions out of the United Kingdom under Schedule D Case V.

The new charge covers income charged in the source legislation under the heads mentioned above, except that trading income derived from intellectual property is to be taxed not under section 579 but under Part 2 of this Act. The rules set out in the section are not intended to widen or restrict the scope of the charges under Schedule D in the source legislation.

2263. The charge embraces royalties which are UK source annual payments (Schedule D Case III in the source legislation), overseas income from intellectual property (Schedule D Case V in the source legislation) and casual profits of an income nature from the exploitation of intellectual property outside the course of a trade (Schedule D Case VI in the source legislation). The charges relating to capital sums arising from the disposal of know-how in certain circumstances and capital sums arising from the sale of patent rights are dealt with further on in this Chapter.
2264. *Subsection (1)* contains the charge on royalties and other income from intellectual property. Royalties are mentioned specifically, even though they are covered by the words “income from intellectual property”, since most of the income within the scope of this section is likely to be royalties. However, no attempt has been made to define the term “royalties”. The source legislation does not do so. Although definitions have been suggested by the courts they are not appropriate to include here as the word “royalties” has only been used to assist the courts to determine whether a payment or receipt is of a revenue or capital nature.
2265. *Subsection (2)* defines intellectual property for the purposes of this section. Intellectual property is an area of rapid change. Because of this, it is not possible to define intellectual property by way of an exhaustive list. Subsection (2)(b) therefore charges United Kingdom source royalties and other income from rights which correspond to or are similar to those listed in subsection (2)(a). Subsection (2)(c) covers rights under foreign law which correspond to or are similar to those listed in subsection (2)(a). Also within the scope of the charge is income from any information or technique not protected by a right within subsection (2)(a), (b) or (c) of this section. So subsection (2) (d) provides the flexibility to bring within the scope of the section income derived from new types of intellectual property as changes occur in this field.

**Section 580: Income charged under section 579**

2266. This section sets out the amount charged to tax under section 579 in respect of royalties and other income from intellectual property. It is supplemented by the detailed calculation rules for certain income in section 582. The section is based on sections 64, 65, 68 and 69 of ICTA.
2267. *Subsection (4)* contains a signpost to section 527 of ICTA (relating to the spreading of patent royalties etc. over several years). Section 527 of ICTA deals with relief in terms

of a reduction in the income tax charge. It will be rewritten together with other similar relieving provisions.

***Section 581: Person liable for tax under section 579***

2268. This section states who is liable for any tax charged under section 579 in respect of royalties and other income from intellectual property. It is based on section 59 of ICTA.

***Section 582: Deductions in calculating certain income charged under section 579***

2269. This section sets out the rules for the deduction of certain expenses from income charged under section 579 other than annual payments (charged under Schedule D Case III in the source legislation) or foreign income charged on the remittance basis in accordance with section 832 of this Act. It applies to income charged under both Schedule D Case V and Case VI in the source legislation. It is new.

2270. There is no express provision in the legislation for deductions of expenditure from Schedule D Case VI income, although it is implied by the word “profits” in section 69 of ICTA (Case VI assessments) and by section 392 of ICTA (Case VI losses). This view has been upheld by the courts (see *Curtis Brown v Jarvis* (1929), 14 TC 744 HC). Expenditure admissible relating to income arising in the United Kingdom within the scope of the section would not cease to be admissible in respect of the same type of income arising outside the United Kingdom. However, under section 64 of ICTA (Case III assessments) no deduction is permitted from income within the Schedule D Case III charge so this section specifically does not apply to annual payments.

2271. *Subsections (2) to (4)* contain general rules about the expenditure which may be deducted. The rules are broadly based on those for deduction of expenses in calculating trade profits. In particular subsection (2) allows only expenses wholly and exclusively incurred in generating income. The intention here is to allow expenses that would be available in computing profits under Schedule D Case V or VI, and not to widen or restrict the scope of deductible expenses.

2272. *Subsection (6)* provides that the deduction of patent expenses under section 600 is additional to the relief due under this section. But where relief is given under section 582, no relief can then be given for the same expenditure as patent expenses – see subsection (5) of section 600.

***Section 583: Charge to tax on income from disposals of know-how***

2273. *Sections 583 to 586* all relate to consideration received for the disposal of know-how. Section 583 charges to tax the proceeds of certain disposals of know-how. It is based on section 531 of ICTA. Under the source legislation, income from disposals of know-how is charged to tax under Schedule D Case VI.

2274. Section 531(6) of ICTA, which categorises a charge under section 531(4) of ICTA as “earned income”, is repealed by this Act and replaced by new section 833(5A) of ICTA (see paragraph 338(5) of Schedule 1 to this Act). The concept of “earned income” in the context of know-how will now only be relevant for the purposes of section 282A of ICTA (jointly held property).

2275. *Subsection (1)* imposes the tax charge. Subsection (1)(b) is based on section 531(8) of ICTA but the words “whether absolute or qualified” have been omitted since they are superfluous. The word “profits” has been used here as it more accurately describes the sum which, after deduction of certain expenditure, is chargeable to tax.

2276. *Subsection (5)* defines “mineral deposits” for the purposes of this Chapter. This restores, for income tax purposes, a definition of “mineral deposits” that applied before CAA was enacted. See *Change 51* in Annex 1.

***Section 584: Exceptions to charge under section 583***

2277. This section sets out the exceptions to the charge under section 583. It is based on section 531 of ICTA.
2278. For the purposes of subsections (4) and (5) of the section, “control” is defined (through section 878(6) of this Act) by reference to section 840 of ICTA. The ICTA definition of “control” is identical in effect to that in section 574 of CAA. But as the relevance of “control” in this Act goes wider than this Chapter, the ICTA definition is used here.

***Section 585: Income charged under section 583***

2279. This section sets out the amount charged to tax under section 583. It is based on sections 69 and 531 of ICTA. There is no exclusion for sums calculated under the remittance basis by section 832 of this Act because, under the source legislation, income from the disposal of know-how is charged under Schedule D Case VI (to which the remittance basis does not apply).
2280. *Subsection (3)* ensures that expenditure may be deducted only once under this section and does not permit a deduction if relief has been obtained for the expenditure elsewhere (for example, as trading expenditure or by way of an allowance under CAA).
2281. *Subsection (4)* contains a signpost to section 603 of this Act which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 531 of ICTA as if it had been contained in CAA.

***Section 586: Person liable for tax under section 583***

2282. This section states who is liable for any tax charged under section 583. It is based on section 531 of ICTA. The specific rules in section 531 of ICTA override the general “person chargeable” rule for Schedule D in section 59(1) of ICTA.

***Section 587: Charge to tax on income from sales of patent rights***

2283. *Sections 587 to 599* deal with sales of patent rights. Section 587 charges to tax capital sums from the sale of patent rights. It is based on section 524 of ICTA. The charge under this section applies equally to both traders and non-traders.
2284. Section 529 of ICTA, which categorises certain income patent rights as “earned income”, is repealed by this Act and replaced by new section 833(5B) to (5E) of ICTA (see paragraph 338(5) of Schedule 1 to this Act).
2285. *Subsection (1)* taxes “profits” from sales of patent rights. The word “profits” has been used here as it more accurately describes the sum which, after deduction of certain expenditure, is chargeable to tax.
2286. *Subsection (2)* contains a special rule providing that non-UK residents are taxed only on profits from the sale of UK patent rights. UK residents are taxed on profits from the sale of patent rights granted under the laws of the United Kingdom or any other country or territory.
2287. *Subsection (3)* provides that tax is not charged where the seller is a non-UK resident company chargeable to corporation tax (for example, trading in the United Kingdom through a permanent establishment). Section 524(5) of ICTA sets out which persons are chargeable to income tax and which to corporation tax under section 524(3) of ICTA. This is necessary because sections 6 and 11 of ICTA, which generally deal with the income tax/corporation tax split, are drafted in terms of “income”. Section 524(5) of ICTA explains how the split is to work in the case of the capital sums charged to tax under section 524(3) of ICTA. Subsection (3) of this section makes it clear that a non-UK resident company chargeable to corporation tax is not chargeable to income tax in respect of capital sums from the sale of patent rights.



**Section 588: Income charged under section 587**

2288. This section sets out the amount charged to tax on profits from the sale of patent rights under section 587. It is subject to the spreading rules in section 590 to section 594. The section is based on section 524 of ICTA.
2289. There is no exclusion for sums calculated under the remittance basis under section 832 of this Act because, under the source legislation, profits from the sale of patent rights are charged to tax under Schedule D Case VI (to which the remittance basis does not apply).
2290. *Subsection (1)* provides that the profits are the proceeds of sale less the deductible costs. The reference to “net proceeds of the sale” in section 524(3) of ICTA implies that some deduction is available, but the source legislation does not further specify which amounts are deductible. The section makes it clearer what amounts may be deducted.
2291. *Subsection (2)* defines deductible costs as the capital cost of the rights sold plus any incidental expenses of sale. The section makes it explicit that such expenses may be deducted. The types of expenses which may be allowed under this section are not listed. Incidental expenses which relate to both capital sale proceeds and other sums not chargeable to tax under section 587 are effectively apportioned under the rules about net proceeds of sale in section 606.
2292. *Subsection (5)* contains a signpost to section 603 which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 524 of ICTA as if it had been contained in CAA. There is also a signpost here to the special rules giving relief from tax on patent income in section 600.

**Section 589: Person liable for tax under section 587**

2293. This section states who is liable for any tax charged under section 587. It is based on section 524 of ICTA. The specific rules in section 524 of ICTA override the general “person chargeable” rule for Schedule D in section 59(1) of ICTA.

**Section 590: UK resident sellers: spreading rules**

2294. This section sets out the spreading rules where the person chargeable under section 587 is resident in the United Kingdom. It is based on section 524 of ICTA.
2295. Section 524 of ICTA imposes a charge to tax where a person sells all or any part of any patent rights and the net proceeds of sale consist wholly or partly of a capital sum. There are separate charges for sellers who are resident in the United Kingdom (this section) and non-UK resident sellers of UK patent rights (sections 591 and 592).
2296. For both UK residents and non-UK residents, tax is charged (depending on whether or not an election is made) either:
- in respect of the whole sum, for the tax year in which it is received, or
  - on one sixth of the sum for that year and for each of the next five tax years.
2297. A “sum” to which the above rules apply could be either the whole sale proceeds or an instalment of the proceeds. So, for instance, where a UK resident seller has not elected otherwise, any receipt of an instalment of sale proceeds charged under the source legislation (section 524(1) of ICTA) would trigger the start of a six year period over which the charge for that instalment would be spread.
2298. In this Chapter, the way in which the rules on the timing of the tax charge apply to instalments is dealt with expressly.

2299. *Subsection (3)* allows the person chargeable to elect to be taxed on the whole amount for the first tax year, subject to the time limit for the normal self-assessment filing date for the tax year concerned (see also subsection(6)).
2300. *Subsection (6)* contains the time limit for elections under this section. The source legislation refers to “an officer of the Board” and the effect of this is maintained by section 878(4) of this Act which draws attention to the rules in TMA, which apply for the purposes of this Act. Those rules require elections to be made to “an officer of the Board”.

### ***Section 591: Non-UK resident sellers: election for spreading***

2301. This section sets out how non-UK residents are taxed on capital sums from the sale of patent rights where the sale proceeds are not received in instalments. It is based on sections 69 and 524 of ICTA.
2302. *Subsection (1)* provides that the whole amount chargeable is taxed for the tax year in which the proceeds are received. This is subject to an election for spreading in subsection (2).
2303. *Subsection (2)* enables the person chargeable to elect to be taxed over six tax years beginning with the tax year in which the proceeds of sale are received. This has been brought into line with section 590 which covers UK residents. Section 524(3) of ICTA provides that if a non-UK resident chargeable to tax makes an election, the proceeds received are *treated* as if they were chargeable to tax over six years and the liability is calculated *as though* the sum were spread over six years. But the effect is the same and there is no reason why the wording in these two sections should not be consistent. However, the source legislation would have been interpreted in this way so this clarification does not amount to a change in the law.
2304. *Subsection (3)* sets out the time limit for making an election under subsection (2) to the Inland Revenue. The reference in section 524(4) of ICTA to “the Board” has not been reproduced. Section 878(4) of this Act draws attention to the rules in TMA, which apply for the purposes of this Act. Those rules require elections to be made to “an officer of the Board”. See *Change 149* in Annex 1.
2305. Section 524(10) of ICTA is not rewritten. Section 524 of ICTA prescribes particular tax treatments with alternatives available by election. Section 524(10) of ICTA requires claims for relief under that provision to be made to the Board. The claim referred to in subsection (10) relates to capital sums received from the sale of patent rights to be spread over six years for the purposes of charging the sum to tax. As spreading is automatic for UK residents, the claim can only be relevant to non-UK residents. However, section 524(1) of ICTA refers to “a claim” and section 524(4) of ICTA, which deals with “spreading” rules for non-UK residents, refers to “the election”. Section 524(10) of ICTA is, therefore, superfluous.

### ***Section 592: Further provision about elections for spreading: instalments***

2306. This section sets out how non-UK residents are taxed on capital sums from the sale of patent rights where the sale proceeds are received in instalments. It is based on sections 69 and 524 of ICTA.
2307. *Subsection (2)* sets out the rule for making an election for spreading where sale proceeds are received in instalments. This makes explicit in the section what was implicit in the source legislation.
2308. *Subsection (3)* contains the time limit for making an election under subsection (2). The reference in section 524(4) of ICTA to “the Board” has not been reproduced. Section 878(4) of this Act draws attention to the rules in TMA, which apply for the purposes of this Act. Those rules require elections to be made to “an officer of the Board”. See *Change 149* in Annex 1.



