

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

EXPLANATORY NOTES – VOLUME 2 (SECTIONS 462 TO 1035)

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Part 9: Special rules about settlements and trustees

Overview

1335. This Part is about special rules that apply to settlements and trustees.

1336. Most income tax rules apply to persons in general, which includes trustees. This Part contains additional rules specific to trustees. Some of these rules apply generally. Others apply more specifically, to particular types of settlement, to certain types of settlement income or to the treatment of income of beneficiaries.

1337. Except for the special position of unauthorised unit trusts, the provisions in this Part do not apply to bare trusts, ie those where the beneficiary is absolutely entitled to both the income and capital.

1338. The provisions in this Part do not apply to personal representatives. Accordingly, the rates at which their income is taxed (the savings, dividend ordinary or basic rates depending on the income concerned) are the rates provided for in Chapter 2 of Part 2.

1339. Rules specific to charitable trusts are in Part 10.

Chapter 1: Introduction

Overview

1340. This Chapter contains an introduction to the Part and some basic definitions.

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1341. There is no attempt to define a settlement or particular types of settlement, although Chapter 2 defines “settled property” and “settlor”.

1342. While it is often useful in practice to categorise a settlement either as an interest in possession settlement (under which the beneficiaries are entitled to the settlement income as it arises) or as an accumulation or discretionary settlement (under which income can be accumulated or paid to beneficiaries at the trustees’ discretion), some settlements are mixed (in that there are both sorts of beneficiary).

1343. The rules in this Part are written so that they apply having regard to the treatment of the income rather than the type of settlement.

Section 462: Overview of Part

1344. This section introduces the Part. It is new.

Section 463: Interpretation of Part

1345. This section provides definitions for the purpose of the Part. It is based on sections 686(6) and 687(4) of ICTA.

Section 464: Scottish trusts

1346. This section concerns beneficiaries of Scottish trusts. It is based on section 118(1) of FA 1993.

1347. For certain income tax purposes, trusts under which the beneficiaries have an equitable right in possession are treated differently to discretionary trusts. Scottish law does not recognise the concept of an equitable right in possession. So this section provides for the law of England and Wales to be applied for the purpose of determining whether beneficiaries under a Scottish trust have an equitable right in possession for income tax purposes.

Chapter 2: General provision about settlements and trustees

Overview

1348. This Chapter provides definitions for income tax purposes that are, as far as possible, aligned with those which apply for the purposes of capital gains tax (see sections 68A to 69 of TCGA). It is based on provisions inserted into ICTA by Schedule 13 to FA 2006.

1349. The definitions in the ICTA provisions apply for the purpose of the Tax Acts and thus extend beyond income tax to provisions of the Corporation Tax Acts. But the extent of their application for the purposes of the Corporation Tax Acts is in fact fairly limited. Accordingly, the ICTA provisions are repealed in favour of a new section 832(2A) in ICTA applying this Chapter for those purposes (see Schedule 1).

Section 465: Overview of Chapter and interpretation

1350. This section introduces the Chapter. *Subsections (1) to (6)* are new. *Subsections (7) and (8)* are based on section 685B(7) and (8) of ICTA.

Section 466: Meaning of “settled property” etc

1351. This section defines “settled property”. It is based on section 685A of ICTA.

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1352. The definition corresponds to that in section 68 of TCGA. It also mirrors the effect of section 60 of TCGA in relation to bare trustees and nominees.

1353. In subsection (3), the expression “under a disability” in section 685A(1) of ICTA has been rewritten as “lacking legal capacity”. This does not change the substance.

Section 467: Meaning of “settlor” etc

1354. This section defines “settlor”. It is based on section 685B of ICTA.

1355. The definition corresponds to that in section 68A of TCGA.

1356. The section introduces a new term “disposable property”, defined in section 468.

1357. *Subsection (6)* is concerned with the case where one person makes or enters into a settlement in accordance with reciprocal arrangements with another person.

1358. As *subsection (8)* makes clear, a wider definition of “settlor” applies to the anti-avoidance provisions in Chapter 5 of Part 5 of ITTOIA.

Section 468: Meaning of “disposable property”

1359. This section defines the new term “disposable property”. It is based on section 685B(5) of ICTA.

1360. The definition covers the same ground as section 62(10) of TCGA.

Section 469: Person ceasing to be a settlor

1361. This section explains when a person ceases to be a settlor for income tax purposes. It is based on section 685B(6) of ICTA.

Section 470: Transfers between settlements

1362. This section and section 471 provide rules for identifying the settlor(s) of property in a settlement where property is transferred from one settlement to another for less than full consideration. The rules are the same as those that apply in section 68B of TCGA.

1363. This section explains when a relevant transfer occurs. It is based on section 685C of ICTA.

Section 471: Identification of settlor following transfer covered by section 470

1364. This section identifies the settlor(s) in circumstances where a transfer of property within section 470 takes place. It is based on section 685C of ICTA.

Section 472: Settlor where property becomes settled because of variation of will etc

1365. This section identifies the settlor in certain cases where a will is varied after a person dies. It is based on section 685D of ICTA.

1366. The rules are the same as those that apply in section 68C of TCGA.

1367. *Subsection (2)* applies when property becomes settled property in consequence of the variation, but would not otherwise have become settled property. In that case a person specified in *subsection (3)* is treated as the settlor.

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1368. In subsection (3), the expression “under a disability” in section 685D(3) of ICTA has been rewritten as “lacking legal capacity”. This does not change the substance.

1369. In *subsection (4)*, the expression “donatio mortis causa” has been retained, in the absence of any simple English expression that adequately summarises its meaning.

Section 473: Deceased person as settlor where variation of will etc

1370. This section deems the deceased person to be the settlor in certain cases where a will is varied after a person dies or that person dies intestate. It is based on section 685D of ICTA.

1371. The rules are the same as those that apply in section 68C of TCGA.

Section 474: Trustees of settlement to be treated as a single and distinct person

1372. This section provides that the trustees of a settlement are collectively regarded as a single person distinct from the persons who are the trustees from time to time. It is based on section 685E(1) and (8) of ICTA.

1373. The rule is the same rule as in section 69 of TCGA.

1374. This rule is of particular significance in relation to the determination of the trustees’ residence for income tax purposes.

Section 475: Residence of trustees

1375. This section sets out rules for determining whether trustees (treated as a single person under section 474) are resident and ordinarily resident in the United Kingdom. It is based on section 685E(2), (3), (4), (6) and (7) of ICTA.

1376. If all the persons who are trustees are UK resident then the single person is UK resident and ordinarily UK resident. If all those persons are non-UK resident then the single person is non-UK resident and not ordinarily UK resident. If the trustees have mixed residence then a tie-breaker applies and the residence of the single person is determined by reference to whether there is a settlor who meets condition C (see *subsection (5)(b)* and section 476).

Section 476: How to work out whether settlor meets condition C

1377. This section applies for the purposes of working out whether a settlor in relation to the settlement meets condition C. It is based on section 685E(4) and (5) of ICTA.

1378. *Subsections (2) and (3)* each provide that a person who is a settlor in relation to a settlement meets condition C if the person was UK resident, ordinarily UK resident or domiciled in the United Kingdom at the time specified in the subsection.

1379. Subsection (2) applies if the settlement arose on the death of the settlor and requires the settlor’s residence and domicile to be determined immediately before the settlor’s death.

1380. Subsection (3) applies in all other cases and requires the settlor’s residence and domicile to be determined at every time when a settlor makes, or is treated as making, the settlement (see, in particular, section 467(3)).

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1381. Subsections (2) and (3) also each provide that a person who meets condition C in relation to a settlement at the time specified in the subsection continues to meet condition C at all subsequent times until the person ceases to be a settlor in relation to the settlement.

1382. Accordingly, the single person mentioned in section 474(1) will be treated as UK resident and ordinarily UK resident for as long as the settlement has mixed residence trustees and there continues to be a settlor who meets condition C in relation to the settlement.

Section 477: Sub-fund elections under Schedule 4ZA to TCGA 1992

1383. This section sets out the income tax position where the trustees of a settlement have made a sub-fund election under Schedule 4ZA to TCGA. It is based on section 685G of ICTA.

1384. The broad effect is that each sub-fund is treated as a separate settlement distinct from the principal settlement and with its own deemed single person trustees.

Section 478: References to settled property etc in regulations

1385. This section provides rules for interpreting terms in regulations. It is based on paragraph 37(1) of Schedule 13 to FA 2006.

Chapter 3: Special rates for trustees' income

Overview

1386. This Chapter provides the main rules about which income is to be charged at either the trust rate or the dividend trust rate.

1387. The main category is "accumulated or discretionary income" which, broadly, is income which is income of trustees under trust law and which is not assessable as income of any beneficiary.

1388. The Chapter also deals with other specific types of receipt to which one or other of the special trust rates apply.

Section 479: Trustees' accumulated or discretionary income to be charged at special rates

1389. This section applies one of two special trust rates to trustees' accumulated or discretionary income. It is based on section 686(1), (1AA), (2) and (5A) of ICTA.

1390. The special rates apply to the trustees even where the receipt will be taxed as the income of the settlor. The settlor will receive credit for the full amount of tax paid by the trustees.

1391. *Subsection (1)* introduces the term "accumulated or discretionary income" which is defined in section 480. The fact that this section does not apply to charitable trusts is given greater prominence than in the source legislation.

1392. *Subsections (2) to (4)* provide that accumulated or discretionary income is charged at either the dividend trust rate or the trust rate instead of the rates that would otherwise apply to that income.

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Section 480: Meaning of “accumulated or discretionary income”

1393. This section defines “accumulated or discretionary income”. It is based on section 686(2), (6ZA), (6ZB) and (6A) of ICTA.

1394. “Accumulated or discretionary income” is a single concept rather than the sum of two separate elements.

1395. *Subsection (2)* is based on section 686(2)(a) of ICTA. This provision spells out the nature and extent of the discretion concerned in more detail than in the source legislation.

1396. Income is not included within “accumulated or discretionary income” simply because trustees have discretion over what expenses to incur or how those expenses are to be charged.

1397. *Subsection (3)(a)* excludes from the meaning of “accumulated or discretionary income” any income to which a beneficiary is entitled as it arises. This is the case where a beneficiary has an interest in possession.

1398. *Subsection (3)(b)* and *subsection (4)* exclude income that arises to certain pension funds, provided that the property giving rise to the income is not held as a member of a property investment LLP (see the definition in section 1004).

1399. *Subsection (3)(c)* and *subsections (5)* and *(6)* exclude income from service charges held on trust by certain bodies.

Section 481: Other amounts to be charged at special rates for trustees

1400. This section applies one of the special trust rates to certain receipts of trustees that are taxed as income. It is based on sections 686 and 686A of ICTA.

1401. The special rates apply to the trustees even where the receipt will be taxed as the income of the settlor. The settlor will receive credit for the full amount of tax paid by the trustees.

1402. *Subsection (1)* sets out the circumstances in which the section applies. The exemption for charitable trusts, which was in section 686A(4)(c) of ICTA before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

1403. *Subsections (2)* to *(4)* apply the trust rate or dividend trust rate to the receipt arising to the trustees instead of the rate that would otherwise apply to that income. The only receipt to which the dividend trust rate applies is Type 1 within section 482.

1404. *Subsection (5)(a)* and *(b)* ensure that receipts are not caught by this section if they are accumulated or discretionary income (and so within section 480) or would be but for the exceptions in section 480(3)(a) or (c). This exemption, which was in section 686A(4)(a) before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

1405. *Subsection (5)(c)* and *subsection (6)* correspond to the exception in section 480(4)(a). That exemption, which was in section 686A(4)(d) before it was amended by FA 2006, has been reinstated. See *Change 85* in Annex 1.

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Section 482: Types of amount to be charged at special rates for trustees

1406. This section lists the types of receipts arising to trustees that are taxed at one of the special trust rates under section 481. It is based on section 686A(2) of ICTA.

1407. Section 686A(2) did not include amounts taxed on trustees under the accrued income scheme and liable at the trust rate by virtue of section 720(5) of ICTA. As it is intended that all amounts that are always liable at the trust rate are treated in the same way, those amounts are included here as Type 2 income. See *Change 86* in Annex 1.

Section 483: Sums paid by personal representatives to trustees

1408. This section concerns the treatment of sums paid by personal representatives to trustees. It is based on section 686(6) of ICTA.

1409. The section applies if personal representatives have received income or other amounts which would have been liable at the special trust rates had they been trustees, and they pay a sum to trustees representing income. In such a case, the sum is treated as income of the trustees and as having borne tax at the rate referred to in section 663(1) of ITTOIA.

1410. Following its substitution by FA 2006, section 686A of ICTA no longer includes the provision that specifically applied this rule to receipts within section 686A. But the reference in section 686(6) of ICTA to income to which section 686 applies includes receipts deemed to be such income as a result of section 686A. Accordingly, it is made explicit that this rule applies to all receipts within this Chapter.

Chapter 4: Trustees' expenses and special rates for trustees

Overview

1411. This Chapter provides for expenses incurred by trustees to reduce the amount of income chargeable at the special trust rates.

1412. Beyond a few basic rules, it is left to trust law to determine what expenses may be taken into account. Generally, it is only expenses incurred in the course of exercising the trustees' duties and powers and solely in managing the trust assets to produce or maintain an income flow which are allowable.

1413. The label "management expenses" has not been used. It does not carry any weight and omitting it avoids giving the impression that all expenses incurred in the course of managing a trust will necessarily be allowable.

Section 484: Trustees' expenses to be set against trustees' trust rate income

1414. This section concerns the trustees' expenses which are to be taken into account in calculating the extent of the income chargeable at the special trust rates. It is based on sections 686(2AA) and 689B(1) of ICTA.

1415. *Subsection (1)* provides that the section applies where the trustees incur allowable expenses. This is in contrast to the source legislation which requires the expenses to have been defrayed. See *Change 87* in Annex 1.

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1416. *Subsection (4)* provides that where allowable expenses are set against income chargeable at the special rates, the income is instead charged at the rate that would normally apply to that type of income.

1417. *Subsection (5)* provides basic rules regarding what constitute allowable expenses.

1418. *Subsection (6)* makes it explicit that expenses are not allowable if they are taken into account (otherwise than under this section) in calculating the trustees' liability for any tax year.

Section 485: Carry forward of unused expenses

1419. This section specifies how expenses are relieved if the amount paid exceeds the income of the year taxable at the special trust rates. It is new.

1420. In essence, if expenses incurred exceed income they are carried forward and allowed as soon as there is sufficient trust rate income. See *Change 87* in Annex 1.

Section 486: How allowable expenses are to be set against trust rate income

1421. This section explains in step terms how allowable expenses are to be set against the trust rate income. It is based on sections 686(2AA) and 689B of ICTA.

1422. The section makes it explicit that it is the grossed up amount of expenses that is set against income charged at the special rates. (The meaning of "grossing up" is given in section 998.) See *Change 88* in Annex 1.

1423. Before the grossing up process, *Step 1* eliminates a proportion of expenses in the case of non-UK resident trustees in receipt of untaxed income (see section 487).

1424. *Steps 2 to 6* require dividend, savings and other income to be considered in turn.

1425. Dividend income not within *subsection (2)* corresponds to foreign income within section 689B(2A) of ICTA.

Section 487: Non-UK resident trustees

1426. This section specifies that a proportion of the allowable expenses of the trustees is ignored if a proportion of their income is not liable to income tax ("untaxed income"). It is based on section 686(2A) and (2B) of ICTA.

Chapter 5: Share incentive plans

Overview

1427. This Chapter is based on sections 686B and 686C of ICTA.

1428. Under a share incentive plan, shares which are not "plan shares" (see paragraph 99(1) of Schedule 2 to ITEPA) are held on accumulation or discretionary trusts. So the trustees' dividend income arising from such shares is potentially chargeable at the dividend trust rate under section 479. But this Chapter provides that such a charge on approved plans does not arise if the shares are awarded to participants in the plan within an "applicable period" (defined in section 489).

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Section 488: Application of section 479 to trustees of approved share incentive plans

1429. This section sets out the circumstances in which section 479 applies to approved share incentive plans. It is based on sections 686B(1), (2) and (6) and 686C(3) of ICTA.

1430. *Subsection (1)* gives the basic condition that the section applies to dividends or other distributions received by the trustees of approved share incentive plans.

1431. *Subsections (2) to (4)* provide that the charge at the dividend trust rate under section 479 arises only if and when the shares are disposed of or the “applicable period” comes to an end without the shares having been awarded to participants in accordance with the plan.

1432. *Subsection (5)* provides that, if shares of the same class are acquired by the trustees at different times, they are treated as awarded shares acquired earlier before shares acquired later.

1433. *Subsection (6)* explains that, for the purposes of this section, shares are also treated as awarded when they are acquired on behalf of a participant as dividend shares.

Section 489: “The applicable period” in relation to shares

1434. This section explains the meaning of “the applicable period”. It is based on sections 686B(3) to (5) and 686C(4) and (5) of ICTA.

1435. *Subsections (2) to (4)* state the basic rule that the applicable period ends at the earliest of:

- five years from the acquisition of the shares;
- two years from the acquisition of the shares if any shares in the company were readily convertible assets at that time; and
- two years from the date that any shares in the company became readily convertible assets.

1436. *Subsections (5) and (6)* provide that the basic rule is varied in a case where the shares were acquired in consequence of a contribution to the plan by the company for which it is allowed a deduction under paragraph 9 of Schedule 4AA to ICTA. In such a case the applicable period ends ten years after the shares were acquired.

