

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 6: Exempt income

Chapter 8: Other Annual Payments

Overview

2791. This Chapter sets out the exemptions from income tax for income which would otherwise be taxable as annual payments.

Section 727: Certain annual payments by individuals

2792. This section is based on the parts of section 347A of ICTA which exempt from income tax annual payments made by individuals.

2793. See the commentary on Chapter 7 of Part 5 of this Act for an explanation of the phrase “annual payment”.

2794. *Subsection (1)* gives the general exemption: annual payments made by individuals which would otherwise be taxable under Part 5 of this Act are exempt from income tax in the hands of the recipient. Section 347A of ICTA applies to annual payments which would otherwise be within the charge to tax under Schedule D Case III, that is, annual payments arising within the United Kingdom. This requirement is in subsection (1)(b).

2795. *Subsection (3)* is based on section 347A(3) of ICTA and applies the exemption to any payment made by an individual’s personal representative if the exemption would have applied had the individual not died. “Personal representatives” is defined in section 878.

2796. In contrast with an English partnership, a Scottish partnership is a separate legal entity. *Subsection (4)* therefore defines “individual” as including a Scottish partnership so that the taxation treatment of English and Scottish partnerships is the same.

2797. Section 347A of ICTA applies to all payments falling due on or after 6 April 2000 and also to certain payments falling due before that date but on or after 16 March 1988. Although unlikely, it is possible for payments to fall due at a time when section 347A did not apply but to be paid after 6 April 2005. Paragraph 146 of Schedule 2 to this Act contains a transitional provision which determines whether the exemption in section 727 and the exemption in section 730 apply in these circumstances.

Section 728: Commercial payments

2798. This section provides an exception to the exemption in section 727. It is based on section 347A(2)(c) of ICTA and provides that annual payments made for commercial

reasons in connection with the individual's trade, profession or vocation are not exempt from tax in the recipient's hands.

Section 729: Payments for non-taxable consideration

2799. This section also provides an exception to the exemption in section 727. It is based on section 347A(2)(d) of ICTA which provides that a payment to which section 125(1) of ICTA applies is not exempt from income tax.
2800. However, to work out whether this exception to the exemption applies, the reader has to work out whether section 125(1) of ICTA applies and this is not straightforward.
2801. Section 125(1) of ICTA applies to any payment which is an annuity or other annual payment (other than interest) taxable under Schedule D Case III and which is made in return for consideration which is not taxable in the payer's hands. But that section does not apply to:
- (a) payments which (in the recipient's hands) are income within section 660A(8) or (9)(a) of ICTA (certain payments on divorce or separation);
 - (b) payments made to an individual in consideration of the surrender, assignment or release of an interest in settled property to or in favour of a person having a subsequent interest;
 - (c) any annuity granted in the ordinary course of a business of granting annuities; and
 - (d) any annuity charged on an interest in settled property and granted at any time before 30 March 1977 by an individual to a company whose business at that time consisted wholly or mainly in the acquisition of interests in settled property or which was at that time carrying on life assurance business in the United Kingdom.
2802. In other words, if the payment falls within paragraphs (a) to (d), it will not fall within section 125(1) of ICTA and the payment therefore falls within the exemption.
2803. **Section 729** rewrites section 347A(2)(d) of ICTA by incorporating the relevant propositions of section 125(1) of ICTA rather than cross-referencing to that section and leaving the reader to work out if it applies. So, if the payment is made for non-taxable consideration (as defined in *subsection (2)*), the payment is exempt in the recipient's hands if either condition B or condition C is met. *Subsection (3)* is based on section 125(3)(a) of ICTA and *subsection (4)* is based on section 125(3)(b) of ICTA.
2804. Section 125(3)(c) of ICTA is not rewritten as an individual would not be authorised to grant annuities in the ordinary course of a business of granting annuities (and if an individual could do so, such a payment would fall within section 728).
2805. Subsections (3)(d) and (5) of section 125 of ICTA are not rewritten in section 729 but have been included in the transitionals Schedule (see paragraph 147 of Schedule 2 to this Act).

Section 730: Foreign maintenance payments

2806. This section is based on section 347A(4) of ICTA and exempts from income tax certain maintenance payments which arise outside the United Kingdom but which would be exempt from income tax if the payments had arisen in the United Kingdom.
2807. *Subsection (2)* explains what is meant by a maintenance payment. Section 347A(4) of ICTA defines a maintenance payment as a periodical payment "(not being an instalment of a lump sum)" and refers to the conditions in section 347B(5)(a) and (b) of ICTA. The words "(not being an instalment of a lump sum)" are not rewritten. The wording of the exemption makes them redundant. Additionally, section 347B(5) of ICTA was repealed by FA 1999 in relation to a payment falling due after 5 April 2000. But the

conditions in *subsection (3)* and *(4)* are rewritten on the basis of the authority in *A-G v Lamplough (1878)*, 3 Ex D 214.