***Section 593: Death of seller***

2309. This section deals with the case where a seller of patent rights dies before the end of the six year spreading period under sections 590, 591 or 592. It is based on section 525 of ICTA.
2310. *Subsection (2)* provides that personal representatives may elect for a reduction in the tax charged under subsection (1) based on “the lifetime tax years”. The term “personal representatives” is now defined in section 878(1) of this Act.
2311. *Subsection (3)* defines “the lifetime tax years” for the purposes of subsection (2). The subsection also deals with sale proceeds which are received in instalments. This makes explicit in the section what was implicit in the source legislation.
2312. *Subsection (4)* contains the time limit for making an election under subsection (2). The reference in section 525(2) of ICTA to “the inspector” has not been reproduced. Section 878(4) of this Act draws attention to the rules in TMA, which apply for the purposes of this Act. Those rules require elections to be made to “an officer of the Board”. See *Change 149* in Annex 1.
2313. The time limit in section 525(2) of ICTA has been changed to fit in with the normal self-assessment filing date for the year in which the death occurs. See *Change 104* in Annex 1.

***Section 594: Winding up of a body corporate***

2314. This section deals with a body corporate which is chargeable to income tax under section 587 where the body corporate commences to be wound up. It is based on section 525 of ICTA.
2315. The section applies where, for example, a company not resident in the United Kingdom (and not trading in the United Kingdom through a permanent establishment) disposes of UK patent rights, makes an election for spreading under section 591 or section 592 and is subsequently wound up before the expiry of the six year spreading period.
2316. *Subsection (2)* also deals with amounts arising to the corporate body in a fiduciary or representative capacity (for example, corporate trustees) which would have been chargeable to income tax for later tax years under section 590(2) or (4).

***Section 595: Deduction of tax from payments to non-UK residents***

2317. This section contains rules relating to the deduction of tax from payments to non-UK residents where a charge arises under section 587 on profits from the sale of the whole or any part of any patent rights. It is based on section 524 of ICTA.
2318. *Subsection (2)* provides that the capital costs in section 588 shall not affect the amount of income tax to be deducted under section 349(1) of ICTA and assessed under section 350 of ICTA. The reference in section 524(9) of ICTA to “section 349(1) and (3)” was clearly intended to read “sections 349(1) and 350”. This has been corrected in the consequential amendment which inserts section 349ZA into ICTA (see paragraph 149 of Schedule 1 to this Act).
2319. *Subsection (3)* provides that sections 349ZA and 350 of ICTA are not affected by any election under this Chapter for spreading provisions to apply. The reference to instalments makes explicit in the section what was implicit in the source legislation.

***Section 596: Adjustments where tax has been deducted***

2320. This section contains rules relating to adjustments which may be necessary where tax has been deducted from payments to a non-UK resident under subsection (2) of section 595. It is based on section 524 of ICTA.

2321. *Subsection (2)* provides that, where an election for spreading has been made, the necessary adjustments are to be made by treating one sixth of the sum deducted from the proceeds of sale or instalment as income tax paid for each of the six years. The reference to instalments makes explicit in the section what was implicit in the source legislation.

***Section 597: Licences connected with patents***

2322. This section provides some definitions connected with patents which extend the meaning of patent rights for the purposes of section 587 to section 596. The definitions relate to licences and are based on section 533 of ICTA.

***Section 598: Rights to acquire future patent rights***

2323. This section deals with the sale of rights to acquire patent rights in the future, before the patent has been granted. It is based on section 533 of ICTA.
2324. *Subsection (1)* provides that a sum paid to obtain an option to acquire future patent rights is to be treated as the purchase of patent rights in the hands of the payer and a sale of patent rights in the hands of the recipient. Any capital sum received is therefore chargeable under section 587 on the recipient and the payer may obtain relief for the expenditure under section 588 when the rights acquired are disposed of.
2325. The section makes it more explicit than the source legislation that there is a deemed sale of patent rights where an option to acquire future patent rights is sold or granted and also clarifies the position regarding the costs of such options. However, the section does not change the law since the source legislation would have to be read in this way.

***Section 599: Sums paid for Crown use etc. treated as paid under licence***

2326. This section provides that sums paid for Crown use, or by a government of a country outside the United Kingdom, in certain circumstances are to be treated as having been paid under a licence. It is based on section 533 of ICTA.
2327. *Subsection (1)* sets out the conditions under which sums paid in respect of an invention which is the subject of a patent and used in the service of the Crown, or the government of a country outside the United Kingdom, are to be treated as having been paid under a licence. The treatment of licences connected with patents is dealt with in section 597.
2328. The reference in section 533(4) of ICTA to “sections 46 to 49 of the Patents Act 1949” has not been reproduced in this section. This is because patents granted under these provisions have ceased to have effect so it is unnecessary to reproduce this reference. The removal of this unnecessary material follows the line adopted in section 482 of CAA.
2329. The words “used” and “use” in this section (which correspond with the relieving legislation in section 482 of CAA) are intended to be read widely and cover “make” and “sell”.

***Section 600: Relief for expenses: patent income***

2330. This section provides relief for certain expenditure in connection with patents. The section sets out the nature of the expenditure for which relief may be given under section 601. It is based on sections 526 and 528 of ICTA. The deduction is on the basis of expenses incurred. This relaxes any requirement in the source legislation that fees have to be paid before a deduction can be made.
2331. *Subsection (2)* defines “inventor’s expenses” for the purpose of this section. To the extent that relief is not given elsewhere (for example, as a deduction, where appropriate, in calculating trade profits) a claim may be made under this section for such expenses to be relieved against income from patents.

2332. The word “net” in “the net amount of any expenses” in section 526(2) of ICTA has not been reproduced. This word is superfluous having regard to subsection (6) of the section which contains a signpost to section 603 (contributions to expenditure).
2333. *Subsection (3)* defines “patent application and maintenance expenses” for the purposes of this section. Relief for such expenses is excluded from the scope of this section if the expenditure is incurred for the purposes of a trade carried on by the payer. This is because there is a similar provision in section 89 for trading expenses connected with patents.
2334. *Subsection (5)* excludes from the scope of this section expenditure for which relief is given elsewhere. Section 526(2) of ICTA applies this rule only to expenditure incurred by the inventor and now covered by subsection (1)(a) of this section. Section 526(2) of ICTA provides that relief could not be given more than once for expenditure incurred in devising an invention for which a patent has been granted. There is no such explicit double deduction prohibition in section 526(1) of ICTA which deals with expenditure incurred in the grant, extension etc of a patent. To avoid any possible confusion, however, the section prevents a double allowance in respect of all relevant expenditure. This makes clear the implicit rule that the legislation does not enable such expenses to be relieved twice.
2335. *Subsection (6)* contains a signpost to section 603 which deals with contributions to expenditure. This is necessary because section 532 of ICTA treats section 526 and 528 of ICTA as if those provisions had been contained in CAA.

### ***Section 601: How relief is given under section 600***

2336. This section sets out how relief is to be given where a claim is made under section 600 for patent expenses to be set against patent income. It is based on sections 526, 528 and 533 of ICTA.
2337. *Subsection (2)* allows relief for expenditure against patent income in the tax year in which the expenditure is incurred. However, if the expenses exceed the patent income in the tax year, the surplus expenses cannot be used to create a loss under this section.
2338. *Subsection (3)* provides that the excess of eligible expenses over income in a tax year is carried forward and set off against patent income in the next tax year and so on until the expenses have been fully relieved. The carry forward to future years is automatic and no additional claim needs to be made.
2339. *Subsection (5)* reproduces the ordering rule in section 528(3A) of ICTA. This requires the deduction or set-off of any capital allowances under section 479 of CAA in calculating “income from patents” for the purposes of subsection (4) of this section.

### ***Section 602: Payments received after deduction of tax***

2340. This section deals with the position of an individual receiving royalties or other income within this Chapter from which tax has been deducted. It is based on sections 348 and 349 of ICTA. Under section 348(1)(b) of ICTA “a sum representing the amount of income tax thereon” may be deducted from certain annual payments.
2341. The section reproduces the effect of section 348(1)(d) of ICTA, under which the sum is treated as income tax paid by the person to whom the payment is made. The payer is entitled, but not obliged, to deduct this sum representing tax, which is treated as tax paid by the recipient. The tax treated as paid by the recipient of the annual payment is taken into account, along with any other tax paid by deduction at source and any tax credits, in calculating the tax payable for the tax year.
2342. In so far as this section covers payments which are not annual payments within section 348(1) of ICTA, the scope of the provision has been made more explicit. Section 348(1)(d) of ICTA applies, in terms, only to annual payments from which any deduction

is made under section 348(1)(b) of ICTA, but case law effectively extends it to payments under sections 348(2) and 349 of ICTA. See commentary on section 426 of this Act.

***Section 603: Contributions to expenditure***

2343. This section restricts expenditure allowable under section 585, section 588 and section 600 to the extent that the expenditure is met by a public body or someone other than the claimant. It is based on section 532 of ICTA and section 532 of CAA.
2344. Section 532 of ICTA provides that sections 524, 526 and 531 of ICTA are to be treated as if those provisions had been contained in CAA.
2345. *Subsection (3)* excludes this section from applying to incidental expenses incurred by the seller of patent rights (see section 588(2)(b)). This is because section 524 of ICTA only bites in the first place on the net proceeds of a sale.

***Section 604: Contributions not made by public bodies nor eligible for tax relief***

2346. This section provides that contributions not made by public bodies may still be eligible as deductible expenditure in certain circumstances. The section is based on section 532 of ICTA and section 536 of CAA. It qualifies the general rule in section 603.

***Section 605: Exchanges***

2347. This section provides an extended definition of sale to include exchange. It is based on section 532 of ICTA and section 572 of CAA.
2348. Section 532 of ICTA provides that section 524 of ICTA (dealing with the sale of patent rights) and section 531 of ICTA (dealing with the disposal of know-how) are to be treated as if they had been contained in CAA.

***Section 606: Apportionment where property sold together***

2349. This section provides for the apportionment of sale proceeds and expenditure on a just and reasonable basis where property within the scope of this Chapter is sold or disclosed together with other property. It is based on section 532 of ICTA and section 562 of CAA.
2350. Section 532 of ICTA provides that section 524 of ICTA (dealing with the sale of patent rights) and section 531 of ICTA (dealing with the disposal of know-how) are to be treated as if they had been contained in CAA.

***Section 607: Questions about apportionments affecting two or more persons***

2351. This section contains a signpost to section 563 of CAA which sets out the body of Commissioners responsible for determining any question about the way in which a sum is to be apportioned under section 606 where the relevant apportionment affects two or more persons. It is based on section 532 of ICTA and section 563 of CAA.
2352. *Section 532* provides that section 524 of ICTA (dealing with the sale of patent rights) and section 531 of ICTA (dealing with the disposal of know-how) are to be treated as if those provisions had been contained in CAA.

***Section 608: Meaning of “capital sums” etc.***

2353. This section contains a signpost to section 4 of CAA which defines “capital expenditure” and “capital sums”. It is based on section 532 of ICTA and section 4 of CAA.
2354. Section 532 of ICTA provides that sections 524 to 529 and 531 to 533 of ICTA are to be treated as if those provisions had been contained in CAA.

### **Chapter 3: Films and sound recordings: non-trade businesses**

#### **Overview**

2355. This Chapter deals with income arising from the exploitation of films and sound recordings – and the special allocation rules available to the producers and acquirers of films and sound recordings – where the activities carried on do not amount to a trade.
2356. The special allocation rules rewritten in Chapter 9 of Part 2 of this Act for trades apply also to businesses. So this Chapter is needed to cater for businesses which fall short of a trade.
2357. There are no specific charging provisions for income from non-trade film and sound recordings businesses in ICTA. Such income is chargeable under Schedule D Case VI for UK sources and Schedule D Case V for foreign sources under the source legislation. The new charge has been carved out of a general charging provision and dealt with – together with the special allocation rules – in a separate charging Chapter. The new Chapter will apply to both UK source and foreign source businesses.

#### **Section 609: Charge to tax on films and sound recordings businesses**

2358. This section charges to tax income from businesses involving the exploitation of films and sound recordings where the activities fall short of trading. It is based on section 18 of ICTA .
2359. *Subsection (1)* imposes a charge on UK or foreign businesses involving the exploitation of films or sound recordings where the activities do not amount to a trade. Reclassifying the income according to its nature makes sense. The special allocation rules for films and sound recordings in sections 40A to 40D of F(No 2)A 1992 (and sections 41 to 43 of F(No 2)A 1992 for films) apply to both trades and businesses. The creation of a new charge and Chapter for this income provide a convenient link with the special allocation rules for films and sound recordings businesses (where the activities fall short of trading) which might otherwise be missed.
2360. The new charge on income from non-trading film or sound recordings businesses has been carved out of the general sweep up charge (see section 687) of this Act and included in a separate Chapter together with a signpost to the special allocation rules for expenditure relating to such activities.

#### **Section 610: Income charged**

2361. This section sets out the amount charged to tax under this Chapter. It is based on sections 65 and 68 of ICTA.
2362. *Subsection (3)* provides that this section is subject to the special rules for foreign income in Part 8 of this Act. The special allocation rules for films and sound recordings can apply to businesses carried on outside the United Kingdom as well as to businesses carried on in the United Kingdom.