Section 490: Interpretation of Chapter

1437. This section makes provision about the interpretation of the Chapter. It is based on sections 686B(7) and 686C(1) and (2) of ICTA.

Chapter 6: Trustees’ first slice of trust rate income

Overview

1438. This Chapter is based on sections 686D and 686E of ICTA.

Section 491: Special rates not to apply to first slice of trustees’ trust rate income

1439. This section provides for the first £1,000 of any trustees’ income that would otherwise be chargeable at one of the special trust rates to be taxed instead at the rate or rates that normally apply to the income. It is based on section 686D of ICTA.

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1440. *Subsections (3) and (4)* set out the steps to be taken in identifying the first slice of income (if it exceeds £1,000) and in determining the rate of tax to apply to income within that slice.

1441. The order is established by reference to the rules regarding ordering of income in section 16. The effect is that, so far as possible, the first slice consists first of income for which the normal rate is the basic rate, then, of income for which the normal rate is the savings rate and finally, of income for which the normal rate is the dividend ordinary rate. The first slice is then taxed at the normal rates appropriate to the types of income of which it consists.

Section 492: Cases where settlor has made more than one settlement

1442. This section reduces the band of income charged at normal rates if a settlor of that settlement has made other settlements. It is based on section 686E of ICTA.

1443. The £1,000 band is divided by the total number of existing settlements made by the settlor, but not so as reduce the band below £200. If there is more than one settlor for the settlement in question then the lowest threshold arrived at by this calculation is used.

Chapter 7: Discretionary payments

Overview

1444. This Chapter concerns the tax treatment of a payment made by trustees to a beneficiary in the exercise of a discretion. It is mainly concerned with the taxation of the trustees, but contains some provisions affecting the beneficiary.

1445. The discretionary payment is treated as a net amount corresponding to a gross amount from which the trustees have deducted income tax at the trust rate.

1446. That gross amount is chargeable to income tax on the beneficiary as an annual payment within Chapter 7 of Part 5 of ITTOIA, and the beneficiary is treated as having paid the income tax deducted. The deduction of income tax at source provisions that normally apply to annual payments are disapplied by section 899(5)(d) and (e) of this Act.

1447. The trustees, who will be charged to tax on the income of the trust at either the dividend trust rate or the trust rate, with the total tax paid going into a “tax pool”, have to account for the tax deemed to have been deducted only to the extent that there is insufficient tax in the tax pool.

Section 493: Discretionary payments by trustees

1448. This section sets out what payments come within this Chapter. It is based on section 687(1) and (5) of ICTA.

1449. *Subsection (1)* provides that an annual payment is within this Chapter if it is made by trustees in the exercise of a discretion (exercised by the trustees or any other person) and provided that condition A or B is met. And it is made explicit that the trustees must be UK resident. See *Change 89* in Annex 1.

1450. Condition A is that the payment is income of the beneficiary for either income tax or corporation tax purposes. “Beneficiary” is used instead of the phrase “person to whom [the

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payment] is made” in section 687(1)(a) of ICTA. The reference to corporation tax provides a link to section 687A of ICTA.

1451. A discretionary payment from an employment-related settlement may be taxed on a beneficiary as employment income. Such a payment is excluded from this section. But the income arising to the trustees out of which the payment is made is taxable at the special trust rates. In such circumstances there is effectively double taxation and the trustees may be able to claim a payment from HMRC. See ESC A68.

1452. Condition B is that the payment is treated as income of a settlor under section 629 of ITTOIA.

Section 494: Grossing up of discretionary payment and payment of income tax

1453. This section provides for the grossing up of discretionary payments and sets out the treatment of the tax deemed to have been deducted. It is based on section 687(2) of ICTA.

1454. *Subsections (1) and (2)* provide for the amount of the actual payment to the beneficiary to be grossed up by reference to the trust rate for the year in which the discretionary payment is made.

1455. The amount by which a payment is grossed up represents income tax. *Subsections (3) and (4)* provide that the beneficiary or the settlor (in a case where the discretionary payment is treated as income of the settlor), is treated as having paid the tax deemed to have been deducted.

Section 495: Statement about deduction of income tax

1456. This section provides for the recipient of the discretionary payment to be able to obtain a statement from the trustees giving details of the payment and tax treated as deducted. It is based on section 352 of ICTA as it applies to payments under section 687 of ICTA.

1457. In a case where the income is treated as that of the settlor, it is the settlor rather than the recipient who will need these details. Accordingly, this section gives authority to the appropriate person to require a statement from the trustees. See *Change 90* in Annex 1.

Section 496: Income tax charged on trustees

1458. This section sets out the tax effect on the trustees of making a discretionary payment. It is based on section 687(2) of ICTA.

1459. The source legislation provides for all the tax deemed to have been deducted to be assessed on the trustees, subject to set-off under section 687(3) of ICTA (the “tax pool”). But the charge under this section is only on the amount of tax by which the amount treated as deducted exceeds the amount of the tax pool for that year. This is similar to the approach adopted in section 424 (gift aid).

Section 497: Calculation of trustees’ tax pool

1460. This section sets out the calculation of the trustees’ tax pool available for a tax year, in order to determine whether a charge on the trustees arises under section 496. It is based on section 687(3) of ICTA.

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1461. To make the comparison in section 496, the amount of the tax pool available for a tax year is the amount at the end of the tax year (including tax going into the pool in that year) before reduction in respect of amounts of tax deemed to have been deducted from payments in the tax year. It follows that the amount of the pool available for the previous year has to be adjusted at *Step 1* for the amount of tax deemed to have been deducted in the previous year in order to arrive at the correct brought forward figure. See also the transitional provision in Part 10 of Schedule 2.

1462. *Subsections (2) and (3)* ensure that tax only goes into the pool if it is tax paid at a time when the trustees were UK resident. This is a corollary to trustees having to account for tax only on discretionary payments made while UK resident, See *Change 89* in Annex 1 and the commentary on section 493. It is also provided that the opening pool is nil if the settlement is established during the year.

Section 498: Types of income tax for the purposes of section 497

1463. This section sets out the types of income the tax on which goes into the tax pool. It is based on section 687(3) and (3A) of ICTA.

1464. The section streamlines many of the references to other provisions made by section 687(3) of ICTA. For example, following the amendments made by ITTOIA, section 687(3)(a2) and (aa) of ICTA are unnecessary because the sections mentioned there are within Chapter 3 of Part 4 of ITTOIA and so are already covered by section 687(3)(a1) of ICTA.

1465. Following its substitution by FA 2006, section 686A of ICTA brings together the charges on items that were previously charged at the trust rate under various separate provisions. This means that there may have been overlap between paragraph (bc) and other paragraphs of section 687(3) of ICTA and uncertainty about the amount of tax to go into the pool. That uncertainty is removed by this section.

Chapter 8: Trustees' expenses and beneficiary's income

Overview

1466. This Chapter is concerned with how trustees' expenses affect the income of a beneficiary. It has no application to discretionary payments by trustees, but relates to circumstances in which a beneficiary (and no-one else) is entitled to the whole of or a share in the income of a settlement. Such a beneficiary is often described as having an interest in possession.

1467. Much of this Chapter is new, as there is very little statutory guidance about how trustees' expenses affect the measure of a beneficiary's income. The principles set out in this Chapter are mainly derived from trust and tax law, but are well understood and have been the subject of guidance issued by HMRC. See *Change 91* in Annex 1.

Section 499: Application of Chapter

1468. This section sets out the circumstances in which the Chapter applies. It is new.

1469. The key factor is that there is a beneficiary who is entitled to some or all of the income of the trust before it is distributed.

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Section 500: Restrictions on use of trustees' expenses to reduce the beneficiary's income

1470. This section sets out restrictions which apply in arriving at the amount of the trustees' expenses which are to be taken into account in measuring a beneficiary's income. It is new.

1471. *Subsection (1)* provides that expenses may be taken into account if they are incurred in the current tax year or an earlier tax year and are chargeable to a beneficiary's income in accordance with the following subsections. The critical issue is not in which year the expense is incurred, but in which year the beneficiary's income is reduced by reference to the expense. See *Change 91* in Annex 1.

1472. *Subsections (2) and (3)* provide that the expenses must either be chargeable to income under a term of the settlement (subject to any overriding law) or, if the deed contains no such term, they must be chargeable to income under trust law (subject to any overriding term of the settlement). See *Change 91* in Annex 1.

1473. *Subsection (4)* makes it explicit that expenses cannot be used to reduce the beneficiary's income if they have been or will be taken into account in calculating the trustees' liability to income tax for any tax year.

Section 501: Non-UK resident beneficiaries

1474. This section performs a similar function to section 487 (which applies to expenses taken into account in taxing *trustees* in receipt of accumulated or discretionary income) in providing that a proportion of expenses is to be disregarded if part of the *beneficiary's* income is untaxed income. It is based on section 689A of ICTA.

Section 502: Meaning of "untaxed income" in section 501

1475. This section defines "untaxed income" for the purposes of section 501. It is based on section 698A(1) and (5) of ICTA.

1476. The definition is the same as that in section 487(4) and (5) with beneficiary substituted for trustees.

Section 503: How beneficiary's income is reduced

1477. This section explains how trustees' expenses are taken into account in measuring a beneficiary's income. It is based on section 689B of ICTA.

1478. Trustees are liable at the normal rates on the income of the trust. The beneficiary receives income net of tax and expenses, but is entitled to the gross income after expenses. So to calculate the true measure of the beneficiary's income, the net income of each type is calculated, expenses are allowed against that income and what is left is grossed up at the normal rate for that type of income.

1479. *Subsections (1) and (2)* provide that, when trustees' expenses are taken into account, they reduce different types of income of the beneficiary in a particular order.

1480. *Subsection (5)* sets out the calculation in step form. See *Change 91* in Annex 1 and the overview commentary on this Chapter.

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Chapter 9: Unauthorised unit trusts

Overview

1481. This Chapter provides rules about unauthorised unit trusts (UUTs).

1482. There are related sections about UUTs in Chapter 13 of Part 15. Those sections provide for the trustees to be treated as making deemed payments representing the gross amount of the income they receive. They also provide for the trustees to be treated as deducting income tax from those payments at the basic rate, and for the collection of that income tax.

Section 504: Treatment of income of unauthorised unit trust

1483. This section sets out the basis of the taxation of the trustees of a UUT. It is based on section 469(1), (2) to (2B) and (9) of ICTA.

1484. The taxable income of the trustees of a UUT is treated as that of the trustees rather than the unit holders (*subsection (2)*).

1485. All income of the trustees is to be charged at the basic rate (*subsection (3)*). The special trust rates do not apply (see *subsection (4)(a)* and section 481(1)(b)).

1486. Accordingly, certain sums that would ordinarily be treated as carrying a tax credit, or where the recipient is treated as having paid income tax, are not so treated if received by UUT trustees (*subsection (4)(b) to (d)*).

1487. *Subsection (5)* provides that annual payments to unit holders do not come within the special discretionary payments regime in section 494. The general provision for trustees to provide statements of tax deducted, in section 352 of ICTA, is rewritten in section 495. But the provisions concerning such statements by UUT trustees are in section 975 in Chapter 19 of Part 15, where they more naturally belong. So section 495 is also excluded by *subsection (5)*.

Section 505: Relief for trustees of unauthorised unit trust

1488. This section gives relief to the trustees of a UUT for the payments to unit holders treated as made under Chapter 13 of Part 15. It is based on sections 348(1) and 835(6) of ICTA.

1489. The relief is given by deduction in calculating net income. This is in line with the approach adopted generally to rewriting the provisions about charges on income. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8.

1490. The relief is limited by reference to two factors:

- the case law enacted in section 450 (see the commentary on that section and *Change 82* in Annex 1); and
- the trustees' modified net income for the tax year.

Section 506: Special rules for trustees affected by section 733 of ICTA

1491. This section is based on section 733(2) of ICTA.

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1492. Sections 731 to 735 of ICTA are anti-avoidance provisions. They are concerned with cases where:

- a person (“the first buyer”) buys securities and subsequently sells them to someone else; and
- the first buyer becomes entitled to receive any interest payable on them.

1493. Section 733(2) of ICTA addresses the case where:

- interest is payable to the UUT trustees as the first buyer;
- that interest, or some part of it, would be exempt, but is not so, because section 733(1) of ICTA cancels the exemption; and
- the trustees of the UUT are treated as making one or more deemed payments in the same tax year as that in which the interest arises.

1494. The source legislation provides that an annual payment is to be treated as “paid out of profits or gains not brought into charge”. It follows that, even though the exemption is cancelled by section 733(1) of ICTA, leaving interest in charge to income tax, the payment must not be treated as paid out of that interest.

1495. This is rewritten so that relief is only given if, and to the extent that, the trustees have “non-affected income” equal to the payment treated as made. Non-affected income is defined as modified net income less affected income. On modified net income, see the commentary on sections 448 and 1025.

1496. Because this is a rule relating to a very specific type of income, it is necessary to apply it before applying section 505(7).

Chapter 10: Heritage maintenance settlements

Overview

1497. A heritage maintenance settlement (an HMS) is a settlement that holds property (“heritage maintenance property”) solely for the maintenance of, or for making provision of public access to, “qualifying property” designated under section 31 of IHTA. And the heritage maintenance property itself must be the subject of a direction under paragraph 1 of Schedule 4 to that Act.

1498. The provisions of this Chapter grant income tax benefits to complement inheritance tax benefits granted under IHTA provisions. So many of the definitions in section 507 cross-refer to IHTA provisions.

1499. “Qualifying property” is defined in paragraph 3(2) of Schedule 4 to IHTA, and includes:

- land of outstanding scenic, historic or scientific interest;
- buildings of such outstanding historical or architectural interest that special steps should be taken to preserve them, and land essential to protect the character and amenities of such buildings; and
- objects historically associated with such buildings.

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1500. An HMS does not usually own the qualifying property itself. Its role is to hold the heritage maintenance property that has been settled for the purpose of maintaining the qualifying property and providing access to it. The IHTA rules specify that the heritage maintenance property must be subject to the terms of the trust for at least six years from the time it goes into the trust.

1501. An HMS may also have subsidiary purposes, such as the maintenance of property held under the trust for maintenance of the qualifying property. During the six-year period the trust must provide that any other application or devolution of income or capital outside these main and subsidiary purposes must be for the benefit of a charity with heritage purposes or a body listed in Schedule 3 to IHTA.

1502. In the absence of the rules in this Chapter, the ordinary income tax rules would apply for charging the settlors of certain settlements under Chapter 5 of Part 5 of ITTOIA. In such cases all income, and certain capital sums paid to the settlor, are charged on the settlor as income. (The nature of an HMS means that any settlor of any HMS will fall within both the definition of settlor in section 467 of this Act and the definition in section 620 of ITTOIA.)

1503. By contrast, sections 508 and 509 make it possible for the trustees of an HMS to elect, for a tax year, that:

- the income not be treated as that of the settlor; and
- any sum applied out of the heritage maintenance property not be treated as the income of an owner or occupier of the qualifying property.

1504. But the trustees may not consider it appropriate to make such an election. In such cases section 510 ensures that, if in a tax year any sum applied for a property maintenance purpose is greater than the trustees' income for that year, the settlor is not charged to tax on the excess.

1505. And, in the absence of an election, section 511 protects the settlor from double taxation if the trustees' income is applied for a property maintenance purpose through a trade carried on by the settlor and would therefore ordinarily be a receipt of that trade. The settlor is only charged under Chapter 5 of Part 5 of ITTOIA, not also on the trading receipt.

1506. The Chapter also charges the trustees to tax in cases where the conditions for property to be qualifying property, or the rules concerning the purposes of the HMS, are breached (sections 512 to 517).

Section 507: Overview of Chapter

1507. This section draws together a number of important definitions. It is based on sections 690, 691(1), 692(1), 693 and 694(1) of ICTA.

1508. "Heritage maintenance property" is defined as property to which a direction (a "heritage direction") under paragraph 1 of Schedule 4 to IHTA has effect. The property here is not the qualifying property mentioned in paragraph 3(2) of Schedule 3 to IHTA, but the property in the trust set up for the maintenance of that qualifying property.

1509. A "heritage maintenance settlement" is defined as a settlement that comprises heritage maintenance property.

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1510. If there is in the settlement some property that is heritage maintenance property and some that is not, the two blocks of property are treated for the purposes of this Chapter, and for three other purposes, as being comprised in separate settlements – the “separate settlements rule”.

1511. The first of those purposes relates to certain trade losses under Chapter 2 of Part 4. The source legislation refers only to sections 380 to 387 of ICTA, thus excluding sections 388 and 389 of that Act (terminal loss relief) from the operation of the rule.

1512. The second purpose of the separate settlements rule relates to sections 686 to 689B of ICTA, now rewritten in Chapters 2 to 8 of this Part.

1513. The third purpose of the separate settlements rule concerns amounts assessed on the settlor of a settlement under Chapter 5 of Part 5 of ITTOIA. The right to make an election under section 508 can therefore only apply to that part of the settlement that comprises heritage maintenance property. And the special rules about capital sums paid to the settlor (see section 633 of ITTOIA) will also apply only to that part.

Section 508: Election by trustees

1514. This section provides that the trustees of an HMS may make an election for this section to have effect for a tax year. It is based on section 691(1), (2) and (4) of ICTA.

1515. The first effect of an election is that income of the HMS is not to be treated as income of the settlor, as it otherwise would be under Chapter 5 of Part 5 of ITTOIA. So such income will be taxed on the trustees and at trust rates.