Section 731: Periodical payments of personal injury damages

2808. This section provides an exemption from income tax for periodical payments in respect of damages for personal injury. It is based on sections 329AA and 329AB of ICTA as amended by section 100(2) of the Courts Act 2003.
2809. Section 329AA of ICTA exempts periodical payments awarded under the provisions listed in subsection (6) of that section. However, it was never intended to limit the scope of the exemption to particular provisions. The policy is that all periodical payments in respect of personal injury damages should be exempt. As the policy does not rely on the specific statutory references under which the damages are awarded, the statutory references are not rewritten. See *Change 121* in Annex 1.
2810. By omitting the specific statutory references, and particularly the reference to the Fatal Accidents Act 1976 and the Fatal Accidents (Northern Ireland) Order 1977, it would not be clear on the face of the legislation that references to personal injuries includes death from personal injury. *Subsection (4)* therefore makes this explicit. See *Change 121* in Annex 1.

Section 732: Compensation awards

2811. This section exempts from income tax annuity payments made under an annuity purchased to meet an award made by the Criminal Injuries Compensation Board. It is based on section 329AB of ICTA as amended by the Courts Act 2003.
2812. *Subsection (3)* includes in the definition of the “Criminal Injuries Compensation Scheme” the scheme established for Northern Ireland under the Criminal Injuries (Northern Ireland) Order 2002 *SI 2002/796 (NI 1)*. See *Change 19* in Annex 1.

Section 733: Persons entitled to exemptions for personal injury payments etc.

2813. This section and the next one explain who is entitled to the exemption. It is based on sections 329AA and 329AB of ICTA as amended by the Courts Act 2003.

Section 734: Payments from trusts for injured persons

2814. This section extends the exemption to persons receiving payments from trustees on behalf of an individual entitled to the payments (for example, a child’s parents). It is based in section 329AA(4) of ICTA. See *Change 122* in Annex 1.
2815. For the provisions which exempt interest on damages from income tax see section 751.

Section 735: Health and employment insurance payments

2816. This section provides an exemption from income tax for annual payments made under an insurance policy where certain requirements are met. It is based on section 580A of ICTA.

Section 736: Health and employment risks and benefits

2817. This section explains what constitutes a health or employment risk for the purposes of section 735. It is based on section 580A of ICTA.
2818. *Subsections (1)* and *(2)* define “health risk” and “employment risk” respectively. *Subsection (2)* treats a policy that insures against loss of office as an employment risk while section 580A(3)(b) of ICTA, on which it is based, does not. See *Change 123* in Annex 1.

2819. *Subsection (3)* expands on what is meant by “insurance against a risk”. Benefits under this type of insurance are often not restricted to providing an indemnity against a particular liability. This subsection makes it clear that the exemption is also intended to cover benefits other than indemnities.

Section 737: Period for which payments may be made

2820. This section contains the first of the four conditions referred to in section 735(1)(c) and restricts the period for which benefits may be paid if the exemption is to apply. It must be satisfied by all health or employment insurance policies. The section is based on section 580A of ICTA.
2821. Under *subsections (1)* and *(2)* the policy may only provide for payments to be made during periods of ill-health or unemployment or while the insured’s income is lower than it would otherwise have been. Periods which end in the insured’s death and which immediately follow one of these periods are also included. Subsection *(2)(b)* treats a period throughout which the insured does not hold office as a period in respect of which payments may be made. Section 580A(4)(b) of ICTA, on which it is based, does not. See *Change 123* in Annex 1.

Section 738: Risk of significant loss

2822. This section contains the second of the four conditions referred to in section 735(1)(c) and this condition must be satisfied by all health or employment insurance policies. It is based on section 580A of ICTA.
2823. *Subsections (1)* and *(2)* require that the policy, taking into account investment returns on premiums, should involve the insurer in genuine commercial risk.

Section 739: Conditions to be met by policies also providing other benefits

2824. This section contains the third of the four conditions referred to in section 735(1)(c). It is aimed at preventing abuse of the exemption where an insurance policy covers other risks in addition to ill-health or loss of employment. This section is based on sections 580A and 580B of ICTA.
2825. *Subsections (2)* and *(3)* ensure that where other risks are ensured on the same policy the qualifying risks are not significantly different from what they would be if those other risks were not insured by that policy. Section 580B(2)(c) of ICTA refers to “benefits receivable by or in respect of any person” which reduce other benefits “payable to or in respect of that person”. There does not appear to be any significance in the change from “benefits receivable” to “benefits payable” and this subsection refers to benefits “payable” throughout.