#### **Section 611: Person liable**

2363. This section states who is liable for any tax charged under this Chapter. It is based on section 59 of ICTA.

#### **Section 612: Calculation of income**

2364. This section contains calculation rules for income charged under section 609. It is new.
2365. Where a particular type of income is carved out of what would otherwise be a general charge, this Act explicitly sets out the calculation rules applicable to that income. This approach has been extended to foreign source income charged under Schedule D Case



V in the source legislation. This section sets out expenses that would, in practice, be deductible in calculating profits and does not widen or restrict the scope of deductible expenses.

2366. There is no express provision in the legislation for deductions of expenditure from Schedule D Case VI income, although it is implied by the word “profits” in section 69 of ICTA (Case VI assessments) and by section 392 of ICTA (Case VI losses). This view has been upheld by the courts (see *Curtis Brown v Jarvis* (1929), 14 TC 744 HC). Expenditure admissible relating to income arising in the United Kingdom within the scope of the section would not cease to be admissible in respect of the same type of income arising outside the United Kingdom.
2367. *Subsection (4)* precludes expenditure which would not have been allowed had a trade been carried on. So expenses precluded by Chapter 4 of Part 2 of this Act are not deductible here.

### ***Section 613: Application of trading income rules to non-trade businesses***

2368. This section provides that Chapter 9 of Part 2 of this Act – the special allocation rules for trades – apply to non-trade businesses as those rules apply to trades (with certain modifications). It is new.

### ***Chapter 4: Certain telecommunication rights: non-trading income***

#### **Overview**

2369. This Chapter imposes a charge on profits derived from certain telecommunication rights not held for trading purposes. It also sets out how the profits are to be calculated. The Chapter is based on Schedule D Cases III, V and VI of ICTA and Schedule 23 to FA 2000. The rights dealt with in the Chapter are certain telecommunications licences and capacity on telecommunications cable systems, known as indefeasible rights to use (IRU).
2370. *Schedule 23* to FA 2000 does not impose a charge to tax on the income derived from the rights. The main purpose of Schedule 23 to FA 2000 is to allow a taxpayer who acquires qualifying rights a revenue deduction for expenditure that would otherwise be treated as capital for tax purposes. It does this by providing that the income tax treatment follows the treatment in the accounts provided the accounts are prepared in accordance with generally accepted accounting practice. This rule applies not only to the acquisition but also to revaluations and disposals.
2371. In most cases it is likely that the rights will be acquired for use in a trade. For this reason Schedule 23 to FA 2000 is rewritten as Chapter 10 of Part 2 of this Act. But the Schedule applies for all income tax purposes. This Chapter rewrites the charge if the assets are not acquired for the purposes of a trade.
2372. The Chapter applies only to IRUs acquired on or after 21 March 2000. See the transitional rules in paragraphs 130 and 131 of Schedule 2 to this Act. No telecommunications licences to which this Chapter applies were acquired before that date.

### ***Section 614: Charge to tax on certain telecommunication rights of a non-trader***

2373. This section charges to tax income from telecommunication rights arising to a non-trader. It is based on Schedule D Cases III, V and VI, section 18(1) and (3) of ICTA, and paragraph 1 of Schedule 23 to FA 2000.
2374. If the rights are acquired for pure investment purposes and the licensor does not undertake to provide any extra services, ICTA charges the profits to tax under Schedule D Case III as an annual payment (or under Schedule D Case V in the unlikely event that the source is outside the United Kingdom).

2375. If the licensor undertakes to provide services that do not amount to a trade, ICTA charges the profits under Schedule D Case VI (or under Schedule D Case V if the source is outside the United Kingdom).

***Section 615: Income charged***

2376. This section sets out the amount charged to tax. It is based on sections 64, 65, 68 and 69 of ICTA and Schedule 23 to FA 2000.

***Section 616: Person liable***

2377. This section states who is liable for any tax charged. It is based on section 59 of ICTA.

***Section 617: Deductions in calculating certain income charged***

2378. This section sets out how to calculate the income charged to tax if the taxpayer provides services that do not amount to a trade. It is based on section 69 of ICTA and Schedule 23 to FA 2000.
2379. In the source legislation this income would be charged under Schedule D Case VI (or under Schedule D Case V if the source is outside the United Kingdom). The rules set out in this section deal with two aspects of the calculation of this income. First, the general deduction rules that apply to income taxed under Schedule D Case VI. Second, the particular rules that apply to income from telecommunication rights.
2380. There is no express provision in the legislation for deductions of expenditure from Schedule D Case VI income, although it is implied by the word “profits” in section 69 of ICTA (Case VI assessments) and by section 392 of ICTA (Case VI losses). This view has been upheld by the courts (see *Curtis Brown v Jarvis* (1929), 14 TC 744 HC). Expenditure admissible relating to income arising in the United Kingdom within the scope of the section would not cease to be admissible in respect of the same type of income arising outside the United Kingdom. However, under section 64 of ICTA (Case III assessments) no deduction is permitted from income within the Schedule D Case III charge so this section specifically does not apply to annual payments.
2381. [Schedule 23](#) to FA 2000 set out a particular set of rules that apply to income from telecommunication rights. Because they are most likely to apply to trading income this section merely cross-refers to the rewrite of those rules in sections 147 and 148 of this Act.

***Section 618: Payments received after deduction of tax***

2382. This section deals with the position of an individual receiving income within this Chapter from which tax has been deducted. It is based on sections 348 and 349 of ICTA.
2383. Under section 348(1)(b) of ICTA “a sum representing the amount of income tax thereon” may be deducted from certain annual payments. The section reproduces the effect of section 348(1)(d) of ICTA, under which the sum is treated as income tax paid by the person to whom the payment is made. The payer is entitled, but not obliged, to deduct this sum representing tax, which is treated as tax paid by the recipient. The tax treated as paid by the recipient of the annual payment is taken into account, along with any other tax paid by deduction at source and any tax credits, in calculating the tax payable for the tax year.
2384. In so far as this section covers payments which are not annual payments within section 348(1) of ICTA, the scope of the provision has been made more explicit. Section 348(1)(d) of ICTA applies, in terms, only to annual payments from which any deduction is made under section 348(1)(b) of ICTA, but case law effectively extends it to payments under sections 348(2) and 349 of ICTA. See commentary on section 426 of this Act.

## **Chapter 5: Settlements: amounts treated as income of settlor**

### **Overview**

2385. This Chapter rewrites the settlements legislation in Chapters 1A and 1B of Part 15 of ICTA. This legislation prevents the avoidance of tax where a person (the settlor) arranges for his or her income to be received by someone who is either chargeable to tax at a lower rate than the settlor, or not chargeable to tax at all. The legislation operates by treating the income as if it were the settlor's. The legislation operates where:

- the settlor retains an interest in property but the income from that property is received by another;
- payments from a settlement set up by the settlor are made to a minor child of the settlor; or
- payments are made to the settlor from the settlement in the form of capital rather than income.

### **Section 619: Charge to tax under Chapter 5**

2386. This section charges to tax payments, whether income or capital, which are deemed to be the income of the settlor under this Chapter. It also provides that the part which represents distributions attracts the dividend ordinary rate. It is based on sections 660C and 677 of ICTA.

2387. *Subsection (1)* charges to tax the income and capital payments which are treated as the income of the settlor under this Chapter. It rewrites the charges under sections 660C and 677(7) of ICTA. Section 660C(1) of ICTA, which charges income treated as the settlor's because he or she retains an interest in the settlement or because of payments etc to a minor child, imposes a Schedule F charge on distributions and a charge under Schedule D Case VI on other income. Section 677(7) of ICTA, which charges capital payments treated as the settlor's income, imposes a Case VI charge on all such payments. The listing in this subsection of the amounts treated as income acts as an introduction to the Chapter and explains the nature of the charge under the Chapter.

2388. *Subsection (3)* lists the income that is to be treated under *subsection (2)* as within section 1A(2)(b) of ICTA. The income is all distribution income or income treated as such. The effect of this provision is that this income is charged at the dividend ordinary rate (the Schedule F ordinary rate). The income within section 660C(1A), which this subsection rewrites, is included here as follows:

- (1A)(a) is rewritten at (3)(a);
- (1A)(b) is rewritten at (3)(b) and (e);
- (1A)(f) is rewritten at (3)(c); and
- (1A)(g) is rewritten at (3)(d).

2389. Section 660C(1A)(c) to (e) has not been listed because it is unnecessary. The income within section 233(1), (1A) and (1B) of ICTA is already included within section 660C(1A)(a) as "income chargeable under Schedule F". Such income is included within subsection (3)(a) of this section since Chapter 3 of Part 4 of this Act rewrites the Schedule F charge.

2390. Section 660C(1A)(b) of ICTA includes income to which section 1A of ICTA applies "by virtue of it being equivalent foreign income falling within subsection (3)(b) [of section 1A of ICTA] and chargeable under Case V of Schedule D". The "equivalent foreign income" within that subsection is dividends or other distributions of a non-UK resident company which would be chargeable under Schedule F if that company were resident in the UK. Because Chapter 4 of Part 4 of this Act charges foreign dividends

and not foreign *distributions*, subsection (4) provides that any such foreign distributions falling outside that Chapter are included within section 619(3)(e) because they would, if the company were UK resident, fall within Chapter 3 of that Part. Chapter 3 of Part 4 of this Act rewrites the Schedule F charge on both dividends *and* distributions of a UK resident company.

### ***Section 620: Meaning of “settlement” and “settlor”***

2391. This section explains the meaning of “settlement” and “settlor” for the purposes of this Chapter. It is placed in this part of the Chapter to help the reader by giving an early indication of the nature of the charge under this Chapter. It is based on sections 660G and 677 of ICTA.

### ***Section 621: Income charged***

2392. This section sets out the amount charged to tax. It is based on sections 69, 660C and 677 of ICTA.

2393. All the income and capital payments which are to be treated as the settlor’s income are chargeable to tax.

2394. The income to be treated as the settlor’s income under section 624 is the income arising under the settlement. The meaning of income arising under a settlement is given in section 648. Subsection (1) of that section provides that income arising under a settlement includes income chargeable to income tax by deduction or otherwise and, in the case of income from outside the United Kingdom, income which would be chargeable if received by a UK resident. In consequence the appropriate measure of income chargeable and the tax year of charge are provided by the charging sections of other Chapters of this Act (or the appropriate sections of the Income Tax Acts).

2395. [Section 648\(2\)](#) provides that where the settlor is non-domiciled etc and the settlement is entitled to income which would not be chargeable on the settlor if he or she made a claim for the remittance basis to apply, it is excluded from income arising under a settlement and is therefore not chargeable on the settlor.

2396. The amount of income arising under a settlement which is treated as the settlor’s income under section 629 and the year of charge are given in subsection (1) of that section.

2397. The amount to be treated as the settlor’s income under section 633 and the year of charge are given in subsection (1) of that section.

### ***Section 622: Person liable***

2398. This states who is liable for any tax charged. It is based on sections 660A, 660B and 677 of ICTA.

2399. Section 660A(1) of ICTA provides that income charged on the settlor is not treated as the income of any other person. Since that person could be a company, and outside the scope of this Act, new section 660C(4) of ICTA (see paragraph 272(4) of Schedule 1 to this Act) ensures that a charge cannot be made on a company in respect of that income.

### ***Section 623: Calculation of income***

2400. This section allows the settlor the same deductions and reliefs as if he had received as income the amount on which he is chargeable. As a result of this the settlor is charged to tax as if he had received the income arising under the settlement directly. It is based on sections 660C and 677 of ICTA. Section 660C(3) of ICTA is not rewritten in this Act.

**Section 624: Income where settlor retains an interest**

2401. This is the first of the rules under which income is treated as the settlor's. Where the settlor retains an interest in settled property the income arising under the settlement is treated as the settlor's. The section is based on section 660A of ICTA.

**Section 625: Settlor's retained interest**

2402. This section explains when a settlor is treated as having an interest in property for the purposes of section 624 and exceptions to this. It is based on section 660A of ICTA.

2403. *Subsection (1)* explains what is meant by a settlor having an interest in property. The interests may also be those of the settlor's spouse.

2404. *Subsections (2) and (3)* give occasions where a settlor does not have an interest in property. The exceptions cover instances when the settlor may by inadvertence or circumstances likely to be outside his or her control have an interest in property which he or she has settled or an interest in property derived from that property. These circumstances include bankruptcy, where the settlor may obtain an interest in property as a result of the bankruptcy of another person who has an interest in that property. This might occur where the beneficiary of a settlement, who is also the creditor of the settlor, becomes bankrupt and the debt is settled by a payment of settlement income from the bankrupt's estate.

2405. The settlor is also excluded from having an interest in property as long as someone under the age of 25 years is alive during whose lifetime that property cannot be payable to the settlor other than in a bankruptcy or by assigning or charging the individual's interest in the property. While there is no requirement that the person under 25 years should have an interest in that property it may generally be expected that they will.

2406. *Subsection (5)* provides the meaning of "related property" ("derived property" in section 660A(10) of ICTA). When this clause was drafted the House of Lords' decision in *West v Trennery* (2005), TL 3747<sup>1</sup> on the interpretation of "derived property" in section 77(8) of TCGA was not available. The definition of "derived property" in that section is the same as in section 660A(10) of ICTA. In consequence the section closely follows the source legislation.

**Section 626: Exception for outright gifts between spouses**

2407. This section provides an exception to the rule in section 624 for an outright gift of property between spouses which gives rise to income. Such gifts are within the exclusion as long as the property gifted is more than simply a right to income and the right to income is a right to the whole of the income. The section is based on section 660A of ICTA.

**Section 627: Exceptions for certain types of income**

2408. This section provides that section 624 does not apply to certain income between former parties to a marriage and to commercial and charitable payments and pension contributions. It is based on section 660A of ICTA.