1516. The second effect is that certain sums applied from the trust are not to be treated as income of the recipients.

1517. *Subsection (4)(a)* is concerned with any person who has an interest in, or occupies, the qualifying property in respect of which the sum is applied. One example is a sum applied in repairing qualifying property when the occupier is an employee not wholly exempted from the benefit of such expenditure by section 315 of ITEPA. Another example is a sum applied in reimbursing an expense of an owner or occupier (other than the settlor, see section 511) who is carrying on a trade in respect of the qualifying property.

1518. *Subsection (4)(b)* is concerned with section 633 of ITTOIA. Under that provision a capital sum paid to the settlor is taxable on the settlor as income. But if the sum is applied for a property maintenance purpose, the effect of the election is that the sum does not form part of the settlor’s income.

1519. The election is to be made to an officer of Revenue and Customs, rather than to the Commissioners for Her Majesty’s Revenue and Customs. See *Change 5* in Annex 1.

1520. Accordingly, parts of section 691(4) of ICTA are no longer necessary and are omitted. The election is one to which Schedule 1A to TMA applies, as it is not made on the trustees’ self-assessment tax return. So paragraph 2(1) of that Schedule is sufficient to ensure that the election is to be made to an officer of Revenue and Customs. And paragraph 2(3) of that Schedule is sufficient to ensure that it “shall be in such form as the Commissioners may require”.

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Section 509: Change of circumstances during a tax year

1521. This section provides for the splitting of a tax year if there is a change of circumstances, eg if a heritage direction takes effect, or ceases to have effect, during the year. It is based on section 691(5) of ICTA.

1522. Without this provision, if a heritage direction were not in force for the full tax year, no election could be made for that year. The effect of the section is to treat each of the parts of the tax year (before and after the change of circumstances) as a separate tax year, in respect of which an election may be made.

1523. For this section to apply it must be the case, in one of the two parts of the tax year, that a heritage direction applies and the HMS income is taxable on the settlor under Chapter 5 of Part 5 of ITTOIA. In the other part of the tax year, either or both of these statements will not be true.

Section 510: Sums applied for property maintenance purposes

1524. This section addresses a particular issue where an election under section 508 has not been made, and so the income for the year is taxable on the settlor. It is based on section 691(3) of ICTA.

1525. The issue is the treatment of any sum applied for a property maintenance purpose that exceeds the income for the year. Such a sum may already have been taxed on the trustees or the settlor in past years, but it may also be subject to a charge to income tax for one or other of the reasons referred to in *subsection (2)*.

1526. This section cancels such a charge to tax on the excess. The result is that all the income of the HMS for the year is taxable on the settlor solely under Chapter 5 of Part 5 of ITTOIA. There is no other charge on any sum in excess of that income to the extent that the excess is applied for a property maintenance purpose.

Section 511: Prevention of double taxation: reimbursement of settlor

1527. This section prevents a double charge to income tax that may arise if the settlor is carrying on a trade. It is based on section 692 of ICTA.

1528. The source legislation (section 692(1) of ICTA) refers to expenditure that “is (or would apart from the reimbursement be) deductible in computing ... profits”. The bracketed words have been omitted from *subsection (1)(c)* because the amount reimbursed is, strictly, income of the business that is ignored in computing profits. It does not cancel the real expenditure, which in principle remains allowable.

Section 512: Charge to tax on some settlements

1529. This section makes provision for a charge to income tax on income arising to the trustees in a number of circumstances. It is based on section 694(1) and (5) of ICTA.

1530. Most of the circumstances involved (cases A to C) involve a breach of the main IHTA conditions.

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1531. But no charge will arise under this section if the settlor has already been charged on the income as trust income: see section 517. This charge can, therefore, only arise if an election under section 508 has been made.

1532. Case D is an anti-avoidance provision to guard against loss of tax if a non-heritage beneficiary with a reversionary interest in property comprised in the HMS sells that interest to another heritage body (H1).

1533. The charge under this Chapter would not ordinarily arise when the property leaves the HMS on reversion, because the recipient is a heritage body or a charity. But the non-heritage person would have effectively obtained money from the heritage property.

1534. So it is provided that if, earlier or at the time, H1 (or any other heritage body) has paid monetary consideration for any interest under the settlement, a charge on the trustees will arise. But if H1 has acquired the interest from another heritage body, there is no charge.

Section 513: Income charged

1535. This section sets out the measure of the income to be charged to tax under section 512. It is based on section 694(2) and (4) of ICTA.

1536. Other than income applied for a property maintenance purpose or for the benefit of a heritage body, the charge is on all the income that has arisen from the time the HMS came into being to the occasion of charge. But if there has been a previous charge to tax under section 512, the period over which income is measured starts from the date of that previous occasion of charge. There is no credit for any other tax charge on any part of the income that has arisen over the relevant period.

Section 514: Persons liable

1537. This section provides that the persons liable for the tax under section 512 are the trustees of the HMS. It is based on section 694(4) of ICTA.

Section 515: Rate of tax

1538. This section sets out the rate at which the income charged under section 512 is to be taxed. It is based on section 694(2A) of ICTA.

1539. That rate of tax is arrived at by subtracting the trust rate from the higher rate of income tax. This applies to income of all types, including dividend income.

1540. In the particular case of dividend income, the provision does not seek to reinstate the effect of charging the settlor instead of the trustee. (Dividend income would generally be charged on an individual at the dividend upper rate, and on the trustees of the HMS at the dividend trust rate. But the difference between these rates is not necessarily the same as that between the rates referred to by this section.)

1541. From the tax year 2004-05 onwards, the trust rate has been aligned with the higher rate. So, at present, there can be no charge under section 512. But the situation could change in the future.

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Section 516: Transfer of property between settlements

1542. This section addresses occasions when heritage maintenance property leaves the HMS and becomes comprised in another settlement either:

- without a charge to inheritance tax arising on the transfer; or
- when the property does not cease to be heritage property on the transfer.

It is based on section 694(6) and (7) of ICTA.

1543. The “default rule” is that inheritance tax is charged when property leaves an HMS (paragraph 8 of Schedule 4 to IHTA).

1544. But no such charge arises if, within 30 days of the property leaving the HMS, it becomes comprised in another HMS. This is because the exemption for transfers into an HMS overrules the charge when the property leaves an HMS (paragraph 9(1) and (2) of Schedule 4 to IHTA). The only exception to this is when the value of the property leaving the first HMS is greater than its value on entering the second. In that case, inheritance tax is charged on the excess (paragraph 9(4) of Schedule 4 to IHTA). But that charge is ignored in considering the effect of this section (see the words in brackets in *subsection (4)(a)*).

1545. In some circumstances, a charge to income tax under section 512 could still arise, there being, for example, no 30-day permitted period in Case B set out in section 512 to match the “permitted period” in the inheritance tax provision.

1546. *Subsection (2)* ensures that no charge to income tax arises at the time of the transfer of the property if the transfer is also exempt for inheritance tax purposes, or if the property transferred remains heritage property throughout. Instead, the amount chargeable to income tax is deferred and added to any income taxable on the trustees of the later HMS if an occasion of charge occurs.

1547. Accordingly, *subsection (3)* determines the period over which the income to be charged is measured, applying the following modifications to the provisions in section 513:

- the date of the last occasion of charge of the earlier HMS (see section 513(2)(a)) is attributed to the later HMS; and
- the date on which the earlier HMS took effect (see section 513(2)(b)) is likewise attributed to the later one.

1548. The result is that any income of any earlier HMS (however many tax-free transfers have occurred) will be charged on the chargeable settlement to the extent that it has not been subject to this charge already.

Section 517: Exemption for income treated as income of settlor

1549. This section excludes from the charge to income tax under section 512 income of the trustees that is treated as income of the settlor. It is based on section 694(3) of ICTA.

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Part 10: Special rules about charitable trusts etc

Overview

1550. This Part contains rules specific to charitable trusts. It is based mainly on sections 505 to 506C of, and Schedule 20 to, ICTA, section 25 of FA 1990 and section 46 of FA 2000.

Section 518: Overview of Part

1551. This section sets out the scope of the Part and provides signposts to rules about the tax treatment of gifts made to charitable trusts, exemptions from charges to tax under ICTA or ITTOIA, and the restrictions on when exemptions can apply. It is new.

1552. The exemptions for various types of income received by charitable trusts are set out following (so far as relevant) the order in which the types of income concerned are set out in ITTOIA. This order is also followed in Part 4 of this Act (loss relief).

1553. The exemptions are effected by saying that the “income is not taken into account in calculating total income”. The expression “no liability to income tax arises” (used in Part 6 of ITTOIA, where it is supported by section 783(1) of that Act) would go too far in relation to the exemptions provided in this Part as it may be necessary to have regard to the income for certain income tax purposes.

Section 519: Meaning of “charitable trust”

1554. This section defines “charitable trust” for the purposes of this Part. It is based on section 506(1) of ICTA.

1555. The effect of splitting the source legislation between income tax and corporation tax is that the income tax rules apply only to charities constituted in the form of trusts. Schedule 1 to this Act accordingly makes appropriate consequential amendments to the rules (eg in ICTA) relating to charitable companies.

1556. The definition of charitable trust does not include anything coming within the definition of “company” in section 832(1) of ICTA, so charities constituted as unincorporated associations and charities incorporated by Royal Charter are excluded from the definition of “charitable trust”.

Section 520: Gifts entitling donor to gift aid relief: income tax treated as paid

1557. This section specifies that charitable trusts receiving gift aid donations from individuals are treated as receiving a grossed up amount, and that the tax treated as deducted from the gift is treated as paid by the charitable trust. It is based on section 25(10) and (12) of FA 1990.

1558. This paves the way for section 521. In particular, it is what enables charitable trusts to recover income tax treated as deducted by individual donors in cases where the gift is chargeable but exempt (which is normally the case). It also means that, in a case where the gift is chargeable and not exempt, that this income tax is available to be set against any liability.

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Section 521: Gifts entitling donor to gift aid relief: income tax liability and exemption

1559. This section sets out the charge to tax that can arise on gift aid payments received by a charitable trust. It is based on section 505(1) of ICTA and section 25(10) and (12) of FA 1990.

1560. This section imposes a freestanding charge to income tax on gift aid payments, unlike the source legislation which operates by treating the gifts as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the gifts for charitable purposes.

Section 522: Gifts of money from companies: income tax liability and exemption

1561. This section sets out the charge to tax that can arise on gifts made by companies to a charitable trust. It is based on section 339(4) of ICTA.

1562. This section imposes a freestanding charge to income tax on gifts, unlike the source legislation which operates by treating the gifts as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the gifts for charitable purposes.

1563. Companies have no obligation to deduct income tax from qualifying donations (as defined in section 339 of ICTA), which are treated as charges on income. This section, like the source legislation, is silent about the consequences of the payment of a gift which is not a qualifying donation by a company to a charitable trust.

Section 523: Payments from other charities: income tax liability and exemption

1564. This section imposes a charge to tax on certain payments made by a charity to a charitable trust, to prevent charities avoiding the operation of the restrictions on exemptions by routing non-charitable expenditure through other charities. It is based on section 505(1) to (2) of ICTA.

1565. This section imposes a freestanding charge to income tax on payments, unlike the source legislation which operates by treating the payments as annual payments. It also sets out the exemption which will normally apply if the charitable trust uses the payments for charitable purposes.

1566. *Subsection (6)* makes it clear that section 494, which is based on section 687 of ICTA and deals with the grossing up of discretionary payments from trusts, takes precedence over this section where applicable.

Section 524: Exemption for profits etc of charitable trades

1567. This section sets out the exemption for trading profits of charitable trusts. It is based on section 505(1) of ICTA.

1568. The exemption applies only if the trade is a charitable trade. This is defined in section 525.

1569. This section makes it clear that adjustment income (arising from a charitable trade) is exempt, in line with practice. Adjustment income is defined by reference to ITTOIA. See *Change 92* in Annex 1.

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1570. This section also makes it clear that post-cessation receipts (arising from what was a charitable trade) are exempt, in line with practice. Post-cessation receipt is defined by reference to ITTOIA. See *Change 92* in Annex 1.

1571. *Change 92* also affects sections 525, 526, 531 and 539.

1572. Exemptions for small-scale trades are dealt with separately in section 526.

Section 525: Meaning of “charitable trade”

1573. This section defines the meaning of “charitable trade” for the purposes of the previous section. It is based on section 505(1) and (1B) of ICTA.

1574. The main rule, in *subsection (1)*, is that the trade must be exercised in the course of carrying out a primary purpose trade of the charitable trust, ie that it must form part of the primary purposes of the trust, as set out in the trust deed or other governing document. Or that the work in connection with the trade must be mainly carried on by beneficiaries of the charitable trust.

1575. The source legislation in section 505(1)(e) of ICTA refers to the trade being carried on “in the United Kingdom or elsewhere”, and section 505(1)(e)(i) refers to it being exercised in the “actual” carrying out of a primary purpose. The words in inverted commas have been omitted as they add nothing.

1576. *Subsection (4)*, about making apportionments where different parts of a trade are treated as separate trades, makes specific mention of adjustment income and post-cessation receipts. See *Change 92* in Annex 1 and the commentary on section 524.

1577. Any apportionments must be “just” as well as “reasonable”, as in the source legislation. See *Change 93* in Annex 1.

Section 526: Exemption for profits etc of small-scale trades

1578. This section provides an exemption for trading income, adjustment income and post-cessation receipts in circumstances where the amount of income which can be exempted under this section and the next is small, and provided the income is applied to the purposes of the charitable trust. It is based on section 46 of FA 2000.

1579. The exemption provided by this section applies only if the income is not otherwise exempt. So profits from primary purpose trading (including related adjustment income and post-cessation receipts) are exempt under section 524, whereas profits from a non-primary purpose trading activity (including related adjustment income and post-cessation receipts) may be exempt under this section.

1580. The section provides a statutory exemption for adjustment income. See *Change 92* in Annex 1 and the commentary on section 524.

1581. The source legislation restricts the exemption to income from trades carried on wholly or partly in the United Kingdom. This restriction has been dropped. See *Change 94* in Annex 1.

1582. The condition about the level of the income is in section 528.

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Section 527: Exemption from charges under provisions to which section 1016 applies

1583. This section provides an exemption for certain miscellaneous income and gains arising to a charitable trust and applied to the purposes of the charitable trust. It is based on section 46 of FA 2000.

1584. The types of miscellaneous income and gains which can come within the terms of this exemption are defined by reference to section 1016. They are broadly those items which were Schedule D Case VI income before the enactment of ITTOIA.

1585. *Subsection (2)* specifies particular types of income and gains which cannot benefit from the exemption.

1586. The exemption provided by this section only applies if the income or gains are not otherwise exempt. So, for example, post-cessation primary purpose trading receipts and interest are exempt under sections 524 and 532 respectively and post-cessation trading receipts from a non-primary purpose trading activity are exempt under section 526. But profits from the disposal of know-how or the sale of patent rights may be exempt under this section.

1587. The condition about the level of the income and gains is in section 528.

Section 528: Condition as to trading and miscellaneous incoming resources

1588. This section sets out the condition about the level of trading and miscellaneous incoming resources that has to be met if the exemptions in sections 526 or 527 are to be available. It is based on section 46 of FA 2000.

1589. The condition operates by reference to the incoming resources associated with the trading activity and miscellaneous transactions whose profits are not exempt under sections 524, 529, 530, 531 or 536. The expression “incoming resources” is used instead of “gross income” because this accounting term is a more direct and accessible way of capturing the meaning of the income labelled “gross income” in the source legislation. There are also related points of clarification. See *Change 94* in Annex 1.

1590. Trading incoming resources and miscellaneous incoming resources are defined in *subsections (2) and (4)* respectively. Incoming resources relating to trading activities are determined for a basis period for a tax year, since the profits (or losses) of the trade are taxable by reference to basis periods. Incoming resources relating to miscellaneous transactions, and to other non-trading items or activities, are determined by reference to tax years.

1591. The requisite limit is given in *subsection (6)*.

1592. Where basis periods or tax years do not correspond to periods of account, incoming resources are to be apportioned on a time basis, or on any other basis that is reasonable in the circumstances. For the purpose of the comparison required in *subsection (6)(a)*, the total incoming resources for a tax year comprise the incoming resources from trading activities for the relevant basis period for the tax year and the incoming resources from all other sources for the tax year.

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Section 529: Exemption for profits from fund-raising events

1593. This section gives statutory effect to ESC C4 as it applies to charitable trusts and provided the profits are applied to the purposes of the charitable trust. It is new.

1594. The ESC deals with fund-raising events arranged by voluntary organisations or charities and applies if the profits are transferred to charities or otherwise applied for charitable purposes. In the context of charitable trusts, any such transfer or application would have to fall within the scope of the overall purposes of the trust.

1595. The fund-raising event has to fall within the exemption from VAT under Group 12 of Schedule 9 to the Value Added Tax Act 1994. That Schedule provides an exemption from VAT for the supply by a charity of goods and services in connection with an event that is organised primarily to raise money for itself or other charities. The Schedule defines “event” and places certain limits on the number of events that a charity can hold in the same location in any given year.

1596. See *Change 95* in Annex 1. This change also affects section 539.

Section 530: Exemption for profits from lotteries

1597. This section provides an exemption for lottery income provided the income is applied to the purposes of the charitable trust. It is based on section 505(1) of ICTA.