Section 740: Conditions to be met where policies are linked

2826. This section contains the last of the four conditions referred to in section 735(1)(c). It is aimed at preventing abuse of the exemption where a person is insured under more than one policy. The section is based on sections 580A and 580B of ICTA.
2827. *Subsections (2)* and *(3)* ensure that any difference in benefits payable for ill-health or loss of employment which arises simply because benefits under another policy are taken into account may be ignored. The source legislation, in section 580B(3)(d) of ICTA, refers to benefits “receivable by or in respect of any person” which reduce other benefits “payable to or in respect of that person”. There does not appear to be any significance in the change from benefits “receivable” to benefits “payable”. Subsection *(3)* refers to benefits “payable” throughout.
2828. Section 580B(4) of ICTA is not rewritten as it seems unnecessary to state that the terms of a policy include terms fixing the premium or otherwise in respect of insurance against risk.

Section 741: Aggregation of policies where employment ends for health reasons

2829. This section ensures that, where a person leaves employment but continues to receive benefits under a new separate policy derived from a policy entered into for the benefit of one or more employees, the exemption given by this Chapter continues to apply to payments under the new policy. The section is based on section 580A of ICTA.

Section 742: Meaning of “the insured”

2830. This section gives the meaning of “the insured” for this Chapter. It is based on section 580A of ICTA.

2831. Sections 580A and 580B of ICTA refer throughout to “the insured”. During the Standing Committee debate on the Finance Bill which introduced these provisions, it was considered whether the exemption extended to cover insurance policies taken out by parents on behalf of their children. The written answer given by the Financial Secretary to the Treasury was that in such a case the child would be “the insured” to enable the exemption to apply. In practice the exemption has been treated as applying to payments under such policies. In the light of this, sub-paragraph (b) has been added to put the matter beyond doubt. See *Change 124* in Annex 1.

Section 743: Policies for the benefit of others who contribute to premiums

2832. This section provides that where one person takes out a health or employment insurance policy for the benefit of another, that other person may, in certain circumstances, be treated as the insured. It is based on section 580A of ICTA.

2833. Section 580A(7) of ICTA is drafted in terms of the benefits under the policy being apportioned. This section is drafted instead in terms of annual payments in order to be consistent with the other sections dealing with this exemption. This does not alter the effect of the provision.

Section 744: Payments to adopters: England and Wales

2834. This section and the following two sections ensure that certain financial support received by families who adopt are exempt from income tax. The sections are based on section 327A of ICTA which has been split between the different jurisdictions.

2835. [Section 744](#) deals with payments made to adopters (and persons seeking to adopt) in England and Wales. *Paragraph (c)* exempts payments of allowances paid under regulations made under the Adoption Act 1976. The regulations cited in section 327A(1)(c) of ICTA, that is, the Adoption Allowance Regulations 1991, are not rewritten because if the regulations changed before this Act received Royal Assent the citation would be wrong.

Section 745: Payments to adopters: Scotland

2836. This section deals with payments made to adopters (and persons seeking to adopt) in Scotland.

Section 746: Payments to adopters: Northern Ireland

2837. This section deals with payments made to adopters (and persons seeking to adopt) in Northern Ireland.

2838. *Paragraph (c)* exempts payment of allowances under regulations under the Adoption (Northern Ireland) Order 1987. Again, the regulations cited in section 327A(1)(j) of ICTA, that is, the Adoption Allowance Regulations (Northern Ireland) 1996, are not rewritten.

Section 747: Power to amend sections 744 to 746

2839. This section gives the Treasury the power to amend sections 744 to 746 to take account of future changes in the description of financial support payments.

Section 748: Payments by persons liable to pool betting duty

2840. This section is based on section 126(3) of FA 1990 and section 121 of FA 1991. It gives an exemption from income tax for annual payments made by persons liable to pool betting duty provided the conditions mentioned in *subsection (1)* are satisfied (see the commentary on section 162 for the background to this relief).

2841. The exemption applies to payments made in consequence of a reduction in pool betting duty, whenever that reduction is made (see *subsection (2)*). Subsection (2) combines the conditions in FA 1990 and FA 1991. Although the source legislation is restricted to the 1990 and 1991 reductions in pool betting duty, the subsection applies to payments made “in consequence of” any reduction in the duty. See *Change 47* in Annex 1.

2842. *Subsections (3) and (4)* set out two further conditions either of which needs to be satisfied. The subsections do not specify that payments in consequence of the 1990 reduction in pool betting duty must be paid for football safety and comfort (see section 126(3) of FA 1990) or that payments in consequence of the 1991 reduction must be paid to the Foundation for Sport and the Arts (see section 121(3) of FA 1991). Instead each subsection applies to a payment in consequence of any reduction in pool betting duty. See *Change 46* in Annex 1.