2409. *Subsection (1)* enables a person to make a settlement that benefits a former or separated spouse without that income being treated as income of the settlor.

2410. *Subsection (3)(c)* refers to regulations made under the Welfare Reform and Pensions Act 1999 and its equivalent in Northern Ireland although section 660A(11)(c) of ICTA (inserted by paragraph 28 of Schedule 35 to FA 2004) simply refers to regulations made by the Secretary of State. See *Change 105* in Annex 1.



2411. Subsection (3) applies for the tax year 2006-07 onwards and rewrites the changes to section 660A(11) of ICTA introduced by FA 2004. A transitional rule is found in paragraph 132 of Schedule 2 to this Act which gives the rules for “approved pension arrangements” for 2005-06. The FA 2004 changes to pension provisions only apply from 2006-07.

***Section 628: Exception for gifts to charities***

2412. This section provides that certain charitable donations will not be treated as the settlor’s income under section 624. It is based on section 44 of FA 2000.
2413. Section 44 of FA 2000 applies to the charge under both sections 660A and 660B of ICTA (settlor-interested trusts and payments to a minor child of the settlor). Section 44 of FA 2000 is rewritten in two places in this Chapter, once as an exemption from the charge under section 624 and secondly as an exemption from the charge under section 629. (A payment may, for example, be made by trustees to a charity which benefits a minor child of the settlor.) *Subsection (3)(b)*, which includes within the sum paid to a charity sums for which the exemption in section 630 applies, covers the possibility, unlikely though it may be, of a trust changing its nature during a tax year whereby it is no longer a settlor-interested trust and thus one to which section 630 might apply. (A charge under that section will not apply if a charge under section 624 applies.) Any charitable payments exempted from a charge on the settlor under section 629 must be included to give the correct result.

***Section 629: Income paid to unmarried minor children of settlor***

2414. This section provides the second charge under this Chapter. Income paid to or for the benefit of an unmarried minor child of the settlor or income which is treated as that child’s income is charged as income of the settlor if it does not already fall within section 624. The section is based on section 660B of ICTA.
2415. *Subsection (1)* sets out the basic rule. *Subsection (1)(b)* ensures that avoidance cannot arise by using a bare trust arrangement where a child is a beneficiary of the trust, although no income is paid to or for the child’s benefit.
2416. *Subsection (2)* provides that a charge under section 624 will always take precedence over a charge under this section.
2417. See paragraph 133 of Schedule 2 to this Act for the application of this section in relation to income arising under a settlement made before 9 March 1999 or from funds provided before that date.
2418. Section 660B(1) of ICTA provides that income charged on the settlor is not treated as the income of any other person. Since that person could be a company, and outside the scope of this Act, new section 660C(4) of ICTA (see paragraph 272(4) of Schedule 1 to this Act) ensures that a charge cannot be made on a company in respect of that income.

***Section 630: Exceptions for gifts to charities***

2419. This section provides that certain charitable donations will not be treated as the settlor’s income under section 629. This exemption might apply in the unusual circumstances of a charity benefiting the minor child of a settlor, that is to say that payments out of the settlement to the charity were paid to or applied for the benefit of the settlor’s minor child. The section is based on section 44 of FA 2000.
2420. See the commentary on subsection (3)(b) of section 628 as to how subsection (2)(b) of this section applies.

**Section 631: Retained and accumulated income**

2421. This section applies the rule in section 629 where payments are made to or for the benefit of a minor child of the settlor out of a settlement under which income is retained or accumulated. It is based on section 660B of ICTA.
2422. *Subsection (1)* provides the general rule. The payment must be made in connection with the settlement out of a trust under which income may be retained or accumulated. The distinction in trust law between “retained” and “accumulated” income (income the trustees have resolved to treat as capital) has been retained.
2423. *Subsection (2)* provides that such payments are treated as payments of income even though out of capital as long as there is sufficient accumulated or retained income available to make the payment in question.
2424. *Subsection (4)* sets out what is meant by available retained or accumulated income in subsection (2). Income that has arisen under the settlement must exceed the amounts set out in *subsection (5)*. These are amounts that have been paid out in expenses or already treated as the income of the settlor or another person, including a minor child of the settlor.
2425. *Subsections (6) and (7)* provide the computation for income subject to income tax of a minor child of the settlor for the purposes of subsection (5)(d). One first computes a figure for the whole of the child’s income from all sources less allowances and deductions and then compares that with the sums treated as the child’s income under the settlement. If the income less allowances is sufficient to include the child’s income from the settlement then that income is deemed to have been subject to tax, ie the settlement income is treated as the top slice of the child’s income.

**Section 632: Offshore income gains**

2426. This section provides that gains under the offshore funds legislation are deemed to be paid to a minor where they would have been considered as his or her income were it not for his or her minority. (Section 761(1) of ICTA provides that where there is a disposal in an offshore trust the gain is treated as income of the person disposing of it.) The section is based on section 660B of ICTA.

**Section 633: Capital sums paid to settlor by trustees of settlement**

2427. This section provides the third charge under this Chapter. It treats as income of the settlor capital sums paid or lent to the settlor by the trustees of the settlement where those payments are matched by undistributed income within the settlement. It is based on section 677 of ICTA.
2428. *Subsection (1) and (2)* provide the basic rule that capital payments to the settlor are treated as his or her income where there is sufficient available income within the settlement up to the end of that tax year to cover that payment.
2429. *Subsection (3)* deals with the situation where there is insufficient available income up to the end of the year in which the loan is made. One then takes into account the available income for the following year to the extent that it has not been treated as the settlor’s income following a capital payment made in that year. If there is still insufficient available income one takes into account the available income for the year after that and so on.
2430. *Subsection (4)* allows the rule in subsection (3) to run for up to 10 years subsequent to the capital payment.

**Section 634: Meaning of “capital sum” and “sums paid to settlor”**

2431. This section provides the meaning of two terms used in section 633. It is based on section 677 of ICTA.
2432. *Subsection (1)* explains what is meant by “capital sum”. It includes sums paid as a loan, loans repaid or sums paid to the settlor or his or her spouse (see *subsection (7)*) in excess of the market value of goods or services. Settlers cannot therefore avoid tax by extracting income from a settlement in the form of a capital payment by the receiving of loans from the settlement, by the making of loans which are invested by the trustees and then receiving repayment of those loans, or by selling to the trustees of the settlement an item in excess of market value.
2433. *Subsection (3)* excludes sums from being treated as capital sums which are broadly outside the control of the settlor (see commentary on section 625(2)).
2434. *Subsection (5)* prevents a settlor from avoiding a charge under this section by arranging for the trustees to pay a capital sum to a third party from which the settlor may benefit.

**Section 635: Amount of available income**

2435. This section explains what is meant by available income for the purposes of section 633. It is based on section 677 of ICTA.
2436. *Subsections (2)* and *(3)* give the rules for ascertaining available income. It is the income arising under the settlement which has not been distributed, less sums which have already been taken into account under this rule as a capital payment in a previous year or which have been treated as the settlor’s income under sections 624 or 629 or which represent an amount of tax paid on undistributed settlement income.
2437. Section 677(2) of ICTA, on which subsection (3) is based, excludes from the measure of available income such income as has been treated as income of the settlor in tax years before 1995-96 under provisions which have been repealed. These paragraphs of section 677(2) of ICTA are rewritten in paragraph 134 of Schedule 2 to this Act.

**Section 636: Calculation of undistributed income**

2438. This section explains for the purposes of section 635 what is meant by income arising under a settlement that has not been distributed. It is based on section 682 of ICTA.
2439. *Subsection (1)* provides the basic rule with the detail in the remaining subsections. The amounts which may be set against the income arising are classified under three headings which are set out in *subsections (2), (4)* and *(6)*.

**Section 637: Qualifications to section 636**

2440. This section gives special provisions that apply to payments made by the trustees in section 636(2) to (6) and which would otherwise be available to reduce the undistributed income within the settlement. It is based on section 682 of ICTA.
2441. *Subsection (1)* disapplies section 636(2) for payments of interest or payments to connected bodies corporate or other settlements. Such payments are not therefore to be treated as sums which have been distributed under that section.
2442. The purpose of *subsections (2)* to *(7)* is to prevent certain payments of interest that would not be allowable against tax from reducing the undistributed income. Interest payments that are allowable for tax purposes will already have been allowed in arriving at the income arising under the settlement.
2443. Disallowable interest payments should not be available to reduce the income treated as the settlor’s income. Without special rules loan interest payable by the trustees, which

would not be allowed for tax purposes, could reduce the undistributed income and hence the amount chargeable on the settlor.

2444. Interest can only reduce the amount available for distribution to the extent that it represents an expense against income payments to persons other than the settlor. The formula in *subsection (5)* apportions the interest paid on these lines. The resulting sum represents the interest paid in respect of income payments made by the settlement to the settlor and that resulting figure is unavailable to set against the undistributed income.
2445. *Subsection (6)* removes from the computation interest that has been paid to the settlor or spouse of the settlor since tax will already have been borne on that interest and, but for this, double taxation would arise on those sums.

### ***Section 638: Capital sums paid by way of loan or repayment of loan***

2446. This section gives the rules that apply where the capital sums in section 633 are loans or repayments of loans. It is based on section 677 of ICTA.
2447. *Subsections (1)* provides that if a capital loan is repaid no part of it is treated as the settlor's income under section 633 for any year following the year of repayment.
2448. *Subsections (2)* and *(3)* provide that where a second loan is made to the settlor after repayment of the original loan, that loan is only treated as the settlor's income to the extent that it exceeds a previous loan which has been treated as the settlor's income. This is because no repayment of tax is made to the settlor in respect of the repayment of the first loan. He or she has effectively already paid tax on the new amount outstanding.
2449. *Subsections (4)* and *(5)* provide that, where a settlor has made a subsequent loan to the settlement following the repayment of an earlier loan, no part of the repayment on the first loan is treated as the settlor's income after the tax year in which the subsequent loan to the settlement is made, as long as it is not less than the amount of the first loan. The second loan here is treated as a repayment of the capital sum paid out of the settlement as repayment of the first loan.

### ***Section 639: Loans to participators in close companies***

2450. This section serves to avoid a double taxation charge as a result of the application of Chapter 6 of Part 4 of this Act. Under that Chapter loans made by a company to a participator and then written off are treated as income net of tax at the dividend ordinary rate on UK distributions. The rule is that where a charge potentially arises under both this section and under Chapter 6 of Part 4 of this Act this section will take precedence, but if a charge under Chapter 6 of Part 4 of this Act has already been made, then the charge under this Chapter on the settlor is reduced by a corresponding amount. See section 418 of this Act (relief where borrowers liable as settlors) which rewrites section 421(3) of ICTA. The section is based on section 677 of ICTA.

### ***Section 640: Grossing-up of deemed income***

2451. This section explains the grossing-up procedure for capital sums treated as the settlor's income and the tax allowed against the settlor's liability. It is based on section 677 of ICTA.
2452. *Subsection (1)* provides that the settlor is taxed on the grossed up amount of the capital sum treated as his income. Section 877 of this Act explains how sums are grossed up.
2453. *Subsection (2)* then allows a set-off of tax against the settlor's tax liability with the result that only higher rates of tax are chargeable on the settlor. The amount that the settlor may set off against his liability is given in the following subsections.
2454. *Subsection (3)* explains the amount ("the deductible amount") that can be set against the settlor's liability. This is the lesser of the tax at which the capital sum is grossed up

at for the tax year (the rate applicable for trusts) or the amount of tax the trustees are deemed to have paid on the available income (irrespective of the fact that the capital sum is grossed up at the rate applicable to trusts for the tax year in which the loan is treated as the settlor's income). This allows for the fact that where available income to cover the capital sum (see section 633(2)) arose in earlier years, that income may have been charged at different rates to those in the tax year in which the capital sum is treated as the settlor's income.

2455. *Subsections (4) to (7)* provide that, in order to ascertain the appropriate rates of tax for subsection (3)(c), the capital sum is matched against available income arising in earlier years before later years and the given rates of tax are applied for each tax year in which the available income representing the grossed-up sum arose. This includes a nil rate of tax where the available income would not have been subject to UK tax because the available income arose outside the United Kingdom to a non-UK resident. Subsection (6)(b) reflects the change in the rate applicable to trusts in FA 2004. The net effect of these subsections is that the credit available against the tax charge broadly represents the tax paid on the available income which represents the grossed-up capital sum. The nil rate applies in relation to any income in any tax year which falls within subsection (6)(a)(i) and (ii).
2456. Subsection (5) provides for grossing-up at the appropriate rate, that is to say the rates given in subsection (6), in order to ascertain the tax credit to set against the settlor's income (the "deductible amount"). This is a separate grossing-up exercise to that in subsection (1), which provides that the charge on the settlor's income is always on the amount grossed up at the rate applicable to trusts.

#### ***Section 641: Capital sum paid to settlor by body connected with settlement***

2457. This section provides a variation on the preceding rule. It ensures that capital sums paid by a corporate body connected with the settlement are treated as income of the settlor where the payment of that capital sum can be identified with a payment made to the corporate body by the settlement. Thus payments of capital from the settlement to the settlor but dog-legged through a connected third party will not avoid a tax charge on the settlor. The section is based on section 678 of ICTA.
2458. Under *subsections (1) and (2)* where a capital sum is paid to the settlor by a body corporate connected with the settlement and an associated payment is made directly or indirectly to that body corporate by the trustees, the capital sum paid by the body corporate is treated, to the extent that it falls within the associated payment, as if it were paid directly by the trustees to the settlor and section 633 applies accordingly.
2459. Where an associated payment is made in the year following the year in which the payment is made by the corporate body to the settlor, the capital sum is treated as the settlor's income for that tax year and so on, up to the amount covered by the associated payment, for each subsequent year (*subsections (4) to (6)*).
2460. See the entry in paragraph 135 of Schedule 2 to this Act for the application of this section in respect of payments to the settlor made before 1995-96 by a body corporate connected with the settlement.