Section 531: Exemption for property income etc

1598. This section sets out the exemption from income tax for property income and certain trading income arising from land, provided the income is applied to charitable purposes. It is based on section 505(1) of ICTA.

1599. The exemption applies where income is chargeable to tax under Part 2 of ITTOIA as a result of section 261 of that Act, and provided the income is applied to charitable purposes.

1600. Income chargeable to tax under Part 2 of ITTOIA means profits of a trade, adjustment income and post-cessation receipts. This means that the section includes an exemption for adjustment income, and for post-cessation receipts, in line with practice. See *Change 92* in Annex 1 and the commentary on section 524.

1601. There is no requirement for the trade to be exercised in the course of carrying on a primary purpose of the charitable trust. But *subsection (1)* specifies that the income must be chargeable under Part 2 of ITTOIA, rather than Part 3, as a result of section 261 of that Act.

1602. This makes the effect of the source legislation in section 505(1)(a) of ICTA, as amended by ITTOIA, explicit. There is no other income arising from land and chargeable to tax under Part 2 of ITTOIA which is exempt under that provision.

1603. The exemption also refers to Part 3 of ITTOIA, rather than referring to profits or gains arising in respect of rents or other receipts from an estate, interest or right in or over land, to reflect the fact that such income is charged by ITTOIA as the profits of a property business.

1604. The reference to Part 3 of ITTOIA means that the section provides an exemption from income tax for adjustment income of UK property businesses, provided the income is applied to charitable purposes. See *Change 92* in Annex 1. See also the commentary on section 524.

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1605. The reference to Part 3 of ITTOIA also makes it explicit that the section provides an exemption from income tax for post-cessation receipts of UK property businesses, provided the income is applied to charitable purposes.

1606. *Subsection (2)(b)* requires that the estate, interest or right in or over land is vested in a person in trust for a charitable trust or for charitable purposes. A charitable trust has no legal personality and cannot hold land itself, so the land belonging to a charitable trust must be vested in the names of the trustees, or of another person (eg a nominee for the trustees). Hence the reference to the estate, interest or right being vested in any person.

1607. The exemption applies where the income derives from land vested in trust for a charitable trust or for charitable purposes. But if some of the land is vested in trust for charitable purposes and some vested or held for other purposes (for example, as an investment to generate income for non-charitable purposes) it is necessary to allocate the profits of the single property business between the two parts. This reflects the approach of the exemption in the source legislation that looks to particular interests in land, rather than to one overall property business.

Section 532: Exemption for savings and investment income

1608. This section sets out the various categories of savings and investment income that qualify for exemption from income tax, provided the income is applied to charitable purposes. It is based on section 505(1) of ICTA.

1609. The precise terms of the section draw significantly on the consequential amendments made to section 505 of ICTA by ITTOIA.

1610. In *subsection (1)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

Section 533: Exemption for public revenue dividends

1611. This section provides an exemption for public revenue dividends used for the repair of certain places of worship. It is based on section 505(1) and (1A) of ICTA.

Section 534: Exemption for transactions in deposits

1612. This section provides an exemption for profits arising from transactions in certificates of deposit, and for transactions in deposit rights where there is no certificate but the person entitled to the right can call for the issue of a certificate. It is based on sections 56(3) and 56A(1), (3) and (4) of ICTA.

1613. The Uncertificated Securities (Amendment) (Eligible Debt Securities) Regulations 2003 (SI 2003/1633) provides for “eligible debt securities”, which are securities held in a dematerialised system. A paper certificate cannot be issued in respect of these securities. The statutory instrument assimilates these, in the Tax Acts, to certificates of deposit. This section makes explicit the treatment of these eligible debt securities.

1614. *Subsection (2)* specifies that the exemption applies to the extent that profits or gains are applied to charitable purposes.

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which received Royal Assent on 20 March 2007.
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Section 535: Exemption for offshore income gains

1615. This section provides an exemption for a gain on the disposal of a material interest in a non-qualifying offshore fund, provided the gain is applied to charitable purposes. It is based on section 761(6) of ICTA.

1616. Details of offshore funds can be found in Chapter 5 of Part 17 of ICTA. Section 761(6B) of ICTA is inserted by Schedule 1 to this Act.

Section 536: Exemption for certain miscellaneous income

1617. This section provides an exemption for certain categories of miscellaneous income from income tax, provided the income is applied to charitable purposes. It is based on section 505(1) and (1AA) of ICTA.

1618. The precise terms of the section draw significantly on the consequential amendments made by ITTOIA.

1619. In *subsection (1)(b)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

1620. *Subsection (3)(a) and (b)* specify that royalties and other income from intellectual property and income from relevant telecommunication rights, where such income is not taxable as profits of a trade, are eligible for exemption. This is a change from the source legislation in that such income was only exempt if it came within the definition of annual payments. See *Change 96* in Annex 1.

Section 537: Exemption for income from estates in administration

1621. This section provides an exemption for estate income received by the trustees of a charitable trust provided the income is applied to the purposes of the charitable trust. It is new.

1622. Estate income is income from property held by the personal representatives of the estate of a deceased person on behalf of the beneficiaries of the estate. The personal representatives are liable to income tax on the income. The exemption provided by this section allows the trustees of a charitable trust to recover any income tax suffered by the personal representatives. See *Change 97* in Annex 1.

Section 538: Requirement to make claim

1623. This section provides that in general a claim is necessary for an exemption. It is based on sections 56(3), 505(1) and 761(6) of ICTA, section 46(1) of FA 2000 and section 83(4) of FA 2004.

1624. Claims are made either as required during the tax year, eg to secure repayments of income tax treated as paid in relation to gift aid payments, or in a self-assessment return. The need to make a claim ensures that there is a mechanism for appeals in the event of any dispute about the availability or amount of any exemption.

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1625. The self-assessment procedure means that a charitable trust only needs to complete a tax return, and make the associated claims, if the charitable trust is chargeable to tax or is required to do so by HMRC.

1626. The reference in section 505(1) of ICTA to claims being to the Board of Inland Revenue has been changed. Claims will simply be to an officer of Revenue and Customs. See *Change 5* in Annex 1, which also affects sections 542, 551, 554, 557, 558 and 561. One effect of a claim being made to the Board is that appeals are to the Special Commissioners. This is maintained by means of an amendment to section 46C of TMA.

1627. *Subsection (3)* provides that where an individual makes a direction in a self-assessment return for a tax repayment to be paid as a gift to a charitable trust, the trustees are treated as having made a claim. See section 429 and the commentary on that section.

Section 539: Restrictions on exemptions

1628. This section restricts exemptions where income of a charitable trust is attributed to non-charitable expenditure. It is based on section 505(4) of ICTA.

1629. A number of the exemptions have been extended to treat adjustment income and post-cessation receipts as exempt. As a result the restrictions apply to the extended exemptions. See *Change 92* in Annex 1 and the commentary on section 524.

1630. A statutory exemption has been introduced for profits of fund-raising events. The restrictions apply to this exemption. See *Change 95* in Annex 1 and the commentary on section 529.

1631. A statutory exemption has also been introduced for income from estates in administration. The restrictions apply to this exemption. See *Change 97* in Annex 1 and the commentary on section 537.

Section 540: The non-exempt amount

1632. This section specifies how the non-exempt amount is calculated. It is based on section 505(3) and (4) of ICTA.

1633. The term “attributable income and gains” is defined in *subsection (3)*. This label replaces “relievable income and gains” as defined in section 505(3) of ICTA.

1634. *Subsection (5)* specifies that section 256(4) of TCGA is to be ignored in applying subsection (3)(b). Section 256 of TCGA provides the exemption from capital gains tax for certain gains accruing to a charity. Schedule 1 to this Act amends section 256, adding subsections (3) to (5). Schedule 1 also inserts sections 256A and 256B, to deal with the interaction between income tax and capital gains tax as regards attributing income and gains to the non-exempt amount.

Section 541: Attributing income to the non-exempt amount

1635. This section specifies how income is attributed to the non-exempt amount. It is based on section 505(4) and (7) of ICTA.

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1636. It specifies that the non-exempt amount is to have attributed to it amounts of attributable income or amounts of attributable gains or a combination of both, until it is used up.

Section 542: How income is attributed to the non-exempt amount

1637. This section specifies that the charitable trust can decide the attribution of attributable (exempt) income or chargeable gains to the non-exempt amount, to determine which items of otherwise exempt income or chargeable gains should be treated as taxable. It is based on section 505(7) of ICTA.

1638. Where the restrictions apply, an amount of income (or chargeable gains) equal to the non-exempt amount (of expenditure) must be identified (as calculated in accordance with the previous section) in order to enable the charitable trust to complete its tax return and self-assess its tax liability. This section provides the mechanism for the charitable trust to specify the items or elements of income (such as trading income or investment income) which lose the benefit of exemption.

1639. But if the charitable trust has not provided the attribution within a period of 30 days from the day of a request for a specification of the attribution, an officer of Revenue and Customs can decide the attribution. References to “the Board” have been replaced with “an officer of Revenue and Customs”. See *Change 5* in Annex 1 and the commentary on section 538.

Section 543: Meaning of “non-charitable expenditure”

1640. This section defines “non-charitable expenditure”. It is based on sections 506 and 506A of ICTA.

1641. Section 506(1) of ICTA contains a definition of “charitable expenditure”. But neither expenditure itself nor “non-charitable expenditure” are defined explicitly. This section sets out the definition in some detail, to reflect practice and HMRC guidance. See *Change 98* in Annex 1, which also affects sections 544 and 545.

Section 544: Section 543: supplementary

1642. This section applies relevant material located elsewhere (eg rules for computing trading losses and about basis periods) and provides interpretative material. It is new. See *Change 98* in Annex 1.

Section 545: Section 543(1)(f): meaning of expenditure

1643. This section provides interpretative material about the meaning of “expenditure”. It is new. See *Change 98* in Annex 1.

1644. *Subsection (1)* makes it clear that “expenditure” includes expenditure on the acquisition of capital assets. But expenditure on assets qualifying for capital allowances is taken account of in determining, for example, a trading loss and so is not included in expenditure within section 543(1)(f).

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Section 546: Section 543(1)(f): tax year in which certain expenditure treated as incurred

1645. This section specifies the tax year to which expenditure relating to commitments (whether or not contractual in nature) that have been entered into is to be allocated for the purpose of operating the restrictions. It is based on section 506(2) of ICTA.

1646. This rule has been rewritten in terms which make explicit reference to United Kingdom generally accepted accounting practice. See *Change 99* in Annex 1.

Section 547: Section 543(1)(f): payment to body outside the UK

1647. This section provides interpretative material about payments to a body situated outside the United Kingdom. It is based on section 506(3) of ICTA.

1648. The section makes it clear that the onus is on the trustees of the charitable trust to ensure that any payments to a body outside the United Kingdom are applied for charitable purposes. Otherwise the charitable trust must classify the payments as “non-charitable expenditure”.

Section 548: Section 543(1)(i) and (j): investments and loans

1649. This section provides interpretative material about the making of investments or loans. It is based on section 506(5) of ICTA.

1650. The section makes it clear that it is only the expenditure in the tax year on making new investments and loans, or expenditure to fund net increases in such investments or loans, that is included in the calculation of non-charitable expenditure.

Section 549: Transactions with substantial donors

1651. This section defines “substantial donor transaction” and explains when a person is a substantial donor to a charitable trust. It is based on sections 506A(1) and (2) and 506C(3) of ICTA.

1652. Under *subsection (2)(a)* a person giving £25,000 or more in a period of 12 months will be a substantial donor for up to three consecutive tax years.

1653. Under *subsection (2)(b)* a person giving £100,000 or more in a period of six years will be a substantial donor for up to 13 consecutive tax years.

1654. In either case, *subsection (3)* means that the person is also a substantial donor for the five tax years following the last of those consecutive tax years.

1655. It should be noted that references to a charitable trust include connected charities (see section 556) and that references to a substantial donor include persons connected with the donor (see section 557(1)(a)).

Section 550: Meaning of “relievable gift”

1656. This section includes details of the sources of gifts that are “relievable gifts” for the purposes of the preceding section. It is based on section 506C(1) of ICTA.

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Section 551: Non-charitable expenditure in substantial donor transactions

1657. This section specifies that certain amounts relating to substantial donor transactions are to be treated as non-charitable expenditure. It is based on sections 506A(3) to (5) and 506C(2) and (6) of ICTA.

1658. The source legislation specifies that certain matters are to be determined by the Commissioners for Her Majesty's Revenue and Customs. References to "the Commissioners for Her Majesty's Revenue and Customs" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1, which also affects sections 554 and 557. The source legislation specifies that, on an appeal against an assessment, the Special Commissioners may review a decision of the Commissioners, so section 557 specifies that the Special Commissioners may affirm or replace a decision of an officer.

Section 552: Adjustment if section 551(1) and (2) applied to single transaction

1659. This section makes it clear that there can be no double counting. It is based on section 506C(4) of ICTA.

Section 553: Section 551: certain payments and benefits to be ignored

1660. This section provides that payments or benefits arising from transactions, relating to gift aid donations made by individuals or qualifying donations by companies, are to be ignored if they do not disqualify the donations concerned from relief. It is based on section 506B(7) of ICTA.

Section 554: Transactions: exceptions

1661. This section specifies exceptions to the transactions caught by section 549. It is based on section 505B of ICTA.

1662. In particular, the section carves out of the substantial donor provisions transactions of an ordinary commercial nature.

1663. References to "the Commissioners for Her Majesty's Revenue and Customs" and "the Commissioners" have been replaced with references to "an officer of Revenue and Customs". See *Change 5* in Annex 1 and the commentary on section 551.

Section 555: Donors: exceptions

1664. This section specifies exceptions to the donors caught by section 549. It is based on section 506B(8) and (9) of ICTA.

1665. *Subsection (1)* concerns companies set up by charitable trusts, for example to carry on trading activities as a means of generating funds.

1666. *Subsection (2)* concerns registered social landlords and housing associations, which often share services and accommodation with charities as a means of meeting charitable and non-charitable objectives, through complex group structures.

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Section 556: Connected charities

1667. This section extends, for the purposes of sections 549 to 555, the meaning of “charitable trust” to include charities connected with the charitable trust. It is based on section 506C(5) of ICTA.

Section 557: Substantial donor transactions: supplementary

1668. This section provides interpretative material for sections 549 to 555. It is based on section 506C(7) to (9) of ICTA.

1669. References to “the Commissioners” have been replaced with references to “an officer of Revenue and Customs”. See *Change 5* in Annex 1 and the commentary on section 551.

Section 558: Approved charitable investments

1670. This section sets out which investments, including loans made by way of investment, count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA.

1671. The label “approved charitable investments” replaces the label “qualifying investments” in section 506(4) of ICTA.

1672. Paragraph 2 of Schedule 20 to ICTA specifies investments falling within Schedule 1 to the Trustee Investment Act 1961 (TIA 1961) as approved, with a small exception. For trust law purposes TIA 1961 has been largely superseded by the Trustee Act 2000 (TA 2000). So the detail of investments covered by Schedule 1 to TIA 1961 has been incorporated into the sections in a more succinct and updated form, removing the need to refer to a Schedule to an Act (TIA 1961) that trustees no longer need to refer to for investment purposes. See *Change 100* in Annex 1. This affects this section, section 559 and section 560.

1673. The reference to securities traded on the Unlisted Securities Market has been deleted as obsolete, because the Unlisted Securities Market ceased trading in December 1996.

1674. Investments can qualify as approved charitable investments if, despite not falling into any of the specified types not requiring a claim, a claim is made and it is accepted by HMRC. In order to be accepted, the claimant must show that the investment has been made for the benefit of the charitable trust and has not been made for the avoidance of tax.

1675. Investments include loans made by way of investment. And although not explicitly stated, such a loan would include a loan secured by a mortgage over land.

1676. The source legislation includes a reference in paragraph 7(2) of Schedule 20 to ICTA to an “authorised institution” – which in the context of that paragraph clearly means a “bank”. In fact “authorised institution” was amended to read “bank” in paragraph 7(1) by Schedule 37 to FA 1996, but was not amended in paragraph 7(2). This was an oversight and is corrected here.

1677. In *Type 4*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

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1678. References to “the Board” have been replaced with “an officer of Revenue and Customs”. See *Change 5* in Annex 1.

Section 559: Securities which are approved charitable investments

1679. This section sets out details of which investments in securities count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA and Schedule 1 to TIA 1961.

1680. The detail of investments covered by Schedule 1 to TIA 1961 have been incorporated into these sections in a more succinct and updated form. See *Change 100* in Annex 1 and the commentary on section 558.

Section 560: Conditions to be met for some securities

1681. This section sets out details of certain conditions which some of the securities specified in the previous section have to meet to count as approved charitable investments for the purposes of the rules restricting exemptions. It is based on Schedule 1 to TIA 1961.

1682. The detail of the investments covered by Schedule 1 to TIA 1961 is incorporated into these sections in a more succinct and updated form. See *Change 100* in Annex 1 and the commentary on section 558.

1683. *Subsection (8)* specifies (among other things) that a company acquiring control of another company or other companies is treated as having paid a dividend or dividends paid by the other company or companies. The effect of including this provision (rather than cross-referring to a provision in TIA 1961) is that “control” needs to be defined. Consequently the definition of “control” in section 995 applies for the purposes of this subsection. See *Change 100* in Annex 1.

Section 561: Approved charitable loans

1684. This section sets out which loans (not being made by way of investment) count as approved charitable loans for the purposes of the rules restricting exemptions. It is based on Schedule 20 to ICTA.

1685. The label “approved charitable loans” replaces the label “qualifying loans” in section 506(4) of ICTA.

1686. References to “the Board” have been replaced with references to “an officer of Revenue and Customs”. See *Change 5* in Annex 1.

Section 562: Excess expenditure treated as non-charitable expenditure of earlier years

1687. This section treats “excess expenditure” in a tax year as non-charitable expenditure for earlier tax years. It is based on section 505(3) and (5) of ICTA.

1688. The “excess expenditure” is the amount of the non-charitable expenditure of the year in excess of the available income and gains of the tax year.

1689. The term “available income and gains” is defined in *subsection (4)*. This label replaces “total income and gains” as defined in section 505(3) of ICTA.

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Section 563: Rules for attributing excess expenditure to earlier years

1690. This section specifies the earlier tax years to which the excess expenditure is to be attributed, later years taking priority to earlier ones. It is based on section 505(5) and (6) of ICTA.

1691. The amount of excess expenditure that can be attributed to the year 2005-06 or earlier years cannot exceed the amount that would have been attributed if the change in the method of calculating excess expenditure resulting from section 55 of FA 2006 had not been introduced. See the transitional provision in Part 11 of Schedule 2.

Section 564: Adjustments in consequence of section 562

1692. This section then specifies that any necessary adjustments (eg to tax, interest etc) for earlier years may be made. It is based on section 505(5) of ICTA.

Part 11: Manufactured payments and repos

Overview

1693. This Part contains provisions about sale and repurchase arrangements, stock lending and other transactions in the financial markets giving rise to manufactured payments. It is based on sections 231AA, 231AB, 730A, 730B and 736B to 737E of, and Schedule 23A to, ICTA.

Chapter 1: Introduction

Section 565: Overview of Part

1694. This section gives an overview of the Part. It is new.

1695. The remaining sections of this Chapter explain some important terms which are used in the same sense throughout this Part.

Section 566: Meaning of “UK shares” and “UK securities”

1696. This section defines “UK shares” and “UK securities”. It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

1697. This Part uses the label “UK shares” for income tax purposes instead of the label “United Kingdom equities” given in paragraph 1 of Schedule 23A to ICTA, as the definition includes preference shares. The label “United Kingdom equities” is retained in Schedule 23A for corporation tax purposes.

Section 567: Meaning of “overseas securities” and “overseas dividend”

1698. This section defines “overseas securities” and “overseas dividend”. It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

Section 568: Meaning of “stock lending arrangement”

1699. This section defines “stock lending arrangement”. It is based on sections 231AA and 736B of ICTA and sections 263B and 263C of TCGA.

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Section 569: Meaning of “repo”

1700. This section defines “repo”. It is based on sections 231AA, 231AB, 730A, 730B, 737B and 737E of, and paragraph 1 of Schedule 23A to, ICTA.

Section 570: Meaning of “buying back” securities etc.

1701. This section provides the meaning of the expression “buying back” securities. It is based on sections 730B, 737B and 737E of ICTA.

Section 571: Meaning of “related” agreements

1702. This section explains when agreements are “related”. It is based on sections 730B, 737B and 737E of ICTA.

Chapter 2: Manufactured payments

Overview

1703. This Chapter is concerned with the treatment of manufactured payments, in particular:

- the taxability of manufactured payments in the hands of the recipient (or, if different, the owner);
- tax relief for the payer of manufactured payments; and
- taxes management.

1704. The detailed structure of the Chapter is as follows:

- Section 572 - overview of the Chapter;
- Sections 573 to 577 - manufactured dividends on UK shares;
- Sections 578 to 580 - manufactured interest on UK securities;
- Sections 581 and 582 - manufactured overseas dividends (MODs);
- Sections 583 to 585 - special cases;
- Sections 586 to 588 - general regulation-making powers;
- Sections 589 to 591 - minor definitions which apply to this Chapter.

1705. Manufactured payments will normally arise under stock loan and repo agreements, but they may also occur if there has been a short sale of securities. A short sale is a sale of securities by someone who does not own the securities at the time of selling them, so is required to acquire them at a time between the date of the bargain and the date when the seller has to deliver them to the purchaser. Dealers may sell short for a variety of reasons. For example, dealers may expect the market price of the securities to fall between the time of the sale bargain and the time at which they expect to buy and so may choose to delay acquiring securities.

1706. A consequence of short selling can be that the dealer sells the securities cum-div (with dividend) but buys them ex-div (without dividend – leaving the right to the next dividend with the seller). The dealer pays the buyer a sum as compensation for the dividend that the buyer expected to receive, but did not. This sum is a manufactured payment.

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1707. Many of the detailed rules, especially as regards MODs, are laid down in regulations. The Act does not rewrite any of these regulations.

Section 572: Overview of Chapter

1708. This section provides an overview of the Chapter. It is new.

Section 573: Manufactured dividends on UK shares

1709. This section defines “manufactured dividend” and states how the Income Tax Acts apply in the circumstances set out in the section. It is based on paragraphs 2(1) to (3) and 2A(1) of Schedule 23A to ICTA.

1710. For income tax purposes, *subsection (2)* treats the manufactured dividend in the hands of the recipient (or, if different, the owner of the manufactured dividend) as if it was a real dividend on the UK shares.

1711. *Subsections (1) and (2)* together ensure that if an income tax payer claims title to the manufactured dividend through or under a recipient (such as a nominee), the manufactured dividend is still treated for income tax purposes as if it was a real dividend even if the recipient is not an income tax payer.

1712. *Subsections (3) and (4)* deal with the position of the payer. Subsection (4) is subject to sections 574 and 575 (allowable deductions).

Section 574: Allowable deductions: matching

1713. This section details the special rules on deductibility of manufactured dividends for the payer which are referred to in section 573(4). It is based on paragraphs 2A(1) to (1A) and (4) of Schedule 23A to ICTA.

1714. The effect of the full-out words at the end of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured dividend is deductible as a trading expense, for example, it is not deductible under sections 574 and 575.

1715. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under subsection (2). The amount mentioned in subsection (2) is allowable to the extent that it is matched with a dividend-type receipt or with deemed interest on a repo under *subsection (4)* or (7) respectively.

Section 575: Allowable deductions: restriction on double-counting

1716. This section prevents double relief. It is based on paragraph 2A(1B) of Schedule 23A to ICTA.

Section 576: Manufactured dividends on UK shares: Real Estate Investment Trusts

1717. This section deals with manufactured dividends (manufactured property income dividends or MPIDs) which are representative of dividends (property income dividends or PIDs) paid by Real Estate Investment Trust companies or by principal companies of Real Estate Investment Trust groups. It is based on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

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1718. This section treats the MPID in the hands of the recipient (or, if different, the owner of the MPID) as if it was a real property income dividend. And it ensures that if an income tax payer claims title to the MPID through or under a recipient (such as a nominee), the MPID is still treated for income tax purposes as if it was a real PID even if the recipient is not an income tax payer.

1719. A dividend may be partly but not wholly a PID. *Subsection (2)* therefore provides that the section applies only so far as the manufactured dividend is representative of a PID.

Section 577: Statements about manufactured dividends

1720. This section imposes an obligation on the payer of a manufactured dividend to give the recipient a statement setting out information which may be relevant for tax purposes. It is based on paragraph 2(6) to (8) of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

1721. The application of section 577 will depend on the tax status of the payer of a manufactured dividend, rather than that of the recipient. Under *subsection (1)*, section 577 will apply only if the payer is within the charge to income tax. If the payer is within the charge to corporation tax, corresponding obligations will be imposed by paragraph 2(6) to (8) of Schedule 23A to ICTA or (by virtue of paragraph 2(2) of that Schedule) section 234A of that Act. These provisions are signposted in *subsection (8)*.

1722. *Subsection (2)* disapplies the provisions of this section so far as the manufactured dividend is an MPID. *Subsection (9)* gives a signpost to the power to make regulations concerning statements about MPIDs.

Section 578: Manufactured interest on UK securities

1723. This section deals with the income tax treatment of persons receiving or paying manufactured interest on UK securities. It is based on paragraph 3(1), (2) and (3) of Schedule 23A to ICTA.

1724. *Subsection (1)* defines “manufactured interest” and states when the section applies.

1725. For income tax purposes, *subsection (2)* treats the manufactured interest in the hands of the recipient (or, if different, the owner of the manufactured interest) as if it was a real payment of interest on the UK securities.

1726. Subsections (1) and (2) together ensure that if an income tax payer claims title to the manufactured interest through or under a recipient (such as a nominee), the manufactured interest is still treated for income tax purposes as if it was a real payment of interest even if the recipient is not an income tax payer.

1727. *Subsection (3)* deals with the position of the payer. It is subject to sections 579 and 580 (allowable deductions).

Section 579: Allowable deductions: matching

1728. This section details the special rules on deductibility of manufactured interest for the payer which are referred to in section 578. It is based on paragraph 3(2), (2A) and (10) of Schedule 23A to ICTA.

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1729. The effect of the closing words of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured interest is deductible as a trading expense, for example, it is not deductible under this section.

1730. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under *subsection (2)*. The amount mentioned in *subsection (2)* is allowable to the extent that it is matched with an interest-type receipt, with a taxable amount under Chapter 2 of Part 12 (accrued income profits), or with deemed interest under a repo under *subsection (4)*, *(6)* or *(7)* respectively.

1731. Paragraph 3(2) of Schedule 23A to ICTA, so far as relevant, provides that “the manufactured interest shall be treated, *except in determining whether it is deductible*, as if it were an annual payment”. As explained in the commentary on section 919, this Act does not continue the annual payment pretence and the italicised words have therefore not been rewritten.

1732. *Subsections (6)* and *(10)* include by implication a minor change in the law on accrued income profits; see *Change 101* in Annex 1.

Section 580: Allowable deductions: restriction on double counting

1733. This section prevents double relief. It is based on paragraph 3(2B) of Schedule 23A to ICTA.

Section 581: Manufactured overseas dividends

1734. This section deals with the income tax treatment of MODs in the hands of the recipient (or, if different, the owner). It is based on paragraph 4(1), (2), (3) and (4) of Schedule 23A to ICTA.

1735. *Subsections (1)* and *(3)* together ensure that if an income tax payer claims title to the MOD through or under a recipient (such as a nominee), the MOD is still treated for income tax purposes as if it was a real overseas dividend even if the recipient is not an income tax payer.

1736. *Subsection (6)* identifies the provisions of the Income Tax Acts in relation to which the deeming provisions in *subsections (4)* and *(5)* have effect: namely, those applicable to UK residents or persons carrying on business through a UK branch or agency.

Section 582: Powers about manufactured overseas dividends

1737. This section is concerned with double taxation relief. It is based on paragraph 8(1A) of Schedule 23A to ICTA.

Section 583: Manufactured payments exceeding underlying payments

1738. This section deals with special cases, as do sections 584 and 585. It is based on paragraph 7(1) of Schedule 23A to ICTA.

1739. Unlike sections 573 to 577 (manufactured dividends on UK shares), sections 578 to 580 (manufactured interest on UK securities) and sections 581 and 582 (MODs), sections 583 to 585 are not restricted to a single type of manufactured payment.

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1740. This section overrides sections 573 to 582 (main rules about manufactured payments) and Chapter 9 of Part 15 (deduction of income tax at source: manufactured payments). If it applies, the excess is taken out of the rules about manufactured payments and is treated as a separate fee. This may affect relief for the payer or taxability for the recipient (or, if different, the owner) or both, if the person concerned is an income tax payer; it may also affect the amount of income tax which has to be deducted or accounted for and paid under Chapter 9 of Part 15.

Section 584: Manufactured payments less than underlying payments

1741. This section overrides sections 578 to 582 (main rules about manufactured interest and MODs) and 589(3) (meaning of gross amount of MOD). It is based on paragraph 7 of Schedule 23A to ICTA.

1742. If it applies, the gross amount of the manufactured interest or MOD is adjusted for the purposes of giving income tax relief to the payer.

Section 585: Power to deal with other special cases

1743. This section is a general power to modify the rules about manufactured payments contained in sections 572 to 582 and Chapter 9 of Part 15. It is based on paragraph 8(1) of Schedule 23A to ICTA.

Section 586: Powers about administrative provisions

1744. This section is the first of a group of sections (sections 586 to 588) which are about general regulation-making powers. It is based on paragraph 8(2) to (3) of Schedule 23A to ICTA.

Section 587: Power for manufactured payments to be eligible for relief

1745. This section enables the Treasury to make exceptions to the main rules in this Chapter on the taxability of manufactured payments. More specifically, it enables manufactured payments to be exempt from income tax in the hands of pension funds if the actual dividends or interest which the manufactured payments represent would have been exempt from income tax in their hands. It is based on section 737D of ICTA and not, like the rest of this Chapter, on Schedule 23A to that Act.

Section 588: Regulation-making powers: general

1746. This section is based on paragraph 8(4) of Schedule 23A to ICTA.

Section 589: Meaning of “gross amount”: interest and manufactured overseas dividends

1747. This section defines “gross amount” for the purposes of the rules in this Chapter about interest and manufactured overseas dividends. It is based on paragraphs 3(13), 4(5) and 7(1) of Schedule 23A to ICTA.

Section 590: Meaning of “relevant withholding tax”

1748. This section defines “relevant withholding tax” for the purposes of this Chapter. It is based on paragraph 4(5) and (6) of Schedule 23A to ICTA.

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Section 591: Interpretation of other terms used in Chapter

1749. This section gathers up minor definitions for the purposes of this Chapter. It is based on paragraphs 1(1), 2(1), 3(1), 4(1) and 7(1) of Schedule 23A to ICTA, section 153(2) of FA 2003. and on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

Chapter 3: Tax credits: stock lending arrangements and repos

Overview

1750. This Chapter denies the recipient of a manufactured dividend the benefit of a tax credit on it. It is based on sections 231AA and 231AB of ICTA.

1751. Sections 231AA and 231AB of ICTA are potentially relevant to the shadow ACT regime, and this Act therefore includes consequential amendments which will confine them to corporation tax.

Section 592: No tax credits for borrower under stock lending arrangement

1752. This section prevents the borrower under a stock lending arrangement from claiming a tax credit when that person in economic terms does not retain a dividend on the securities, but passes it on to the lender, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA and section 263B of TCGA.

Section 593: No tax credits for interim holder under repo

1753. This section prevents the interim holder under a repo from claiming a tax credit when that person in economic terms does not retain a dividend on the securities, but passes it on to the counterparty, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA.

Section 594: No tax credits for original owner under repo

1754. This section counters unusual repo arrangements where the original owner does not pass entitlement to the dividends to the interim holder under the repo but the interim holder nonetheless pays the lender a manufactured dividend. It prevents shareholders using these arrangements to generate multiple tax credits in respect of the same dividend. It is based on section 231AB of ICTA.

Section 595: Meaning of “manufactured dividend”

1755. This section gives “manufactured dividend” the same meaning in this Chapter as in Chapter 2. It is based on sections 231AA(4) and 231AB(3) of ICTA.

Chapter 4: Deemed manufactured payments

Overview

1756. This Chapter extends the scope of Chapter 2 (manufactured payments) to certain arrangements under which there is no actual manufactured payment.

Section 596: Deemed manufactured payments: stock lending arrangements

1757. This section, which is the first of a group of sections (sections 596 to 600) concerned with stock lending arrangements, deems the borrower in a stock lending arrangement to make

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a manufactured payment in certain circumstances. It is based on sections 736B, 736D and 231AA of ICTA.

1758. Usually, a stock lending arrangement will require the borrower to make a manufactured payment to the lender, in which case Chapter 2 (or, as the case may be, Schedule 23A to ICTA) will apply.

1759. Exceptionally, a stock lending arrangement may be structured in such a way that the lender is not entitled to receive a manufactured payment, even though the lender has forgone interest or dividends on the securities transferred. In such a case, this section deems the borrower to make a manufactured payment. In consequence, Chapter 2 applies and, in particular, if the securities are UK securities or overseas securities, then potentially either the borrower is subject to the main charge or the lender is subject to the reverse charge. But the borrower is denied any tax relief for the deemed manufactured payment.

1760. *Subsection (5)* provides that for the purposes of this section a quasi-stock lending arrangement is treated as if it were a stock lending arrangement.

Section 597: Deemed interest: cash collateral under stock lending arrangements

1761. This section is a targeted anti-avoidance rule, deeming interest to arise to the borrower on collateral provided under certain stock lending arrangements. It is based on section 736C(1) to (7) and (11) of ICTA.

Section 598: Cash collateral under stock lending arrangements: supplementary

1762. This section supplements section 597. It is based on section 736C(8), (10) and (12) to (14) of ICTA.

1763. Section 736C(11) of ICTA provides that money includes money expressed in a currency other than sterling. This section omits it.

Section 599: Sections 597 and 598: quasi-stock lending arrangements and quasi-cash collateral

1764. This section extends the ambit of sections 597 and 598 to cover arrangements which, although achieving the same economic effect as a stock lending arrangement with cash collateral, fall outside either or both of the detailed definitions of “stock lending arrangement” and “cash collateral”. It is based on section 736D(4), (5), (7), (8) and (10) of ICTA.

Section 600: Meaning of “quasi-stock lending arrangements” and “quasi-cash collateral”

1765. This section defines the expressions “quasi-stock lending arrangements” and “quasi-cash collateral”. It is based on section 736D(1) to (3), (6) and (10) of ICTA.