#### ***Section 642: Exception for certain loans or repayments of loans***

2461. This section provides time limits for section 641. Where the capital sum paid to the settlor is repaid within 12 months or loans made to the settlor by a body corporate connected with the settlement are not outstanding for more than 12 months in five years, the capital sum is not treated as the settlor's income. The section is based on section 678 of ICTA.



**Section 643: Interpretation of sections 641 and 642**

2462. This section provides definitions of and further information on terms used in sections 641 and 642. It is based on section 678 of ICTA.
2463. *Subsection (1)* provides the same tests as section 633 in ascertaining whether a capital sum has been paid to a settlor.
2464. *Subsection (4)* widens the meaning of payments made by or to another body corporate. It enables sections 641 and 642 to apply where the body corporate making the payment to the settlor is a different body corporate to that receiving the payment from the trustees, whether directly or indirectly, but where both bodies corporate are associated.

**Section 644: Application to settlements by two or more settlors**

2465. This section explains how the provisions of this Chapter apply where there is more than one settlor. It is based on sections 660E and 682A of ICTA.
2466. The Chapter is written in terms of a single settlor and the rules in *subsections (2) to (5)* allow the property originating from each settlor to be considered in isolation.

**Section 645: Property or income originating from settlor**

2467. This section explains what is meant by property or income originating from a settlor for the purposes of section 644. It is based on sections 660E and 682A of ICTA.
2468. *Subsection (1)* rewrites section 660E(5) of ICTA. Section 660E(5) of ICTA provides under paragraph (c) that property originating from a settlor means property that represents property provided by the settlor and other property as, on a just apportionment, represents the property so provided. This is rewritten as “on a just and reasonable apportionment”. See *Change 14* in Annex 1.

**Section 646: Adjustments between settlor and trustees etc.**

2469. This section enables a settlor to recover from the trustees or others tax which has been charged on him or her under sections 624 or 629 as well as requiring him to repay to the trustees any tax repayment which would not have arisen to him or her apart from the charge under these two sections. The section is based on section 660D of ICTA.
2470. *Subsection (1)* enables the settlor to recover from the trustees, or whoever else has received the settlement income, the tax payable by the settlor as a result of a charge under sections 624 or 629. Since the settlor has not in fact received the income it is considered inequitable that he or she should have to pay the additional tax. The net effect where such a recovery is made is that the trustees or beneficiary of the settlement effectively pay the tax on the income but at the settlor’s highest tax rate.
2471. *Subsection (2)* enables the settlor to request a certificate of tax paid from the Inland Revenue which is conclusive, under *subsection (3)*, of the facts in it.
2472. Section 660D(1)(b) refers to “an officer of the Board”. Similar references have been replaced in this Act by the term “Inland Revenue” to achieve a more consistent approach. This is not a change in the law since section 878(1) of this Act defines “the Inland Revenue” as “any officer of the Board of Inland Revenue”.
2473. *Subsections (4) and (5)* require a repayment of tax to the trustees or other persons receiving the settlement income which a person would not have received but for a charge under sections 624 and 629. This is most likely to arise where the income charged on the settlor has had tax deducted at source and a repayment of tax is made to the settlor because there is a surplus of allowances or reliefs to set against that income. The repayment may be apportioned where the settlement income was received by more than one person.

2474. Section 660D(2) of ICTA refers to “a person” obtaining a repayment of income tax. This is rewritten here as “a settlor”. The person referred to can only be the settlor and the use of “person” simply reflects the language of FA 1922, on which that section is based, which refers to the settlor as “a person making a disposition”.
2475. *Subsection (8)* ensures that a charge on settlement income in respect of settlor-interested settlements and settlements in respect of minor children of the settlor may still be made on the trustees as recipients of the income.

### ***Section 647: Power to obtain information***

2476. This section allows the Inland Revenue to require parties to a settlement to provide them with information within a specified time limit. It is based on section 660F of ICTA.
2477. Section 660F refers to “an officer of the Board”. Similar references have been replaced in this Act by the term “Inland Revenue” to achieve a more consistent approach. This is not a change in the law since section 878(1) of this Act defines “the Inland Revenue” as “any officer of the Board of Inland Revenue”.

### ***Section 648: Income arising under a settlement***

2478. This section explains what is meant by income arising under a settlement. It is based on section 660G of ICTA.
2479. *Subsection (1)* includes all income chargeable to tax on a UK resident from sources within or outside the United Kingdom.
2480. *Subsections (2) to (5)* apply where the settlor is either not resident in the United Kingdom or not domiciled or not ordinarily resident here. In that case any foreign source income is excluded unless it is remitted to the United Kingdom and the settlor would be chargeable to tax in respect of it if it were his own income. In that case it is included in the income arising under a settlement in the year of remittance.
2481. The net effect of this section is to include all UK source income within income arising under a settlement but to exclude foreign source income if the settlor is non-UK resident. If the settlor would have been charged on an amount calculated by reference to section 832 (relevant foreign income charged on the remittance basis) had he or she been entitled to the income, then that foreign source income is charged only to the extent that it is remitted here.

## ***Chapter 6: Beneficiaries’ income from estates in administration***

### **Overview**

2482. This Chapter charges to income tax income paid or payable by personal representatives to residuary beneficiaries from estates in administration. The Chapter rewrites sections 695 to 698 and 699 to 702 of ICTA. Section 698A of ICTA (which deals with rates of tax) and section 700(4), (5) and (6) of ICTA (which deal with administrative matters) have not been rewritten in this Chapter. These provisions will be rewritten together with other provisions dealing, respectively, with rates of tax and administrative matters.
2483. Personal representatives are taxable only at the basic rate, lower rate or the dividend ordinary rate (Schedule F ordinary rate in the source legislation) on any income they receive during the administration period. When the income which arises to the personal representatives is paid to the residuary beneficiaries, it is treated as having borne tax at those rates. So this Chapter ensures that beneficiaries liable at the higher rate are chargeable at the higher rate or, as appropriate, the dividend upper rate (Schedule F upper rate in the source legislation), as well as allowing beneficiaries liable at the lower rate, or not liable to income tax, to reclaim some or all of the tax paid by the personal representatives.

**Section 649: Charge to tax on estate income**

2484. This section charges estate income to tax. It is based on sections 695, 696, 698 and 701 of ICTA.
2485. The approach of Part 16 of ICTA is to deem sums to have been paid as income for all tax purposes. In the case of UK estates, the income is not charged under a particular Schedule or Case and it is implicit that tax is charged on those sums. For foreign estates, a charge is imposed under Schedule D Case IV. This section applies to both UK and foreign estates. And it has now been made explicit that the charge to tax applies to all estate income which is treated as arising under the Chapter from a deceased person's estate.
2486. *Subsection (2)* provides a definition of "estate" and "estate income". It provides that the charge under this section applies to all estate income. This includes income from both UK and foreign estates.
2487. *Subsection (3)* ensures that estate income is treated as income for income tax purposes. Without the rules in this Chapter (and Part 16 of ICTA for corporate beneficiaries within the charge to corporation tax), payments by personal representatives to residuary beneficiaries would, in law, be payments of capital.
2488. *Subsection (4)* recognises that an estate may be divided into different parts with different residuary dispositions. Where, for instance, a proportion of an estate is subject to different dispositions from the remainder and each set of dispositions involves there being a residue, each part of the estate should be treated for the purposes of this Chapter as if they were separate estates. While this subsection applies where the testator has property abroad which he or she disposes of by a separate will, it can also apply to dispositions in the same will. For example, a testator could leave a limited interest in half his or her residuary estate to one child and half to the other with the capital comprising each half share to their respective issue. This would be treated, for the purposes of this Chapter, as two separate estates.

**Section 650: Absolute, limited and discretionary interests**

2489. This section defines the three types of interest in the whole or part of the residue of an estate. It is based on sections 698 and 701 of ICTA.
2490. *Subsection (1)* defines an absolute interest in the whole or part of the residue of an estate. *Subsection (1)(a)* refers to the capital being properly payable to the person with the interest if the residue had been ascertained. This simply reflects the fact that the amount of any residue, and the income from it, can only be an estimate until the residue has been ascertained.
2491. *Subsection (2)* defines a limited interest in the whole or part of the residue of an estate. *Subsection (2)(b)* mirrors *subsection (1)(a)* of this section.
2492. *Subsection (3)* defines what is referred to as a "discretionary interest" in the whole or part of the residue of an estate for the purposes of this Chapter. The income has to be properly payable to the person with the discretionary interest "if the residue had been ascertained at the beginning of the administration period". Effectively, this imposes a working assumption that there will be sufficient income from the residue to make the discretionary payments when the residue has been ascertained.
2493. *Subsection (4)* covers the following four situations:
- income/capital properly payable directly to the person with the interest;
  - income/capital properly payable to the person with the interest indirectly through a trustee or other person;

- income/capital properly payable for the benefit of the person with the interest to another person in that person's right, and that income/capital is paid directly to that other person; and
- income/capital properly payable for the benefit of the person with the interest to another person in that person's right, and that income/capital is paid indirectly through a trustee or other person.

2494. An amount is only treated as properly payable to a person if it is "properly payable to the person, or to another in the person's right, for the person's benefit". This makes it clear that, whether the amount is properly payable to the beneficiary or to another in the beneficiary's "right", it must still be payable for the beneficiary's benefit (eg where a payment is made to a person having a power of attorney for a beneficiary). An example of a situation in which this condition is not met is where the residuary beneficiary is in bankruptcy. The income/capital would not be properly payable to the residuary beneficiary but would be payable to the trustee in bankruptcy in his or her right. But any payments would not be made for the benefit of the trustee in bankruptcy as the trustee receives them in a fiduciary capacity.

2495. *Subsection (5)* deals with the situation where personal representatives would have an absolute or limited interest in the residue of another deceased person's estate if a right they have as personal representatives were vested in them for their own benefit. In these circumstances they are treated as having that interest. The term "personal representatives" is defined in section 878(1) of this Act.

2496. *Subsection (6)* makes it clear that for the purposes of subsection (4) it does not matter whether the payment is made directly to the beneficiary by the personal representatives or through a trustee or other person. For example, the payment may be made to the guardian of a child or to whoever is appointed to look after the finances of a mentally incapacitated adult.

### ***Section 651: Meaning of "UK estate" and "foreign estate"***

2497. This section defines "UK estate" and "foreign estate" for the purposes of this Chapter. It is based on sections 699A and 701 of ICTA. The definitions in this section underpin the whole of this Chapter.

2498. *Subsections (2), (3) and (5)* contain the conditions which determine whether an estate is a UK estate for a tax year. A "foreign estate" is an estate which is not a "UK estate" for the tax year.

### ***Section 652: Estate income: absolute interests in residue***

2499. This section sets out the basis on which estate income is treated as arising in a tax year in the case of absolute interests in residue. It is based on section 696 of ICTA.

2500. *Subsections (2) and (3)* set out the relevant conditions. A payment need not be made in the final tax year because the net amount of estate income in that year is always equal to the assumed income entitlement for that year. Under section 696(5) of ICTA, taxing a person with an absolute interest in a residuary estate depends on whether the person receives payments and, in the final year of administration, on a fictional payment under that section. The same effect is achieved in this section by determining the liability by considering the assumed income entitlement in all years. Assumed income entitlement is dealt with in section 665.

### ***Section 653: Meaning of "the administration period" and "the final tax year"***

2501. This section defines "the administration period" and "the final tax year". It is based on sections 695, 701 and 702 of ICTA.

2502. *Subsection (1)* defines “the administration period” for the purposes of this Chapter. The reference to “the period commencing on the death” in section 695(1) of ICTA suggests that the actual time of death could be important in determining whether income arose before or after death. In general, this will not be the case because income such as earnings, rent, interest and dividends does not arise at a particular time of the day. If such income arises on the date of death, it will be deemed to be income passing to the deceased immediately on the commencement of that day.
2503. But the administration period has not been defined in this Act as beginning the day after the date of death. This is because the possibility cannot be excluded that income will arise after the death, but on the same date, as a result of the efforts of the personal representatives and this should properly be regarded as income of the estate.
2504. *Subsection (2)* defines when the administration of the estate is completed for Scotland. A full definition for Scotland is required because the completion of the administration of an estate would otherwise have no meaning under Scottish law (although the definition has been updated by replacing the archaic expression “for behoof of”). In contrast, there are cases under English law which have established that the administration is complete when the residue of the estate is ascertained and is ready for distribution. Case law explains what this means in particular circumstances (see, for example, *R v Special Commissioners ex parte Dr Barnardo’s Homes* (1921), 7 TC 646 HL, *Daw v CIR* (1928), 14 TC 58 HC and *CIR v Sir Aubrey Smith* (1930), 15 TC 661 CA).
2505. *Subsection (3)* defines “the final tax year” to avoid repeating the full meaning throughout the Chapter.

#### ***Section 654: Estate income: limited interests in residue***

2506. This section deals with estate income relating to limited interests. It is based on section 695 of ICTA.
2507. The section sets out the basis on which estate income is treated as arising in a tax year for limited interests in residue. The section reflects the need to deal with tax years before the final tax year. Also, a limited interest might cease on the death of the beneficiary before the final tax year so that situation has to be provided for.