Section 601: Repo cases in which deeming rules apply

1766. This section defines circumstances under which sale and repurchase arrangements (repos) are deemed, under section 602, to give rise to manufactured payments to which Chapter 2 applies. It is based on sections 231AA, 231AB, 737A, and 737B, of ICTA.

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1767. If, as a matter of legal analysis, a transaction includes an amount which is a manufactured payment within Chapter 2 or, as the case may be, Schedule 23A to ICTA, then Chapter 2 (or, as the case may be, Schedule 23A) will apply to that amount. But if there is no separately identifiable amount then, as a matter of legal analysis, there may be no manufactured payment within Chapter 2 or Schedule 23A.

1768. Sale and repurchase arrangements could therefore be made under which no manufactured payment was payable and, instead, the pricing of the transaction reflected the fact that a payment of interest or dividend on the securities was receivable otherwise than by the seller. Such arrangements would be outside Chapter 2 and Schedule 23A. Chapter 4 plugs this gap by deeming the arrangement to include the making of a manufactured payment.

Section 602: Deemed manufactured payments: repos

1769. This section activates the rules about manufactured payments in a case in which section 601 is satisfied. It is based on sections 231AA, 231AB, 737A and 737C of ICTA.

1770. *Subsection (2)(b)* ensures that, in a repo of Real Estate Investment Trust shares, the deemed manufactured payment will in appropriate circumstances be an MPID.

1771. *Subsections (3) and (4)* prevent the holder of securities acquired under a repo from obtaining a tax deduction for a deemed payment representing interest or dividends unless that person is also the person to whom the securities were first transferred.

Section 603: Deemed deductions of tax

1772. This section treats deductions of tax as having been made in the circumstances specified in the section. It covers payments representative of PIDs, periodical payments of interest on UK securities and overseas dividends on overseas securities. It is based on section 737C of ICTA.

1773. This section is the first of a group of sections (sections 603 to 605) all of which are based on section 737C of ICTA (deemed manufactured payments: further provisions). Section 737A of ICTA (sale and repurchase of securities: deemed manufactured payments) interacts not only with Schedule 23A to ICTA (manufactured dividends and interest) but also with section 730A of ICTA (treatment of price differential on sale and repurchase of securities). Section 737C of ICTA ensures that the interaction does not give rise to anomalies.

Section 604: Deemed increase in repurchase price: price differences under repos

1774. This section ensures that, if this Chapter deems a manufactured payment to be made, this is factored into the calculation of the price difference under Chapter 5. It is based on section 737C of ICTA.

Section 605: Deemed increase in repurchase price: other income tax purposes

1775. This section extends the circumstances in which the deemed increase in the repurchase price made by section 604 has effect. It is based on section 737C(11A) of ICTA.

Section 606: Interpretation of Chapter

1776. This section defines various terms. It is based on sections 231AA, 231AB and 737A to 737C of ICTA and section 139 of, and paragraph 4 of Schedule 17 to, FA 2006.

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Chapter 5: Price differences under repos

Overview

1777. This Chapter contains provisions about the treatment of the difference between the sale price and the repurchase price in relation to sale and repurchase agreements. It is based on sections 730A and 730B of ICTA, with supplementary provisions based on section 737E of ICTA.

1778. Section 737A of ICTA deals with repos which straddle an ex-dividend date; if it applies, there is a deemed manufactured payment to which Schedule 23A to ICTA applies. Section 737A is rewritten in Chapter 4 of this Part.

1779. For the purposes of section 730A of ICTA, by contrast, it does not make any difference whether the repo straddles an ex-dividend date, and section 730A does not have a direct connection with Schedule 23A. If a sale and repurchase agreement is within section 730A, the difference between the sale price and the repurchase price is deemed to be a payment of interest on a deemed loan. If the other conditions are met, this deemed interest may come within the withholding obligation of section 349(2) of ICTA. Section 349(2) is rewritten in Chapter 3 of Part 15 (deduction of income tax at source: deduction from certain payments of yearly interest).

Section 607: Treatment of price differences under repos

1780. This section deals with the treatment of price differences under repos. It is based on sections 730A(1), (2), (3) and (8A), 730B and 737B of, and paragraph 1(1) of Schedule 23A to, ICTA.

Section 608: Exceptions to section 607

1781. This section disapplies section 607 in certain cases. It is based on section 730A(8) of ICTA.

1782. It disapplies section 607 in cases where:

- the agreement or agreements for sale and repurchase are not what one would expect of persons dealing at arm's length; or
- the interim holder has all the benefits and risks from fluctuations in the market value of the securities between their sale and repurchase.

Section 609: Additional income tax consequences of price differences

1783. This section deals with some additional consequences of section 607. It is based on section 730A(4), (4A) and (7) of ICTA.

Section 610: Repurchase price in deemed manufactured payment case

1784. This section deals with the interaction between Chapters 4 and 5 of this Part. It is based on sections 730A of ICTA.

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Section 611: Power to modify Chapter in non-arm's length case

1785. This section enables the Treasury to make regulations modifying the provisions of this Chapter in cases where agreements for sale and repurchase are not what one would expect of persons dealing at arm's length. It is based on section 737E of ICTA.

1786. Section 737E(3) of ICTA does not mention section 730B of ICTA. But section 611(1), in rewriting section 737E(3), includes within its scope section 610, which rewrites section 730B. This does not mean that section 611(1) changes the law.

1787. Since section 737E(3) refers to section 730A and section 730B has the sidenote "interpretation of section 730A", the omission of "section 730B" from section 737E(3) is not significant. Section 737E(3) enables the Treasury to modify section 730B indirectly (for example, by making a regulation saying that, despite anything in section 730B, section 730A applies as if it said ...).

Chapter 6: Powers to modify repo provisions

Overview

1788. This Chapter contains powers to modify some of the provisions of Chapters 4 and 5 of this Part.

Section 612: Non-standard repo cases

1789. This section is a power to make regulations dealing with certain non-standard repo cases. It is based on section 737E(1), (8) and (9) of ICTA.

Section 613: Redemption arrangements

1790. This section is a power to make regulations dealing with certain cases involving repos and the redemption of securities. It is based on sections 737B(1) and 737E(2), (8) and (9) of ICTA.

Section 614: Sections 612 and 613: supplementary

1791. This section contains provisions which supplement sections 612 and 613. It is based on section 737E(5), (6) and (7) of ICTA.

Part 12: Accrued Income Profits

Overview

1792. This Part is based on sections 710 to 727A in Chapter 2 of Part 17 of ICTA. These provisions are commonly known as the "accrued income scheme". The Part has therefore been named by reference to this common name. The accrued income scheme deals with the transfer of interest bearing securities where the person taxable in respect of interest on the securities may not be the person who held the securities when that interest was accruing. The scheme attributes to certain persons "accrued income profits", taxed under Chapter 2 of this Part, and "accrued income losses", which may reduce liability under other provisions in respect of the interest arising. Certain transactions and/or certain persons may be excluded from the operation of the scheme (in particular, if an individual has, or personal representatives or certain trustees have, only small holdings of securities).

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1793. Chapter 2 sets out the provisions which explain when the scheme applies and to whom, how to calculate accrued income profits and accrued income losses and when accrued income profits are taxed. It also contains definitions for the scheme.

1794. Chapter 3 sets out how relief is obtained for accrued income losses. Accrued income losses are not set against accrued income profits (as a figure of profits or losses is already a net figure for payments treated as made or received by the person in question). Rather, relief for accrued income losses is given by setting the losses against interest received on the securities in relation to which the losses arise (that is, the interest which has been taken into account in calculating the losses). In effect, the accrued income losses exempt from income tax so much of the interest as is equal to those losses.

1795. Prior to FA 1996, the accrued income scheme applied for both income tax and corporation tax. Chapter 2 of Part 4 of FA 1996 (loan relationships) now applies for corporation tax in relation to transfers of securities with accrued interest. The transitional application of the scheme for corporation tax as regards transfers of securities taking place before 1 April 1996, in section 710(1A) of ICTA, has been repealed as redundant in conjunction with the income tax rewrite (see Schedule 3 to this Act which repeals sections 710 to 727A of ICTA).

1796. Section 728 of ICTA (power to obtain information for the purposes of sections 710 to 727A) is not rewritten in this Part.

Chapter 1 Introduction

Section 615: Overview of Part

1797. This section describes the scope of the Part and provides or signposts the definition of a number of key terms used in the Part. It is based on sections 714, 716 and 723 of ICTA.

1798. *Subsections (2) and (3)* refer to “profits treated as made” under a number of sections in Chapter 2 where interest bearing securities are transferred. But for the charge made by this Part, the profit on the transfer in question would usually be a capital profit. See section 119 of TCGA (as amended by Schedule 1 to this Act) for rules which amend the calculation of a gain or loss under that Act if the accrued income scheme applies.

1799. Profits are treated as made under section 628 if the transfer occurs in an interest period of the security. Profits are treated as made under section 630 if the transfer is of variable rate securities or a transfer with unrealised interest and the settlement day for the transfer is outside an interest period. Section 670 treats as profits the recovery of relief given previously in respect of unremittable transfer proceeds from foreign securities. Some rules apply all such profits. But some apply only to one or to one or more but not all such types of profits or the transactions giving rise to them. References to sections 628, 630 and 670 are therefore used, both in this Part and in other provisions in the Tax Acts which refer to the accrued income scheme, to indicate which type of profit is in point for the operation of the other provision (for example, see section 667).

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Chapter 2: Accrued income profits and losses

Section 616: Charge to tax on accrued income profits

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

Section 617: Income charged

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

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

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

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

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

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

1806. *Subsection (4)* determines the tax year in which accrued income profits are treated as made if the proceeds of the transfer could not be remitted to the United Kingdom (and so relief from the accrued income scheme was claimed under section 668 or 669) but can be remitted subsequently (which triggers a charge by virtue of section 670).

Section 618: Person liable

1807. This section determines the person liable to income tax for the purposes of this Chapter. It is based on sections 714(2) and (2B), 716(3) and (3B) and 723(4) of ICTA. The accrued income profits that a person is treated as making may be from transfers where the person is the transferor, or from transfers where the person is the transferee, or from a mixture of such transfers.

1808. See also section 1015 (territorial scope of charges under certain provisions to which section 1016 applies). This Chapter is among the provisions listed in Part 2 of that section.

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But see also section 643 which in practice cuts down the extent to which a non-UK resident is chargeable to tax under this Chapter.

1809. (See Chapter 3 of Part 9 (special rates for trustees' income) for the rate that applies if trustees are the person liable. Section 482 (types of amount to be charged at special rates for trustees) is based in part on section 720(5) of ICTA.)

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

1810. This section defines "securities" for the purposes of the Chapter. It is based on section 710 of ICTA.

1811. The rule in *subsection (6)*, what is meant by securities of the same kind, is important because accrued income profits and losses treated as made under section 628 are computed by reference to transfers of securities of the same kind which occur in the same interest period.

Section 620: Transactions which are transfers: general

1812. This section defines "transfer" for the purposes of the Chapter. It is based on section 710 of ICTA. "Transfers" are the transactions and events giving rise to the income tax charge (or relief) for accrued income profits (or losses).

1813. *Subsection (1)* is subject to the cases mentioned in *subsection (6)*, which exclude certain transfers from the application of the Chapter in the case of strips of gilt-edged securities, stock lending and sale and repurchase agreements.

1814. The vesting of securities in trustees is a transfer within *subsection (1)*. But where securities vest on the appointment of a new or additional trustee, and the new or additional trustees are resident in the United Kingdom, there are no net accrued income scheme consequences because the payments treated as made effectively cancel each other out. This may not be the case if the new or additional trustees are not resident in the United Kingdom.

1815. *Subsection (3)* deals with the timing of the transfer where there is an agreement for the transfer of securities. The transfer is treated as taking place when the agreement is made, even if the agreement provides for the transfer of the securities at some future date.

1816. The time at which a transfer occurs is important for a number of provisions in the accrued income scheme (see, for example, section 660(1)). The time of the transfer must be distinguished from the settlement day for the transfer, although the two dates may be the same in certain circumstances.

Section 621: Transferors and transferees

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

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

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Section 622: Application of Chapter to different kinds of transfer

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

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

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

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

Section 623: Transfers with accrued interest

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

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

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

Section 624: Transfers without accrued interest

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

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

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

Section 625: Transfers with unrealised interest

1828. This section explains what is meant by a transfer “with unrealised interest”. It is based on section 716(1) of ICTA.

1829. It applies if securities are transferred together with interest which is ripe for payment because the due and payable date has passed, but the holder of the securities has not called for payment of the interest. This will most commonly arise in the case of bearer securities with separate coupons for each interest instalment. But it does not follow that there could not be other circumstances where securities are transferred with unrealised interest.

Section 626: Transfers of variable rate securities

1830. This section provides that a transfer of variable rate securities is not treated as a transfer with or without accrued interest, regardless of whether it would otherwise be such a transfer. It is new.

1831. By excluding transfers of variable rate securities from the normal rules for transfers with accrued interest, the special rules which apply to transfers of variable rate securities then apply directly without first treating them as transfers with accrued interest, and without having to modify the normal rules. See in particular sections 630, 631 and 635.

1832. See *Change 102* in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

Section 627: Meaning of “variable rate securities”

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

1834. *Subsection (4)* applies the test for qualifying as variable rate securities in a special way if securities are issued in tranches (“new securities”) and section 649 applies.

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

1835. This section determines if accrued income profits or accrued income losses are made when (as is normally the case) the settlement day for the transfer in question falls within an interest period. It is based on section 714 of ICTA.

1836. The accrued income scheme applies predominantly:

- where securities are transferred with accrued interest and
- where they are transferred without accrued interest.

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1837. The aim in both cases is to ensure that the accruing interest is taxed as income of the person who is the owner of the securities over the period in which the interest accrued. The approach taken by this section is to treat the parties as though a payment is made from one to the other as a result of the transfer.

1838. Where securities are transferred with accrued interest, the transferee is treated as making a payment to the transferor. And, where securities are transferred without accrued interest, the transferor is treated as making a payment to the transferee (see sections 632 and 633). This approach reflects the reality of these transactions, as the purchase price on a sale of securities is increased or reduced according to whether interest which has accrued or will accrue goes to the transferor or transferee.

1839. The calculation in section 628 is made by comparing the total amount of the payments treated as made *by* a person to the total amount of the payments treated as made *to* that person for each kind of security transferred in each interest period.

1840. *Subsection (2)* provides that section 630 applies instead if the settlement day falls outside an interest period (this can only be the case in relation to some transfers of variable rate securities or a transfer with unrealised interest).

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

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

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

1842. This section provides that accrued income profits are made where the settlement day for the transfer involved occurs after the end of the securities' last interest period (and so does not fall in an interest period). It is based on sections 716(3), 717(10) and (11) of ICTA.

1843. A transfer of variable rate securities may also be a transfer with unrealised interest, so the section may apply doubly to a single transfer. An amount of accrued income profits will be found under both subsections (1) and (3) of section 631.

1844. In contrast with transfers which take place in an interest period (see section 634 and section 635), where there is a deemed payment made by the transferor (partly matching the approach in section 628 and section 629), no such deemed payment is introduced here. The section deems the transferor to have made accrued income profits by virtue of the circumstances set out in *subsection (1)*. And without any deemed payments, an accrued income loss cannot arise in the case of the transfers to which this section applies.

1845. See *Change 101* in Annex 1 which treats other transfers of variable rate securities where the settlement day is outside an interest period as redemption of such securities. And see *Change 102* in Annex 1 which drops the fiction that transfers of variable rate securities are transfers with accrued interest.

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

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

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Section 632: Payment on transfer with accrued interest

1847. This section sets out the payments treated as made when securities are transferred with accrued interest. It is based on section 713 of ICTA.

1848. *Subsection (1)* sets out the payment treated as made by the transferee to the transferor. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is:

- to charge the transferor to income tax on the interest accruing on a day-by-day basis to the settlement day, that is, the transferor makes an accrued income profit in accordance with section 628 which is taxed by section 616, and
- to give the transferee equivalent relief when the transferee is taxed (e.g. under Chapter 2 of Part 4 of ITTOIA) on the interest arising at the next interest payment date, that is, the transferee makes an accrued income loss in accordance with section 628 which is relieved under section 679.

1849. *Subsection (1)* also indicates that the payment is treated as made in the interest period in which the settlement day for the transfer falls. This also determines the interest period in which the profit arises and therefore the tax year in which the profit is taxed.

1850. *Subsections (2) and (3)* quantify the amount of the payment where the interest which has accrued to the settlement day is separately accounted for to the transferor by the transferee (as it is for many transactions within the financial markets, with a corresponding adjustment in the consideration for the transfer of the security). The amount of the payment is the amount of interest accounted for.

1851. If *subsections (2) and (3)* do not apply and the settlement day is coincidentally an interest payment day, *subsection (4)* quantifies the amount of the payment as the amount of the interest payable on that day.

1852. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest accruing to the settlement of the transfer. The formula applies regardless of whether the interest period in question would be (but for section 673 (meaning of “interest period”)) greater than 12 months.

1853. *Subsections (7) and (8)* modify the operation of *subsection (1)* if the transfer in point is one for which there is either no transferor or no transferee because of the rules applying in the sections mentioned.

Section 633: Payment on transfer without accrued interest

1854. This section sets out the payments treated as made when securities are transferred without accrued interest. It is based on section 713 of ICTA.

1855. In this case the transferor retains entitlement to all the interest due at the interest payment date falling after the transfer date although the transferor will not be the holder of the security at that time. This will commonly occur where the security in question has gone “ex-dividend” when the transfer is agreed (that is, interest will be paid on the next interest date to whoever is the registered holder when the books for the security are closed until after the interest payment date). *Subsection (1)* explains that, where securities are transferred

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without accrued interest, a payment is treated as made by the transferor to the transferee – the reverse of section 632(1).

1856. The right to the interest is retained by the transferor, who will be taxable on the interest arising at the next interest payment. If there are no other transfers of the same kind of security in the interest period, the effect of treating this payment as made is to charge the transferee to income tax on the interest accruing on a day-by-day basis *after* the settlement of the transfer, the accrued income profit, and to give the transferor equivalent relief when the transferor is taxed on the interest arising at the next interest payment date, the accrued income loss.

1857. Subsection (1) also provides that the payment is treated as made in the interest period in which the settlement day for the transfer falls.

1858. As in section 632, *subsections (2) and (3)* deal with transfers where the interest which will accrue from the settlement day to the next interest payment day is separately accounted for. The amount of the payment is the amount of the gross interest accounted for.

1859. If subsection (2) does not apply and the settlement day also happens to be an interest payment day, *subsection (4)* makes clear that the amount of the payment is nil. That reflects the fact that the interest retained by the transferor accrues wholly in the period to the settlement day (and is taxable on the transferor). The accrued income scheme is only interested in disturbing the normal tax rules, in the case of a transfer without accrued interest, where part of the interest period falls *after* the settlement day (and an amount representing interest should be attributed to the transferee).

1860. In other cases, *subsection (5)* provides for the interest due on the next interest payment day to be time apportioned to ascertain the interest which will accrue after the settlement of the transfer.

1861. *Subsections (7) and (8)* modify the operation of subsection (1) if the transfer in point is one for which there is either no transferor or no transferee.

Section 634: Payment on transfer with unrealised interest

1862. This section sets out the payment treated as made where securities are transferred with unrealised interest and where (as is normally the case) the settlement day for the transfer involved falls within an interest period. It is based on section 716 of ICTA. “Unrealised interest” is defined in section 625.

1863. A payment is treated as made to the transferor (see *subsection (1)*) but *subsection (4)* makes clear that no one is treated as making the payment. *Subsection (5)* therefore confirms that the deemed payment does not form part of any accrued income profit or loss calculation for the transferee.

1864. *Subsection (2)* provides that the amount of the payment is the amount of the unrealised interest. The effect of this section is that the transferor is charged to income tax on the amount of the unrealised interest.

1865. *Subsection (6)* signposts section 681 which, notwithstanding the rules in subsection (4) and (5), grants the transferee exemption from tax on the interest (when realised) if certain

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conditions are satisfied. That exemption is equivalent to the exemption given in section 679 by reference to accrued income losses.

1866. As explained in the commentary on section 622, where securities are transferred with unrealised interest they may also be transferred with or without accrued interest, and a payment may also arise under section 632 or 633.

Section 635: Payment on transfer of variable rate securities

1867. This section sets out the payment treated as made where variable rate securities are transferred and the settlement day for the transfer falls within an interest period. It is based on section 717 of ICTA. Section 627 gives the meaning of “variable rate securities”.

1868. *Subsection (1)* provides that a payment is treated as made to the transferor. But no one is treated as making the payment (see *subsection (3)*), nor does the payment enter the calculation of any accrued income profit or loss of the transferee (see *subsection (4)*).

1869. This is an anti-avoidance provision. The interest on a security could be structured so as to circumvent the intended effects of the accrued income scheme (for example, by using wide variations in the rate of interest payable at various times over the lifetime of the security). Where this happens, a time apportionment formula, which assumes that interest accrues at an even rate, would not produce an amount consistent with the value of the accruing interest. Instead, *subsection (2)* simply provides that the amount of the payment treated as made should be “just and reasonable” (and the transferor should make a self-assessment for the relevant tax year accordingly).

1870. No provision is made in this case for any exemption for interest received by the transferee.

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

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

1872. Under *subsection (2)*, if the personal representatives of a deceased person transfer securities to a legatee in the interest period in which the individual died, neither the personal representatives nor the legatee are treated as making or receiving payments. So, in these circumstances no accrued income profit or accrued income loss can arise. But, because the transfer itself is not excluded, section 681 (exemption for unrealised interest received after a transfer within Chapter 2) may still be in point.

1873. *Subsection (3)* deals with certain transfers of variable rate securities. It treats accrued income profits as not arising, rather than a payment as not being made, in line with the approach taken in sections 630 and 631. It applies to all variable rate securities (see *Change 101* in Annex 1 which extends the treatment of transfers of variable rate securities on redemption which was provided under section 717(11) of ICTA to other transfers of variable rate securities where the settlement day is outside an interest period).

1874. If the transfer does not take place in the interest period in which the individual died, then the accrued income scheme applies to that transfer as normal.

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1875. “Personal representatives” has the meaning given by section 989. (See *Change 150* in Annex 1.)

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

1876. This section provides for a particular treatment of an accrued income loss. It is based on section 714 of ICTA.

1877. Where a person makes accrued income losses there are two ways of relieving those losses. The most common is by exempting the interest arising at the end of the interest period to which the accrued income loss relates to the extent of the amount of the loss. This relief is given by section 679, which is signposted in *subsection (3)* together with other exemptions which may apply when the interest period ends with an interest payment day.

1878. This section deals with the far less common circumstance where the interest period does not end with an interest payment day and so interest does not arise at the end of it. (This can occur where an interest payment day is more than twelve months after the previous one. The accrued income scheme restricts all interest periods to no more than twelve months. See section 673(1)(b)).

1879. *Subsection (2)* treats the person who made the accrued income loss as making a payment in the next interest period. So losses are in effect carried forward and taken into account in computing the accrued income profit (or accrued income loss as the case may be) on securities of the same kind in the next interest period. If that interest period does not end with an interest payment date and there are still losses to carry forward, the process repeats until the losses are those of an interest period which does end with an interest payment day.

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

1880. This section disregards certain payments treated as made to or by a person, if that person is an “excluded transferor” or “excluded transferee”, in calculating whether that person has made accrued income profits or losses. It is based on section 715 of ICTA.

1881. By virtue of this section, the accrued income scheme does not (or does not in full) apply to them. This is either because it is unnecessary to apply the scheme to them or because applying the scheme would be unduly burdensome for both taxpayers and HMRC. The section also explains the consequences of being excluded from the scheme.

1882. Although the section generally applies to both transferors and transferees, and operates by disregarding payments treated as made by or to a person, *subsection (3)* provides that in determining under section 630 whether a person has made accrued income profits, no account is taken of the transfer. There is an effect only for the transferor in that case.

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

Section 639: Small holdings: individuals

1884. This section excludes individuals whose holdings are below the specified limit. It is based on section 715(1)(b) of ICTA.

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1885. *Subsections (1) to (3)* set out the limit for exclusion for individuals in relation to the various types of transfer of securities and by reference to the relevant basis on which income is charged under section 617. The limit is set at a total nominal value of £5,000 of all securities held by the individual on any day in the prescribed period. An individual's holding may, however, be combined with another's (see *subsection (5)*) and, where that is the case, the limit applies to the combined holding.

1886. *Subsection (3)* adapts the rule for transfers of variable rate securities as more than one basis on which income is charged under section 617 may apply to such securities. *Change 101* in Annex 1 (which applies to other transfers of variable rate securities the treatment of transfers of such securities on redemption that was provided by section 717(11) of ICTA) applies as regards such transfers for the purposes of this and the following two sections.

Section 640: Small holdings: personal representatives

1887. This section excludes personal representatives whose holdings are below the specified limit. It is based on section 715(1)(c) and (2)(b) of ICTA.

1888. When an individual dies, securities in the deceased's estate automatically vest in the deceased's personal representatives. This vesting is not a transfer for the purposes of the accrued income scheme. However, except where section 636 applies, the transfer of securities by an individual's personal representatives is a transfer for the purposes of the accrued income scheme.

1889. *Subsections (1) to (3)* accordingly provide exclusions for personal representatives identical to those for individuals. But there is no equivalent of section 639(5) so there is no question of the personal representatives' holding being combined with another's. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)

1890. "Personal representatives" has the meaning given by section 989. (See *Change 150* in Annex 1.)

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

1891. This section excludes trustees of a disabled person's trusts whose holdings are below the specified limit. This section is based on section 715(1)(e) and (2)(b) of ICTA.

1892. *Subsections (1) to (3)* provide exclusions for trustees of a disabled person's trusts identical to those for individuals and personal representatives. (*Change 101* in Annex 1 applies here; see the commentary on section 639(3) (small holdings: individuals).)

1893. *Subsection (4)* signposts the definition of "disabled person's trusts" which applies for the purpose of this provision. Broadly, that definition includes trusts where the beneficiary may be incapacitated to a degree that interferes with their management of their affairs.

Section 642: Traders

1894. This section excludes financial traders from the accrued income scheme. It is based on sections 715(1)(a) and 715(2)(a) of ICTA.

1895. It is unnecessary for such traders to be included in the scheme as profits and losses on any securities they transfer are already included in their trading profits and losses.

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Section 643: Non-residents

1896. This section excludes persons who are non-UK residents or are not ordinarily UK resident from the accrued income scheme. It is based on section 715(1)(f) and (2)(b) of ICTA.

1897. In practice it would be very difficult to apply the scheme to such non-residents consistently. While non-residents could take the benefit of relief for accrued income losses to get repayments of tax suffered if tax is deducted at source, it would be difficult to enforce the charge to tax on accrued income profits.

1898. *Subsections (2) to (4)* ensure that non-residents who trade in the United Kingdom through a branch or agency are not excluded from the scheme by subsection (1) if the securities are situated in the United Kingdom and are used or held for the purposes of the branch or agency (such non-residents may still be excluded by section 642).

Section 644: Individuals to whom the remittance basis applies

1899. This section excludes from the accrued income scheme individuals entitled to the benefit of the remittance basis in respect of interest on the securities transferred. It is based on section 715(1)(k) and (2)(b) of ICTA.

1900. Such individuals are taxed on the amounts of income received in the tax year and not on the amount of income arising in that year. The accrued income scheme applies the equivalent of the arising basis to the amounts it charges as accrued income profits.

Section 645: Charitable trusts etc

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

Section 646: Pension scheme trustees

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

Section 647: Makers of manufactured payments

1903. This section excludes makers of “manufactured payments” from the accrued income scheme. It is based on section 715(6) of ICTA.

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

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1905. This section ensures that the tax charge under that Part takes priority over any possible tax charge under the accrued income scheme. It does so by treating the person who manufactures interest:

- as an excluded transferee in relation to the transfer under which the securities were acquired; and
- as an excluded transferor in relation to the onward sale.

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

Section 648: Strips of gilt-edged securities

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

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

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

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

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

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

1913. Where strips are consolidated into a gilt-edged security, the consolidated security may be issued part way through an interest period for securities of that kind. As the consolidated security is fully fungible with other securities of the same kind, that interest period is taken (by virtue of the general rule in section 673(1)) to have begun immediately after the last interest payment day before the settlement day. (See *Change 106* in Annex 1 which amends

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the meaning of “interest period” for the purposes of that section.) The formulas in sections 632(5) and 633(5) can work on that basis because they operate by reference to interest periods of securities of that kind.

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

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

Section 649: New securities issued with extra return

1916. This section provides a special rule where securities are issued in tranches. It treats the issue of the new securities as a transfer with accrued interest. It is based on section 726A of ICTA.

1917. See also the commentary on section 662 which explains the special rule about payments treated as made.

1918. To raise finance, debt issuers may make further issues of the same securities (“new securities”) rather than issue fresh securities. The new securities issued in each new tranche are intended to be fungible with the very first securities of that kind issued, so they have identical terms.

1919. However, where new securities are issued part way through an interest period, the interest payable on the next interest payment date would be less than the interest payable on that date for existing securities (assuming the same rate of accrual). To compensate for this and to ensure complete fungibility, the issuer will pay an extra amount of interest on these securities. The issue price of the securities in the new tranche may therefore be set to take account of this extra return.

1920. Under the accrued income scheme the extra return is treated in the same way as accruing interest.

1921. As the new securities have identical terms to the original securities they should pay the same interest on the next interest payment day. However, if they are issued part of the way through an interest period, the effective rate of interest will be different. So the securities may well fall within the definition of “variable rate securities”, in which case this provision will not apply. Section 627(4) applies the test for variable rate securities to the new securities as though the interest payable on the first interest payment day after their issue relates to the period from the last interest payment day (or, if there was no such day, the date of issue) of the original securities to that day.

1922. This section makes the equivalent provision for the accrued income scheme that section 845 makes in relation to the charge to tax on interest.

Section 650: Trading stock appropriations etc

1923. This section treats as a transfer of securities certain changes in the capacity in which securities are held by a trader. It is based on section 722 of ICTA.

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1924. Section 642 excludes financial traders from the accrued income scheme as profits and losses on any securities they transfer are already included in trading profits and losses. But a financial trader may hold securities as personal investments as well as in the capacity of financial trader.

1925. *Subsections (1) and (2)* deal with the case where securities are acquired in a non-trading capacity and are then appropriated as trading stock.

1926. *Subsections (3) and (4)* deal with the reverse case where securities held as trading stock are appropriated for some non-trading purpose.

1927. *Subsections (5) and (6)* deal with the case where securities are held as trading stock but the trade ceases without the securities changing ownership.

1928. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 651: Owner becoming entitled to securities as trustee

1929. This section treats the owner of securities who settles the securities on trust and becomes trustee of them (or one of the trustees of them) as transferring them. It is based on section 720 of ICTA.

1930. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 652: Securities ceasing to be held on charitable trusts

1931. This section treats trustees as transferring the securities in their capacity as charitable trustees to themselves in another capacity, if securities cease to be held on charitable trusts. It is based on section 715(3) of ICTA.

1932. The transfer treated as made is then a transfer within the appropriate type or types in section 622 for the purposes of the accrued income scheme.

Section 653: Stock lending

1933. This section excludes stock lending transactions from the accrued income scheme. It is based on section 727 of ICTA.

1934. Broadly, stock lending is a mechanism by which a securities dealer makes an arrangement for an institutional investor to place some of its securities at the dealer's disposal. The dealer is therefore able to deliver securities the dealer has contracted to sell even if the dealer has been unable or unwilling to buy them in the market. (The dealer undertakes to return the securities, or equivalents, to the institution later. Although the mechanism is referred to as "lending", the securities do change ownership.)

1935. As the lending institution is entitled to the return of securities of the kind transferred under the lending arrangement, and effectively retains rights to the interest on them, the accrued income scheme disregards stock lending transfers.

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Section 654: Sale and repurchase arrangements

1936. This section sets out the conditions under which section 655 applies. It also applies for the purposes of sections 656 to 658 which provide powers to modify the application of section 655. It is based on sections 727A, 730B and 737E(8) and (9) of ICTA.

1937. The section makes provision for repos for the purposes of the accrued income scheme equivalent to that made for repos in Part 11 (manufactured payments and repos) (see sections 569, 570 and 571).

1938. See paragraphs 125 and 126 of Schedule 2 which modify the operation of this and the following section for securities in relation to which amendments to the source legislation, by FA 1995 and FA 2003 respectively, do not apply.

1939. See also SI 1995/3220 (Sale and repurchase of securities (modification of enactments) Regulations 1995) which provides that in certain circumstances securities include substituted securities and the meaning of “buying back” securities is extended.

Section 655: Transfers under sale and repurchase arrangements

1940. This section excludes transfers under sale and repurchase agreements (“repos”) from the accrued income scheme, if the transferor or a person connected with the transferor is required or entitled to repurchase the securities. It is based on section 727A of ICTA.

1941. Under a repo, as with stock lending, the economic benefit of the interest on the securities sold and repurchased remains with the original holder of the securities, to whom they return. The original owner is taxed on the interest under other rules so there is no need for the accrued income scheme to apply to either the sale or the repurchase.

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

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

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

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

Section 657: Power to modify: redemption arrangements

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

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

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Section 658: Powers to modify: supplementary

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

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

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

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

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

Section 660: Transfers with unrealised interest: interest in default

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

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

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

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

1955. This section only deals with the position of the transferor. Accordingly *subsection (6)* signposts the exemption under section 681 for interest payable to the transferee. See in particular subsections (3) to (6) of that section which deal with the situation where unrealised interest is in default.

Section 661: Successive transfers with unrealised interest in default

1956. This section modifies the application of section 660 where the securities have previously been transferred with unrealised interest in default. It is based on section 719(4) of ICTA.

1957. *Subsection (1)* applies where the transferor originally acquired the securities with unrealised interest. In that case, A (see commentary on section 660) is reduced by the value of the right to receive the interest (“B”) on the day the transferor acquired the securities (see *subsection (5)*). That is, the transferor is now given credit for the amount of consideration given for that value when the securities were acquired.

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1958. But, if the transferor has received any of the interest in the meantime (or an amount on account of that interest), *subsection (4)* applies so that B is reduced by the amount of the interest received, thus increasing A. That is, to the extent the transferor has received the benefit of B, and has therefore recouped some of the consideration given for the securities, the credit given against the amount now chargeable, on the present transfer of the securities, is reduced.

1959. *Subsection (6)* makes clear that the amount of the reduction of A is itself reduced to nil where the amount of the credit found under subsection (4) or (5) exceeds the value found under subsection (1) by reference to section 660. That is, if the transferor has recouped amounts equal to or exceeding the value of the right to receive unrealised interest, at the time the securities were acquired, there is no credit to set against the value, A, which is now used in section 634(2) rather than the amount of the unrealised interest itself.