#### ***Section 655: Estate income: discretionary interests in residue***

2508. This section deals with estate income relating to discretionary interests in residue. It is based on section 698 of ICTA.
2509. The section sets out the basis on which estate income is treated as arising in a tax year for discretionary interests in residue. Estate income is treated as arising if a payment is made in the tax year in exercise of the discretion in favour of the person with the discretionary interest.

#### ***Section 656: Income charged: UK estates***

2510. This section sets out the amount charged to tax under section 649 for income from UK estates. It is based on sections 695, 696 and 698 of ICTA.
2511. As there are fundamental differences between the basis of charge for income from UK and foreign estates, the rules for foreign estates have been dealt with in a separate section (section 657).
2512. *Subsection (2)* provides that income from a UK estate is charged on the gross amount of the estate income arising in the tax year. This is the basic amount of the income grossed up at the applicable rate. “Basic amount” is a new term. This avoids confusion with the term “net amount” since it is the “net amount” which is actually charged to tax in the case of a foreign estate (except where section 680 (income treated as bearing income tax) applies).



***Section 657: Income charged: foreign estates***

2513. This section sets out the amount charged to tax under section 649 for income from foreign estates. It is based on sections 65, 68, 695, 696, 698 and 699A of ICTA.
2514. *Subsection (5)* provides that, so far as the income is not within section 680, the charge is on the basic amount of that income. Where the income is within section 680, the charge is on the gross amount of the income calculated in accordance with section 663.

***Section 658: Special rules for foreign income***

2515. This section is based on sections 695, 696 and 698 of ICTA. It indicates that estate income arising outside the United Kingdom may be subject to the special rules for foreign income in Part 8 of this Act.
2516. *Subsection (2)* provides that the special rules in Part 8 of this Act for “relevant foreign income” only apply to foreign estates. This preserves the effect of the source legislation under which those special rules only apply to income charged under Schedule D Cases IV or V. And under the source legislation, only income from foreign estates is charged under Schedule D Case IV.

***Section 659: Person liable***

2517. This section states who is liable for any tax charged under section 649. It is based on sections 695, 696 and 698 of ICTA.
2518. The person who is liable will very much depend on the nature of the interest held by the beneficiary. The various interests are set out in the section together with the person liable for each of those interests.

***Section 660: Basic amount of estate income: absolute interests***

2519. This section explains how to calculate the basic amount of estate income for absolute interests. It is based on section 696 of ICTA.
2520. For years before the final tax year, the basic amount is the total of all sums paid in the tax year in respect of the interest or the person’s assumed income entitlement, whichever is the lower. Surplus payments are excluded because an absolute income beneficiary may receive sums which comprise both capital and income but the section taxes only the income element. For the final tax year, it is the person’s assumed income entitlement for that year which is taxed.
2521. This section removes all the deeming of amounts to have been paid in Part 16 of ICTA. Instead, it looks at either amounts actually paid or the assumed income entitlement. It then catches all previously untaxed income due to the absolute interest holder by taxing the assumed income entitlement in the final year. This avoids the two stage process inherent in section 696(5) of ICTA.
2522. *Subsection (3)* introduces a new rule allowing excess estate deductions in the final tax year to be set off against the basic amount of estate income for that year. See *Change 106* in Annex 1.

***Section 661: Basic amount of estate income: limited interests***

2523. This section explains how to calculate the basic amount of estate income for limited interests. It is based on section 695 of ICTA.
2524. Essentially, the basic amount of estate income is all the sums referred to in section 654 falling within a particular tax year added together. It is impossible for there to be sums within both section 654(3)(c) and (4)(c) in the same tax year.

**Section 662: Basic amount of estate income: discretionary interests**

2525. This section identifies the basic amount of estate income relating to discretionary interests. It is based on sections 695 and 698 of ICTA.

**Section 663: The applicable rate for grossing up basic amounts of estate income**

2526. This section provides for basic amounts of estate income to be grossed up, as appropriate, for the purposes of the income charged sections (section 656 for UK estates and section 657 for foreign estates) by reference to the rate at which tax is borne by the aggregate income of the estate. The aggregate income of the estate is defined in section 664. Section 663 is based on sections 699A and 701 of ICTA

**Section 664: The aggregate income of the estate**

2527. This section explains what is meant by the “aggregate income of the estate” for a tax year. It is an important definition of general application. Essentially, the aggregate income is all the taxable income of the personal representatives plus certain sums which are treated as having borne income tax at particular rates. The section is based on sections 249, 421, 547, 701 and 702 of ICTA.

2528. *Subsection (2)* defines the income and amounts within the aggregate income of the estate. *Subsection (2)(a)* brings in income chargeable to UK income tax. *Subsection (2)(b)* brings in foreign source income.

2529. *Subsection (4)* provides that the amount of income falling within *subsection (2)(b)* takes account of any deductions which would have been available if it had been subject to UK income tax. So *subsection (4)* brings foreign source income into line with UK source income.

2530. *Subsection (5)* provides that two types of income are excluded from the aggregate income of the estate. This subsection excludes income from property devolving on the deceased’s personal representatives otherwise than as assets for payment of the deceased’s debts. The subsection also excludes from the aggregate income of the estate income to which any person may become entitled under a specific disposition. This second exclusion is new to the definition of the aggregate income of the estate although it is similar to section 697(1)(b) of ICTA which deals with amounts which are deductible from the aggregate income in calculating the residuary income of the estate.

2531. It does not seem appropriate for income from specific dispositions or income from contingent interests to be treated as part of the aggregate income of the estate. See *Change 107* in Annex 1.

2532. Section 698(1) of ICTA deals with the position where the deceased person (“A”), whose estate is being administered by personal representatives, had an absolute or limited interest in the residue of the estate of another deceased person (“B”). Section 698(1) of ICTA deems the personal representatives to have the same interest as “A” “notwithstanding that that right is not vested in them for their own benefit”. The substance of this is rewritten in section 650(5). Section 698(1) of ICTA also deems any income in respect of such an interest to be part of the aggregate income of A’s estate. This part of the source legislation is not rewritten because such income will fall within the definition of the aggregate income of the estate anyway, once the personal representatives are deemed to have the interest, because it will be the income of the deceased’s personal representatives as such. It is immaterial for this purpose that that right in relation to the estate of another deceased person “is not vested in them for their own benefit”.

2533. It is not considered necessary to expand on the two types of excluded income mentioned in *subsection (5)* of this section (with the exception of *subsection (6)* of this section) since it will be clear when such income arises. Consequently, section 701(6) and (7) of ICTA are not rewritten.

**Section 665: Assumed income entitlement**

2534. This section explains the new concept of the “assumed income entitlement”. It is based on section 696 of ICTA.
2535. The concept of “assumed income entitlement” has been introduced as a tool for calculating the basic amount of estate income for absolute interests. It is similar to the “aggregated income entitlement” in section 696 of ICTA but applies in a more straightforward way.
2536. *Subsection (1)* sets out the steps to be considered to determine whether a person has an assumed income entitlement for a tax year. The assumed income entitlement is the amount by which the absolute holder’s share of residuary income (after, in the case of UK estates, deduction of tax at the applicable rate) for tax years up to and including the tax year in question exceeds the total of the basic amounts for which he is chargeable for all previous tax years. Thus, for example, if the beneficiary receives his share of the residuary income in each tax year up to the year in question, then the assumed income entitlement is the basic amount of his share of the residuary income for that year.
2537. Step 4 in subsection (1) deals also with situations where a corporate beneficiary liable to income tax was, at some earlier point during the administration period, chargeable to corporation tax. It also deals with other situations where a non-UK resident beneficiary becomes UK resident, when the estate is a foreign estate.

**Section 666: The residuary income of the estate**

2538. This section explains how the residuary income of the estate is calculated. Beneficiaries with absolute interests need to know the residuary income of the estate for a tax year in order to work out their assumed income entitlement. The section is based on section 697 of ICTA.
2539. *Subsection (2)* lists the “allowable estate deductions”. This is a new label for the items which may be deducted from the aggregate income of the estate. Subsection (2)(a) refers to “all interest paid in that year by the personal representatives ...”. Section 697(1)(a) of ICTA refers to “the amount of any annual interest, annuity or other annual payment for that year which is a charge on residue ...”. The requirements that interest must be annual and also a charge on residue have not been reproduced. See *Change 108* in Annex 1.
2540. In practice, the Inland Revenue allow income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate in the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not be deducted from it. See *Change 107* in Annex 1.
2541. Subsection (2)(b) deals with annual payments. Because of the restricted meaning given to annual payments, much of the wide definition in section 701(6) and section 702(d) of ICTA is otiose. Any liabilities which are annual payments will now have to meet only the requirement that they are properly payable out of residue and this is also a requirement of section 701(6) of ICTA. Omitting the remainder of the definition removes unnecessary material. As a consequence of the change, section 701(7) of ICTA, which limits the meaning of “charges on residue” in relation to specific dispositions, does not need to be rewritten either.
2542. The section does not contain an ordering rule for allocating allowable estate deductions against different categories of income. It is not considered appropriate to state explicitly that the taxpayer may choose whichever allocation is most advantageous. This is implicit in the section.

**Section 667: Shares of residuary income of estate**

2543. This section is based on section 696 of ICTA. It explains the rules for determining the share of residuary income treated as arising from a person's absolute interest in the whole or part of the residue of an estate.

**Section 668: Reduction in share of residuary income of estate**

2544. This section provides that the share of the residuary income of the estate of a person with an absolute interest is reduced at the end of the administration period in certain circumstances. It is based on sections 4 and 697 of ICTA.

2545. This is beneficial to a person with an absolute interest because a lower share of the residuary income results in a lower (or no) assumed income entitlement. The section ensures that the beneficiary is not charged to tax on more income than he or she actually enjoys. The reduction may apply where, for example, the debts of the estate exceed the amount ultimately realised from the capital assets available for their payment and so part of the income received from the assets is also used, leaving only part available for the residuary beneficiary.

2546. *Subsection (2) and (3)* provide that if there is an excess within *subsection (1)*, that excess is available to reduce the person's share of the residuary income in the final tax year. If that share is reduced to nil then any remaining excess is available to reduce the share of the residuary income in the previous tax year and so on.

2547. *Subsection (5)* provides that, for the purposes of *subsection (1)(b)*, a sum paid during the administration period is grossed up by reference to the basic rate for the tax year in which it was paid in the case of UK estates. And it provides that a sum payable at the end of the administration period is grossed up by reference to the basic rate for the final tax year in the case of UK estates. Section 4(1) of ICTA provides that any provision requiring, permitting or assuming the deduction of income tax shall be construed as referring to deduction or payment of income tax at the basic rate. This has been made explicit in *subsection (5)* itself.

**Section 669: Reduction in residuary income: inheritance tax on accrued income**

2548. This section deals with the case where an absolute interest holder is a higher rate taxpayer and income accruing before death has been taken into account both in calculating the residuary income and for inheritance tax purposes. The section is based on section 699 of ICTA.

2549. The overlap in the two tax charges may arise where income has accrued before death but is received after death. The section provides for a reduction in the residuary income in such circumstances.

2550. *Subsections (1) and (2)* explain the basic principle. The reduction applies when pre-death income (as defined) is taken into account both in calculating the residuary income of the estate for a tax year and in determining the value of the deceased's estate for inheritance tax purposes.

2551. *Subsection (4)* sets out a method statement for calculating the reduction in three steps. For liabilities to be deductible from pre-death income, they have to have affected both the value of the estate for inheritance tax purposes and the residuary income of the estate for the tax year. In the latter case, they might have been deducted in calculating the aggregate income of the estate or have been deducted from the aggregate income in calculating the residuary income.

2552. *Subsections (7) and (8)* are administrative provisions. They provide that the amount of inheritance tax chargeable and the value of the estate cannot be reopened once agreed or settled in proceedings. The reference to "the Board" in section 699 of ICTA has been

replaced in this section by “the Inland Revenue” which is defined in section 878(1) of this Act. See *Change 149* in Annex 1.

2553. Section 699(6)(b) of ICTA, which provides that references to inheritance tax include references to capital transfer tax, is not rewritten; it is spent.

***Section 670: Applicable rate for determining assumed income entitlement (UK estates)***

2554. This section sets out the calculation of the applicable rate for the purposes of calculating income tax to be deducted from the residuary income in step 2 of section 665(1). The section is based on section 701 of ICTA.

***Section 671: Successive absolute interests***

2555. This section explains the position where two or more absolute interests in the residue of an estate are held successively by different people. It is based on sections 697 and 698 of ICTA.
2556. In each tax year in which a payment is made in respect of an absolute interest, it is necessary to calculate the beneficiary’s assumed income entitlement. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous tax years are taken into account. In order to give a true picture of the assumed income entitlement of someone who has an absolute interest in succession to another person, the position of the previous holder needs to be brought into the calculations. Otherwise, in certain circumstances, an element of the residuary income might escape taxation.
2557. *Subsections (1) and (2)* apply where successively there are different persons with absolute interests in the residue of an estate of a deceased person or in parts of such a residue. They apply primarily for situations where one absolute interest is succeeded by another. This might occur where, for example, an absolute interest holder dies or there is a deed varying the will so that the interest passes for income tax purposes to another beneficiary from the date of the deed etc.
2558. *Subsection (3)* contains an ordering rule to ensure that all determinations under subsection (2) or section 672(2) are made in relation to the person with the earlier interest before the person with the later interest. This subsection has been inserted to make explicit what is already implicit in the source legislation.
2559. *Subsection (4)* provides a special rule where there are two or more absolute interests in the final tax year. It is intended to ensure that it is the last absolute interest which is charged to tax on the assumed income entitlement, which will comprise all the residuary income, in the final year. This is because the last absolute interest holder will receive the capital of the residue (and also all outstanding income in respect of it).
2560. *Subsections (5) and (6)* contain special rules where section 668 (reduction in share of residuary income of estate) applies and there are successive absolute interests. These subsections provide that the calculation under section 668(1)(a) and (b) is to be made by reference to all the absolute interests taken together. Then, after applying the reduction to the last absolute interest under section 668(1) and (2), any remaining excess is applied to the previous absolute interest holders working backwards from the beginning of the last interest. See *Change 109* in Annex 1.

***Section 672: Successive interests: assumed income entitlement of holder of absolute interest following limited interest***

2561. This section (and section 673) explains the position of the absolute interest holder where successive limited and absolute interests in the residue of an estate are held by different people. It is based on section 698 of ICTA.



2562. The section only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death (the position of limited interests which cease on the death of the holder before the final tax year are dealt with in section 654(4)). All sums paid or remaining payable in respect of that interest after the tax year of death are treated as estate income arising in the tax year of death.
2563. Examples of situations, in relation to limited interests, that are covered by the section include:
- the disclaiming of a life interest which accelerates an existing interest under the will; and
  - an interest which is only held until marriage or attaining a certain age.
2564. *Subsections (3) and (4)* contain the two rules introduced by *subsection (2)*. They deal with the limited interest which ceases otherwise than on death. They also explain how such an interest is brought into the calculation of whether the person with the absolute interest has an assumed income entitlement and, if so, its amount. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous years are taken into account.

***Section 673: Successive interests: payments in respect of limited interests followed by absolute interests***

2565. This section covers the position where the absolute interest holder is entitled to receive payments in respect of a preceding limited interest which has ceased otherwise than on death. It is based on section 698(1A) and (1B) of ICTA.
2566. *Subsection (2)* deals with such payments while the absolute interest holder still has the absolute interest. It provides that a payment made to the absolute interest holder in respect of the limited interest is treated as paid in respect of the absolute interest (and not the limited interest). Thus, such payments may form part of the basic amount of estate income in tax years before the final tax year.
2567. *Subsection (3)* deals with the position where the holder's absolute interest has itself ceased (but the administration period continues). The approach here is to treat any such sum paid in these circumstances as a payment in respect of the earlier limited interest. The result is that such payments are treated as estate income under the limited interests provisions. But *subsection (6)* provides that the payments are treated as paid or payable in respect of the absolute interest for the purposes of section 668 (reduction in share of residuary income of estate).
2568. The taxation of successive interests in the residue of an estate is dealt with in section 698(1A) to (2) of ICTA. Section 698(1B) of ICTA deals with the case where there were successive interests in an estate which ceased otherwise than on death and the earliest or one of the earlier interests was a limited interest (see section 698(1A) of ICTA).
2569. Section 698(1B)(a) of ICTA provides that Part 16 of ICTA applies as if all the interests were the same interest ("the deemed single interest"), so that none of them is to be treated as having ceased on being succeeded by any of the others. Section 698(1B)(b) of ICTA then determines who had the deemed single interest. It is either the person in respect of whose interest or previous interest the payment was made (section 698(1B)(b)(i) of ICTA) or a person who has or had an interest and is entitled to receive the payment (section 698(1B)(b)(ii) of ICTA). So a beneficiary who does not give up his or her entitlement to income which is unpaid at the time the interest ceases is taxable on the payment, rather than the person holding the successive interest at the time when the payment is made. However section 698(1B)(b) of ICTA is made subject to section 698(1B)(c) of ICTA. Section 698(1B)(c)(i) of ICTA provides that, so far as a later interest is an absolute interest, it is to be treated as having always existed and the

earlier interest or interests as having never existed for the purposes of the provisions dealing with absolute interests in section 696(3A) to (5A) of ICTA.

2570. In rare circumstances the later absolute interest may itself have ceased at the time the payment is made. For example, A has a limited interest which is succeeded by absolute interests held first by B and then by C, and a payment is received by B in respect of A's earlier limited interest after B's own interest has ceased but before the end of the administration period. As a result of section 698(1B)(b)(ii) of ICTA, Part 16 of ICTA applies to the payment as if B had the deemed single interest. So section 696(3) of ICTA deems the sum to be paid to B as income in the year in which it is actually paid. That is a tax year in which C had the absolute interest. Under section 698(1B)(c)(i) of ICTA for the purposes of section 696(3A) to (5) of ICTA, Part 16 of ICTA is to apply as if the later interest of C had always existed and the earlier interests had never existed. Section 698(1B)(c)(ii) and (iii) of ICTA then provides that sums paid as income in respect of the earlier interests are deemed to be sums paid in respect of the later interest of C.
2571. The relationship between these particular provisions, where the later interest has itself ceased at the time the payment is made but the administration period continues, is difficult to work out. It would seem that the payment in the above example should be taxed on B because of section 696(3) of ICTA. The payment is then brought into account when the payments made in respect of C's interest are compared to his aggregated income entitlement (in making the final year calculation under section 696(5) of ICTA in respect of C's interest to determine whether any amount should be treated as having been paid to C immediately before the end of the administration period). So although section 698(1A) and (1B) of ICTA operate in a very convoluted way in the above circumstances, the end result appears to be that B, the person with the absolute interest who receives the payment, is taxed on it, but it does not affect B's aggregated income entitlement.
2572. In order to spell out how a payment made in these circumstances should be treated, section 673(3) and (4) provide that where such a payment is made, this Chapter applies as if the earlier limited interest had continued to subsist while the later absolute interest subsisted and had been held by the holder of the later absolute interest. The result is that payments to that holder are treated as estate income under the provisions about limited interests.
2573. Sums to which that holder is entitled that remain payable at the end of the administration period are treated in the same way. They will be basic amounts arising from the limited interest in the tax year in which the absolute interest ceases and are dealt with by sections 654 and 661. The effect of this on later absolute interests is then determined by the successive absolute interests provisions in section 671. Under subsection (6) of section 673, however, these sums are to be treated as paid or payable in respect of the absolute interest for the purposes of the provisions about the reduction in shares of residuary income under section 668.

#### ***Section 674: Successive interests: holders of limited interests***

2574. This section explains the position of a limited interest holder where successive interests in the residue of an estate are held by different people and the earlier, or if there are more than two, the earliest of the interests is a limited interest. It is based on sections 695 and 698 of ICTA.
2575. The section only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death.
2576. *Subsections (3) to (5)* cover three sets of circumstances described as "cases" where the estate income in respect of successive limited interests is treated as arising. The cases are the equivalent for successive limited interests of the three cases for single limited interests in section 654. But the section recognises that there may be more than

one limited interest in the chain of succession, so references are made to “one of the interests” and subsection (5) refers to “the last of the successive interests”.

2577. There is also an additional sub-paragraph in each case providing that a limited holder (as defined) is entitled to receive the payment. This reflects the fact that the person who receives the payment in these circumstances is not always the person in respect of whose interest the payment is made. For example, on disclaiming a life interest, a beneficiary may also disclaim any entitlement to income accrued in respect of that interest but not yet paid.
2578. The section does not make it explicit that a new chain of succession begins with the first limited interest (and a previous absolute interest is ignored) for the purposes of this provision. Nor does the section make it explicit that two limited interests which are preceded by a limited interest which ceased on the death of the beneficiary are covered by the section. These conclusions are implicit in the section.

### ***Section 675: Basic amount of estate income: successive limited interests***

2579. This section explains how to calculate the net amount of estate income for successive limited interests. It is based on sections 695 and 698 of ICTA.
2580. The section is the equivalent provision to section 661 for limited interests that are not successive. Essentially, the basic amount of estate income is all the sums referred to in section 674 falling within a particular tax year added together. It is impossible for there to be sums within both section 674(4)(c) and (5)(c) in the same tax year.

### ***Section 676: Apportionments***

2581. This section applies where successive interests apply to only part of the residue. In other words, the residuary estate is divided up and one or more of the successive interests provisions apply to a part or parts of that estate. It also applies where one of the interests covers the whole estate and the other interest covers part of it.
2582. In such circumstances, it is possible that a subsequent interest does not cover exactly the same part of the residuary estate as the interest which preceded it. For example, a limited interest holder may give up half his or her interest, thus accelerating the interest of the absolute interest holder. Only half the share of the residuary income and half the net amounts of the limited interest holder would be needed for the calculation of whether the absolute interest holder has an assumed income entitlement in accordance with section 672(2). The section provides for just and reasonable apportionments to be made in these circumstances.
2583. The section is new. See *Change 110* in Annex 1.

### ***Section 677: Relief where UK income tax borne by foreign estate: absolute interests***

2584. This section provides for relief if income, which has borne UK tax, arises to a person with an absolute interest in the residue of a foreign estate. It is based on section 696 of ICTA. The relief has been expressed as a formula to make it easier to compute.
2585. *Subsection (2)* contains the formula for calculating the relief where a claim is made. The labels in section 696(7)(a) and (b) of ICTA – “the deemed income” and “the aggregate income” respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.

### ***Section 678: Relief where UK income tax borne by foreign estate: limited and discretionary interests***

2586. This section provides for relief if income, which has borne UK tax, arises to a person with a limited or discretionary interest in the residue of a foreign estate. The section is

based on sections 695 and 698 of ICTA. The relief has been expressed as a formula to make it easier to compute.

2587. *Subsection (2)* provides for a reduction to be made from the tax charged on the person following a claim for relief. The tax is to be reduced by an amount equal to the appropriate fraction of that tax. The fraction here (based on section 695(5) of ICTA) is slightly different to the fraction used for absolute interests (based on section 696(7) of ICTA). The labels in section 695(5)(a) and (b) of ICTA – “the deemed income” and “the aggregate income” respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.
2588. Section 695(6) of ICTA is not rewritten. The meaning of this provision, which was introduced when surtax was still charged, is now obscure and it is difficult to see how it could operate in the context of Self Assessment. See *Change 111* in Annex 1.

### ***Section 679: Income from which basic amounts are treated as paid***

2589. This section sets out the rules for determining from which part of the aggregate income of the estate a basic amount is treated as paid. It is based on sections 699A and 701 of ICTA.
2590. Personal representatives may receive such income from a number of sources. And different rates of tax apply to different types of income. Some of the income is taxed in the hands of the personal representatives at “the applicable rate” (the basic rate, the lower rate or the dividend ordinary rate; see section 680).
2591. The basic amounts of estate income do not always correlate precisely with the income received by the personal representatives. It is therefore necessary to attribute payments out of the residuary estate in the form of basic amounts to particular types of income received by the personal representatives.
2592. *Subsections (4) to (6)* deal with situations where some of the aggregate income of the estate is income treated under section 680 as bearing tax. In such circumstances, a third assumption is introduced. That third assumption is to be applied before the two assumptions referred to in *subsections (2) and (3)*.

### ***Section 680: Income treated as bearing income tax***

2593. This section deals with income which is treated as bearing income tax. It is based on section 699A of ICTA.
2594. For certain types of income (for example, stock dividend income) the amounts treated as received by individuals are gross amounts on which they are treated as having paid tax at the dividend ordinary rate (the Schedule F ordinary rate in the source legislation) or the lower rate (as appropriate). They may then be chargeable to tax at the dividend upper rate or the higher rate on that income. Where such income forms part of the aggregate income of the estate (as a result of section 664(2)), this section treats the income as having borne tax at either the dividend ordinary rate or the lower rate (as appropriate) for certain provisions within the Chapter.
2595. *Subsection (1)* sets out the provisions within the Chapter affected by the section. The provisions in question all affect the aggregate income of the estate (see section 664).
2596. *Subsection (5)* provides that no repayment shall be made of any income tax which is treated as having been borne under section 656(3) or section 657(4) so far as the basic amount comes from sums within this section.
2597. Section 699A(1)(b) of ICTA is not rewritten in this Act. This provision provides that the sums to which section 699A(1)(a) of ICTA applies must be sums in respect of which the personal representatives are not directly assessable to UK income tax. Of the income referred to in section 699A(1)(a) of ICTA to which section 699A(1)(b) of ICTA applies,

none appears to be directly assessable. So section 699A(1)(b) of ICTA serves no useful purpose.

2598. Section 699A(6) of ICTA is not rewritten in this Act. It deals with deduction of tax at source and will be rewritten together with the rewrite of sections 348 and 349 of ICTA. The purpose it achieves is served by the new subsection (4)(e) in the consequential amendment to section 348 of ICTA.

### ***Section 681: Transfers of assets etc. treated as payments***

2599. This section is concerned with the appropriation of assets by personal representatives to themselves, any other transfer of assets and the set off or release of a debt. The section is based on section 701 of ICTA.
2600. *Subsections (1) and (2)* provide that the relevant events are treated as payments when they occur.
2601. *Subsections (3) and (4)* provide that where the relevant events have not happened by the end of the administration period, amounts equal to the value of the assets or debt are treated as payable.

### ***Section 682: Assessments, adjustments and claims after the administration period***

2602. This section deals with adjustments after the end of the administration period. It is based on section 700 of ICTA.
2603. *Subsections (1) and (3)* deals with adjustments where the person previously appeared to be chargeable to either a greater or lesser amount.
2604. *Subsections (2) and (4)* make provision for all necessary adjustments and repayments to be made (and where a person has been allowed too much relief, for tax to be charged). They also make provision for the person to be assessed and taxed (and where, for example, the beneficiary is a charity, for relief or additional relief to be allowed).

## ***Chapter 7: Annual payments not otherwise charged***

### **Overview**

2605. The Chapter rewrites the part of section 18(3) Schedule D Case III (a) of ICTA which deals with annual payments and the parts of Schedule D Cases IV and V which deal with foreign annual payments.
2606. Under section 18(3) of ICTA there are no individual charges on income from different types of source within the Schedule D Case IV or V charge. The system of identifying and classifying income by Schedule and Case is replaced by individual charges on types of income, which previously would have fallen under a general Schedular/Case charge. In the context of income which would have previously been charged under Case IV or V, as appropriate, the charge is being fully integrated with the equivalent income arising from a UK source.
2607. This Chapter sets out the charge to income tax on any annual payments that are not charged to tax by any other provision of this Act or any other legislation. Annuity payments made under purchased life annuities and distributions from unauthorised unit trusts (which in the source legislation are treated as annual payments) are generally regarded as investment income. So the charge to tax for this income is in Part 4 of this Act. Royalties which are annual payments are generally regarded as income from intellectual property and are therefore taxed alongside other intellectual property income under Chapter 2 of Part 5 of this Act. Annual payments derived from telecommunication rights are also taxed under a separate Chapter, Chapter 4 of Part 5 of this Act. So, as the annual payments charge in Chapter 7 of Part 5 of this Act takes effect



*These notes refer to the Income Tax (Trading and Other Income)  
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

only if an amount is not otherwise charged to income tax, there is no overlap between the charge under this Chapter and the ex-Case III charges elsewhere in this Act.

2608. The charge to tax is in the penultimate Chapter of Part 5 of this Act to emphasise that it is a residual charge.
2609. The exemptions from the charge to income tax on annual payments are in Part 6 of this Act.
2610. The phrase “annual payment” is retained but not defined. The phrase is not defined in the source legislation. Instead it derives its meaning from an extensive body of case law. That case law illustrates that the phrase has a meaning for tax purposes far different from its natural one. Replacing that phrase risks breaking the link to case law without making the law any clearer or easier to understand. Because of the volume and complexity of the case law, defining “annual payment” comprehensively in this Act is impracticable and also risks changing the law.
2611. But it is possible to derive from the case law the main characteristics of an annual payment.
2612. For example, Jenkins L.J., in *Commissioners of Inland Revenue v Whitworth Park Coal Company* (1959), 38 TC 531 HL (at pages 548 to 550) regarded the following propositions as established:
- (i) “To come within the Rule as an “other annual payment” the payment in question must be *eiusdem generis* with the specific instances given in the shape of interest of money and annuities (*Hill v Gregory* 6 TC 39; *Earl Howe v Commissioners of Inland Revenue* 7 TC 289)...;
  - (ii) The payment in question must fall to be made under some binding legal obligation as distinct from a being a mere voluntary payment (*Smith v Smith* 1923)...;
  - (iii) The fact that the obligation to pay is imposed by an Order of the Court and does not arise by virtue of a contract does not exclude the payment from Rule 1(a) of Case III (*Smith v Smith* 1923; *CIR v Corporation of London (as Conservators of Epping Forest)* 34 TC 293) ...;
  - (iv) The payment in question must possess the essential quality of recurrence implied by the description “annual” (*Smith v Smith* 1923) ...;
  - (v) The payment in question must be in the nature of a “pure income” profit in the hands of the recipient (*Earl Howe v CIR* 7 TC 289).
2613. The value of the first proposition is not without doubt. Not only has Parliament changed the genus from that considered in *Hill v Gregory* and *Earl Howe*, but the Court of Appeal in *R - v - Special Commissioners of Income Tax ex parte Shaftesbury Homes and Arethusa Training Ship* (1922), 8 TC 367 CA, in construing “any yearly interest or other annual payment” held that the expression “other annual payment” could not be construed *eiusdem generis* with the expression “any yearly interest”.

***Section 683: Charge to tax on annual payments not otherwise charged***

2614. This section is based on section 18(1) and (3) (Schedule D Case III (a) and Cases IV and V) of ICTA. *Subsection (1)* charges residual annual payments to tax.
2615. The charge to tax in the source legislation is in respect of “any annuity or other annual payment”. The reference to “any annuity or other” is omitted because most annuities are not charged to tax under Chapter 7 of Part 5 of this Act but under Part 4 of this Act or ITEPA. Including a reference to annuities might therefore be misleading.

*These notes refer to the Income Tax (Trading and Other Income)  
Act 2005 (c.5) which received Royal Assent on 24 March 2005*

2616. Likewise the examples of annual payments in Schedule D Case III (a) are omitted on the basis that including these risks misleading the reader either by excluding a right which may give rise to an annual payment or by including rights which may not.
2617. The words “whether such payment is payable within or out of the United Kingdom” in Schedule D Case III (a) are also omitted. See the commentary on section 369 of this Act.
2618. The charge to tax in the source legislation excludes “any payment chargeable under Schedule A”. It is not necessary to rewrite this as the priority rules (see section 575 (2)) ensure that property income is taxed under Part 3 of this Act and not under any other Part.
2619. *Subsection (2)* ensures that any exemption from other charges to income tax is not reversed by the charge under this Chapter. It protects an exemption, whether provided by Part 6 of this Act or other legislation.
2620. *Subsection (3)* rewrites “or whether the same is received and payable half-yearly or at any shorter or more distant periods”.

***Section 684: Income charged***

2621. This section sets out the amount charged to tax, which is the full amount of the annual payments (*subsection (1)*). It is based on sections 64 and 65(1) of ICTA.
2622. The words “without any deduction” in section 64 of ICTA are omitted. It is unnecessary to reproduce this phrase because one of the defining characteristics of an annual payment is that the recipient may make no deductions for expenses from it. See also the commentary on section 370 of this Act.
2623. *Subsection (2)* makes subsection (1) subject to the rules in Part 8 of this Act. Part 8 sets out the special rules which apply to foreign income including allowable deductions from foreign income and the remittance basis (see further the commentary on Part 8).
2624. *Subsection (3)* signposts the tax provision in ICTA which deals with the position of a person who receives income from a discretionary trust.

***Section 685: Person liable***

2625. This section states who is liable for any tax charged and is based on section 59(1) of ICTA. The phrase “receiving or entitled to” is retained because it is generally understood and has been widely interpreted by the courts. See further the commentary on section 371 of this Act.

***Section 686: Payments received after deduction of tax***

2626. *Subsection (1)* confirms that if income tax has been deducted by the payer of the annual payment, the recipient is treated as having paid that income tax. It is based on sections 348(1) and 349(1) of ICTA. The gap otherwise filled by case law (see *Allchin v Corporation of South Shields* (1943), 25 TC 445 HL, particularly *Viscount Simon LC* on page 461, *Stokes v Bennett*, (1953) 34 TC 337 HC, and *Grosvenor Place Estates Ltd v Roberts* (1960), 39 TC 433 CA) has been expressly rewritten. See further the commentary on section 426 of this Act.

***Chapter 8: Income not otherwise charged***

**Overview**

2627. This Chapter charges to tax any income that is not charged by any other income tax provision, whether elsewhere in this Act or in any other part of the Tax Acts, including ITEPA. It is based on section 18 of ICTA.

2628. Schedule D is the residual Schedule into which income falls for income tax purposes if neither ITEPA nor another Schedule of ICTA applies to it. Section 18(1)(a) of ICTA charges “annual profits or gains arising or accruing... from any kind of property whatever...”. Section 18(1)(b) of ICTA charges “...other annual profits or gains not charged under Schedule A or under ITEPA 2003 as employment income, pension income or social security income, and not specially exempted from tax”. Schedule F (rewritten in Chapter 3 of Part 4 of this Act) has sole charging rights over the amounts within its scope. Tax is charged under Schedule D Case VI “in respect of annual profits or gains not falling under any other Case of Schedule D and not charged by virtue of Schedule A or by virtue of ITEPA 2003 as employment income, pension income or social security income”.
2629. Case VI is itself the residual Case under Schedule D. Schedule D Case V includes an identical function for “relevant foreign income” (see the definition in section 830) of this Act. The scope of Case V is “tax in respect of income arising from possessions out of the United Kingdom not being employment income, pension income or social security income on which tax is charged under ITEPA 2003”. Case law has established the comprehensive scope of Case V in relation to “income from possessions out of the United Kingdom” (see the commentary on the overview to Part 8 of this Act). So far as any amount is “income from possessions out of the United Kingdom”, Case V is the “last resort” charging provision, not Case VI. And a corollary of that rule is that income charged by Case VI (other than amounts which are directed to be taxed under Case VI) can only derive from a source in the United Kingdom.
2630. So far as is practicable, income charged by the source legislation under Schedule D Cases IV to VI is the subject of separate charges in this Act. See, for example:
- Chapter 4 of Part 4 of this Act, taken from Case V, which deals with dividends from non-UK resident companies;
  - Chapter 3 of Part 5 of this Act, taken from Cases V and VI, which deals with films and sound recordings (non-trade businesses); and
  - Chapter 4 of Part 5 of this Act, partly taken from Cases V and VI, which deals with certain telecommunication rights (non-trading income).
2631. This Chapter brings together the “sweep up” functions of Cases IV to VI. And it contains the charge to tax on two types of income where, in most cases, income will be wholly covered by relief. See section 688(2)(a) and (b).
2632. The charge under this Chapter is restricted to amounts that are “income” on first principles. That is, they are “annual profits or gains” under section 18(1) of ICTA, as that phrase has been interpreted by case law, and are not profits or gains of a capital nature (although some amounts of that nature have been treated as income charged to income tax, whether under a Case of Schedule D or otherwise). This is indicated by the use in section 687(1) of the words “from any source” and by the disapplication of the definition of “income” in section 878(1) of this Act by section 687(4). (For the significance of the reference to “any source”, see the commentary on the overview to Part 8 of this Act on recent judicial remarks on “source”.)
2633. Although some charges to income tax, whether in ICTA or elsewhere in the Tax Acts, are not rewritten in this Act or ITEPA, none of them overlaps with the charge under this Chapter. Nor is there any overlap with any other charges which themselves are limited to income not otherwise chargeable.
2634. Under the source legislation, Case VI losses may be set against Case VI profits or gains (see section 392 of ICTA). Paragraph 168 of Schedule 1 to this Act amends that section so that, in conjunction with section 836B to ICTA (inserted by that Schedule), where a loss arises in circumstances that, had there been income rather than a loss (other than relevant foreign income) the income would have been charged under this Chapter, the same loss relief applies. The only equivalent loss relief for relevant foreign income is

under section 391 of ICTA. But this relief is restricted to losses from a trade, profession or vocation carried on wholly abroad. Any income from such a source would be charged under Part 2 of this Act. Section 391 of ICTA does not, therefore, apply to losses from a source where any income would be charged by this Chapter.

### **Section 687: Charge to tax on income not otherwise charged**

2635. This section is based on section 18 of ICTA. Schedule D Cases IV and V charge tax in respect of *income*, whether from securities or possessions out of the United Kingdom. Schedule D Case VI charges tax in respect of *annual profits or gains*. The scope of all three cases is derived from section 18(1) of ICTA, which refers to “annual profits or gains”. Case law does not indicate a difference, in the context of section 18 of ICTA, in the meaning of “annual profits and gains” and “income”. The choice of term appears to be dictated (although not consistently) by the degree to which a calculation of profit or loss is relevant to the calculation of the income charged.
2636. The section uses *income* rather than (*annual*) *profits or gains*. There is nothing known which is “income” within the usual meaning of the term and therefore caught by this section but which would not be caught under Schedule D Cases V or VI.
2637. *Subsection (2)* ensures that section 683 (charge to tax on annual payments not otherwise charged) has the exclusive right to charge any annual payments not falling within any other charge.
2638. *Subsection (3)* protects an exemption, whether provided by Part 6 of this Act or other legislation.
2639. *Subsection (5)* lists some exemptions which apply particularly to this charge. Other exemptions may (exceptionally) apply: for example, see section 771 of this Act (relevant foreign income of consular officers and employees).

### **Section 688: Income charged**

2640. This section is based on sections 65, 68 and 69 of ICTA. The rules in sections 65(1) and 68(1) of ICTA, for income chargeable under Schedule D Cases IV and V, and under section 69 of ICTA, for income chargeable under Schedule D Case VI, are broadly similar. But there is a difference in terms used (*income* in sections 65 and 68 of ICTA, *profits or gains* in section 69 of ICTA). For the reasons set out in the commentary on the preceding section, that difference has no significance here.
2641. As regards any income within this charge which is relevant foreign income (defined in section 830 of this Act), Part 8 of this Act applies. That Part rewrites the calculation rules in sections 65 and 68 of ICTA, for income charged under Schedule D Cases IV and V, setting out all the material differences between those rules and those in section 69 of ICTA for income charged under Schedule D Case VI. Chapter 4 of Part 8 of this Act contains rules that apply to income arising outside the United Kingdom, whether or not it is relevant foreign income.
2642. See also paragraph 159 of Schedule 2 to this Act. This paragraph provides that such case law guidance as there is on the calculation of income under this and other charges, as regards deductions allowed and not allowed, continues to apply. In respect of income that was formerly within Schedule D Case VI, this ensures that the guidance in, for example, *Curtis Brown Ltd v Jarvis* (1929), 14 TC 744 HC remains applicable. (The effect of that guidance is spelt out in the sections mentioned in that paragraph.)
2643. See also Chapter 2 of Part 10 of this Act for further rules that affect the calculation of income under this section.

### **Section 689: Person liable**

2644. This section is based on section 59 of ICTA.