1960. Paragraph 127 of Schedule 2 saves the transitional rule that was in section 716(6) of ICTA (as substituted by section 719(4) of ICTA). That paragraph disapplies this section if the acquisition of the securities by the transferor occurred before 28 February 1986.

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

1961. This section provides for calculating the amount of the payment treated as made where securities have been issued in tranches and the conditions in section 649 apply. It is based on section 726A of ICTA.

1962. *Subsection (1)* provides that the amount of the payment is not calculated under section 632. Instead the amount is calculated by reference to *subsection (3)* or *(4)* (which are equivalent to the calculation rules in sections 632 and 633).

1963. The amount of the payment (that is, the extra return) is therefore taken into account under section 628 in calculating whether an accrued income profit or an accrued income loss is made. The effect of this (assuming no other transfer of the same kind of security has taken place in the interest period) is that the recipient of the new securities will only be taxed on the interest which accrued during the time he or she owned the securities.

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

1964. This section reduces the amount of the payment treated as made to the maker of a manufactured payment (the transferee) under section 633 if that person is not an excluded transferee under section 647(3) because the transferee has contracted to sell fewer securities than have been transferred to the transferee. It is based on section 715(6) and (7) of ICTA.

1965. The amount of the payment is treated as reduced to the extent that the maker of the manufactured payment has already contracted to sell securities of that kind. That is, while the maker of the manufactured payment is only an “excluded transferee” in relation to the acquisition of the securities if the securities sold on equal or exceed in amount those acquired, this section abates the amount of the payment under section 633 to the extent the acquisition and onward sale are in fact matched. This again ensures there is not a double charge to tax under Part 11 (manufactured payments and repos) and under the accrued income scheme.

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

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

1967. This section sets out the rules for converting amounts into sterling.

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

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

1969. This section sets out the rules for converting amounts or values into sterling.

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

1970. This section provides for another person (or persons) to be regarded as the transferor or transferee if there is a transfer by or to trustees or nominees. It is based on section 720 of ICTA.

1971. *Subsection (1)* ensures that, where someone holds securities through a nominee, transfers of securities by or to the nominee are treated as being made by or to the person for whom the nominee acts. Consequently the charges under the accrued income scheme fall not on the nominee but on the principal.

1972. Likewise, *subsection (2)* ensures that, where securities are held on trust but the beneficiary is absolutely entitled to direct how the securities are to be dealt with, transfers of securities by or to the trustees are treated as being made by or to the beneficiary.

1973. *Subsections (3), (4) and (5)* explain what is meant by a beneficiary being “absolutely entitled” against a trustee. *Subsection (8)* provides that a lack of legal capacity is ignored in deciding whether someone is absolutely entitled against a trustee.

1974. *Subsections (6) and (7)* apply the same rules as in subsections (1) and (2) but where two or more persons effectively own the securities. As subsection (7) makes provision for the case where two or more persons are absolutely entitled against a trustee, for consistency subsection (6) spells out for the case of nominees what may otherwise be derived from the application of the Interpretation Act 1978.

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

1975. This section provides for certain accrued income profits to be taken into account for the purposes of Chapter 5 of Part 5 of ITTOIA (where settlement income is taxed on the settlor). It is based on section 720(6) of ICTA.

1976. *Subsection (4)* defines the accrued income profits in question. They do not include profits in respect of a transfer with unrealised interest or profits chargeable under section 670 on the withdrawal of unremittable income relief. But they include profits in respect of transfers of variable rate securities. (See *Change 101* in Annex 1 which treats other transfers

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

1977. *Subsection (1)* ensures that qualifying accrued income profits treated as received by trustees of a settlement are treated as arising under the settlement for the purposes of Chapter 5 of Part 5 of ITTOIA. The income is then chargeable on the settlor. The settlor may be eligible under section 680 for exemption in respect of interest on the securities, if the interest is also chargeable under that Chapter, by reference to accrued income losses arising to the trustees under section 628.

1978. *Subsections (2) and (3)* ensure that trustees who are non-UK resident or domiciled outside the United Kingdom are treated as receiving, for the purposes of the same Chapter, the amount of accrued income profits they would have been treated as receiving if they had been UK resident or domiciled in the United Kingdom. That is, by virtue of their actual residence status, the trustees are likely to be excluded transferors or transferees under section 643 in which case accrued income profits to which subsection (1) applies will not arise to them. By virtue of subsection (3), the same results follow as under subsection (1).

Section 668: Relief for unremittable transfer proceeds: general

1979. This section provides relief from the accrued income scheme charge if transfer proceeds cannot be remitted to the United Kingdom. It is based on section 723 of ICTA.

1980. It is equivalent to the relief provided by Chapter 4 of Part 8 of ITTOIA (unremittable income) for other foreign income.

1981. The section applies if a person is chargeable to income tax on accrued income profits arising from the transfer or transfers of “foreign securities” (defined in *subsection (4)*) and those proceeds are unremittable.

1982. *Subsection (1)* applies to all transfers and includes transfers of securities with unrealised interest. See *Change 103* in Annex 1 which extends the relief to such transfers.

1983. *Subsection (2)* indicates that a claim must be made for the relief to apply. Subsection (2) also explains that the accrued income profits are either reduced to nil or reduced by the amount of the relevant payments.

1984. *Subsection (5)* defines when proceeds are unremittable. Any one of the three reasons given is sufficient for proceeds to be unremittable. See *Change 104* in Annex 1 which broadens one condition in the source legislation for the relief and removes another.

1985. *Subsection (7)* explains that the claim must be made on or before the fifth anniversary of 31 January following the end of the tax year for which the profits would be chargeable were it not for the relief. See *Change 105* in Annex 1 which substitutes this time limit for claiming relief in respect of accrued income profits if the proceeds of the transfer of foreign securities are unremittable for the time limit in the source legislation.

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

1986. This section provides the same relief as section 668 but in respect of section 630 profits (cases where the settlement day is outside the interest period). It is based on section 723 of ICTA.

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1987. See also *Change 101*, *Change 103* and *Change 105* in Annex 1.

Section 670: Withdrawal of relief

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

Section 671: Meaning of “interest”

1989. This section defines “interest” for the purposes of this Chapter. It is based on section 711(9) of ICTA.

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

Section 672: Meaning of “interest payment day”

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

Section 673: Meaning of “interest period”

1992. This section defines “interest period” for the purposes of this Chapter. It is based on section 711(3) of ICTA.

1993. If the period between interest payment days exceeds twelve months, it is not an interest period. Instead, the first twelve months of the period, each succeeding period of twelve months within that period, and any rump period, is an interest period. This ensures that charges under the accrued income scheme cannot be deferred by having long intervals between interest payment days.

1994. *Subsection (1)* defines when an interest period begins and when an interest period ends (which includes when twelve months has expired). This is subject to special rules in some cases – see *subsections (3) to (6)*.

1995. See *Change 106* in Annex 1 which amends the meaning of “interest period” in relation to this section.

Section 674: Meaning of “the settlement day”

1996. This section defines the “settlement day” in relation to any particular transaction for the purposes of this Chapter. It is based on section 712 of ICTA.

1997. The main rule is set out in *subsection (1)* and applies where securities are transferred under the rules of a recognised market (such as a stock exchange). Three other rules are set out in *subsections (3), (4) and (6)*, which apply where a transfer is not made under the rules of a recognised stock exchange.

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Section 675: The holding of securities

1998. This section sets out when someone is regarded as holding securities for the purposes of the Chapter. It is based on section 710(7), (8) and (10) of ICTA.

1999. This definition is needed for the “small holdings” tests in sections 639 to 641.

2000. *Subsection (3)* ensures that in Scotland, as elsewhere in the United Kingdom, transfers of securities involving partnerships are treated as though they were carried out by the individual partners and securities held by partnerships are treated as held by the individual partners. (In contrast to the rest of the United Kingdom, where a partnership has no separate legal personality, a partnership under Scots law is a legal person distinct from the partners it comprises.)

Section 676: Nominal value of securities: general

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

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

Section 677: Nominal value: foreign currency securities

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

Chapter 3: Exemptions relating to interest on securities

Section 678: Exemptions relating to interest on securities: preliminary

2004. This section introduces three exemptions from income tax on interest received following the transfer of securities and signposts relevant definitions and provisions in Chapter 2 of this Part. It is new.

Section 679: Interest on securities involving accrued income losses: general

2005. This section provides an exemption for interest on securities by reference to accrued income losses arising in respect of those securities. It is based on section 714(3) to (5) of ICTA.

2006. This is the commonest way in which exemption for interest on securities by reference to accrued income losses is given.

2007. *Subsection (1)* explains the conditions to be satisfied before relief is given and *subsection (2)* explains how much of the interest is exempt from tax. If the amount of interest exceeds the accrued income loss, the excess remains subject to income tax (i.e. under Chapter 2 of Part 4 of ITTOIA or, where a settlor is chargeable on the settlement income under Chapter 5 of Part 5 of ITTOIA, under that Chapter).

2008. For individuals, interest is taxed in the tax year in which it arises. So the tax year in which the accrued income losses arise will be the same as the tax year in which the interest is taxed.

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2009. For partnerships, interest may be taxed more than once in different tax years (and may therefore be taxed in a different tax year from that in which it arises). *Subsection (3)* prevents any person from being entitled to a reduction from interest in more than one tax year, and restricts the year when the reduction may be made to the tax year in which the interest period ends.

2010. See *Change 107* in Annex 1 which substitutes an exemption for a reduction and determines the tax year for which the exemption is available to partners.

Section 680: Interest on securities involving accrued income losses: foreign trustees

2011. This section provides an exemption for a settlor chargeable under Chapter 5 of Part 5 of ITTOIA if the settlor would have benefited from exemption under section 679 had the foreign trustees of the settlement in question been resident or domiciled in the United Kingdom. It is based on section 720(7) of ICTA.

2012. This section complements section 667 in Chapter 2.

2013. *Subsection (2)* confirms that the amount of relief given against a charge under Chapter 5 of Part 5 of ITTOIA is equal to the amount of the settlor's income under that Chapter that would have benefited from exemption under section 679 if the trustees had been resident in the United Kingdom or domiciled in the United Kingdom. (That is, by virtue of their actual residence status, the trustees are likely to be excluded transferors or transferees under section 643 and accrued income profits will therefore not arise to them, so that the condition in section 679(1)(b) is not met.)

2014. See again *Change 107* in Annex 1.

Section 681: Unrealised interest received by transferee after transfer

2015. This section provides an exemption for unrealised interest on securities if the securities have been transferred with unrealised interest. It is based on sections 716(4) and (5) and 719(3) of ICTA.

2016. As explained in the commentary on section 634, if securities are transferred with unrealised interest (and the settlement day falls before the end of the last interest period) a payment is treated as made to the transferor but no one is treated as making the payment. The unrealised interest is acquired by the transferee from the transferor and the effect of treating this payment as made to the transferor is to charge the transferor to income tax on the interest (which accrued while in the transferor's ownership).

2017. It follows that when the unrealised interest is subsequently received by the transferee it should not be taxed in the transferee's hands or the interest would be taxed twice. This section prevents double taxation by exempting the interest from income tax.

2018. *Subsection (2)* indicates that the transferee is exempt from income tax on the receipt of the unrealised interest unless *subsections (3) and (4)* apply.

2019. *Subsection (3)* applies if the issuer of the securities has defaulted on the obligation to pay interest. In such a case, the payment treated as made to the transferor under section 634 is changed to reflect the value of the right to receive interest (instead of the amount of the

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interest). The amount of the interest which is exempt from tax in the hands of the transferee is correspondingly restricted. See the commentary on sections 660 and 661.

2020. The result is that the interest is taxed, but only (see *subsection (6)*) to the extent that it exceeds the value on the day of the transfer of the right to receive the interest (see *subsection (4)*).

2021. See paragraph 128 of Schedule 2 which restricts the application of the section if the transfer mentioned in *subsection (1)* occurred before 19 March 1986.

Part 13: Tax avoidance

Overview

2022. This Part contains provisions relating to various types of tax avoidance. The Chapters are arranged as follows:

- Transactions in securities (Chapter 1);
- Transfer of assets abroad (Chapter 2);
- Transactions in land (Chapter 3);
- Sales of occupation income (Chapter 4);
- Avoidance involving trading losses (Chapter 5).

Chapter 1: Transactions in securities

Overview

2023. This Chapter rewrites, for the purposes of income tax, sections 703 to 709 of ICTA.

2024. Sections 703 to 709 of ICTA were enacted as a wide-ranging anti-avoidance rule which would enable the Crown to counter all manner of devices to avoid income tax involving transactions in shares or other securities or the manipulation of a company's assets or both, and to forestall the creation of such devices in future.

2025. The sections of this Chapter are arranged in the following order:

- Sections 682 and 683 – introduction (section 683 defines the central concept of “income tax advantage”);
- Sections 684 and 685 – definition of the person liable to counteraction of income tax advantages;
- Sections 686 to 694 – circumstances in which, if income tax advantages are obtained or obtainable, the Chapter may apply;
- Sections 695 to 700 – procedure for counteraction of income tax advantages;
- Sections 701 to 703 – clearance procedure and information powers;
- Section 704 – how the special tribunal for the purposes of this Chapter is to be constituted;
- Sections 705 to 711 – appeals;

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- Sections 712 and 713 – supplementary.

Section 682: Overview of Chapter

2026. This section provides an overview of the Chapter. It is based on section 703(1) of ICTA.

2027. *Subsection (2)* provides a signpost to section 698, which is concerned with the issue of notices counteracting income tax advantages.

Section 683: Meaning of “income tax advantage”

2028. This section defines “income tax advantage” for the purposes of this Chapter. It is based on section 709(1) and (2A) of ICTA.

2029. This Act consequentially amends sections 703 to 709 of ICTA to apply solely for corporation tax purposes. In particular, sections 703 to 709 of ICTA will use the term “corporation tax advantage”.

2030. But the definition of “tax advantage” in section 709(1) of ICTA is used in a large number of other anti-avoidance provisions (such as paragraph 13 of Schedule 9 to FA 1996 (loan relationships: unallowable purposes test)). To ensure that these provisions are not disturbed, this Act inserts a new section 840ZA of ICTA (meaning of “tax advantage”), and consequentially amends those provisions outside Chapter 1 of Part 17 of ICTA which use the section 709(1) definition of “tax advantage”.

Section 684: Person liable to counteraction of income tax advantage

2031. This section defines the person liable to counteraction. It is based on section 703(1) and (2) of ICTA.

2032. *Subsection (1)* sets three positive conditions for this section to apply to a person in respect of a transaction in securities or two or more such transactions.

2033. The first condition, in the opening words of subsection (1), is that the person is in a position to obtain or has obtained an income tax advantage.

2034. The second condition, in subsection (1)(a), is that the person is in a position to obtain or has obtained the income tax advantage in circumstances where any of the specified provisions applies in relation to the person.

2035. The third condition, in subsection (1)(b), is that the person is in a position to obtain or has obtained the income tax advantage in consequence of either the transaction or the combined effect of the transactions.

2036. *Subsection (3)* covers the situation when an income tax advantage is obtained or obtainable by a person in consequence of the combined effect of the transaction or transactions and the liquidation of a company.

Section 685: Exception where no tax avoidance object shown

2037. This section provides an exception to section 684 in certain circumstances. It is based on the escape clause in section 703(1) of ICTA.

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2038. *Subsection (1)* provides that a person is taken out of section 684 if that person shows that both conditions A and B are met. These conditions are defined in *subsections (2) and (3)*.

2039. Section 703(1) contains a reference to “the transaction or transactions being carried out”. In Greenberg v CIR (1971), 47 TC 240 HL (at pages 279 and 283) Lord Guest and Lord Simon of Glaisdale said that “carried out” in section 703(1) of ICTA meant “effected” as in section 707 of ICTA rather than “implemented”. Sections 685(2) and 701 (which is based on section 707 of ICTA) therefore both refer to transactions being “effected”. This is a verbal change to provide consistency. It does not change the law.

Section 686: Abnormal dividends used for exemptions or reliefs (circumstance A)

2040. This section is the first in a sequence of sections in which the sets of circumstances in section 704 of ICTA are laid out and expanded in five separate sections. It is based on sections 704 A and 709(3) of ICTA.

2041. The sequence also includes four interpretative sections based on sections 704 D and 709 of ICTA. The approach here takes account of the comments of Slade J in CIR v Garvin (1981), 55 TC 24¹ at page 50:

The five circumstances set out in [what is now section 704 of ICTA] are set out in minute detail, not for the assistance of the Crown but for the protection of the subject, in the context of a preceding section of a penal nature.

2042. *Subsection (1)* requires that three conditions set out in *subsections (2) to (4)* must be satisfied if section 686 is to apply to a person.

2043. *Subsection (3)* lays down what the receipt must be in connection with. The approach taken here differs from that in the source legislation. First, the subsection brings together provisions that were previously drafted in separate subsections. Second, in line with judicial comment on these provisions, it does not treat section 709(3)(a) and (b) as non-exhaustive definitions. The approach taken here is consistent with the case law on these provisions: CIR v Parker (1966) 43 TC 396 HL, CIR v Cleary (1967) 44 TC 399 HL, Hague v CIR (1968) 44 TC 619 CA, CIR v Horrocks (1968) 44 TC 645 Ch D and CIR v Wiggins (1978) 53 TC 639 Ch D².

2044. *Subsection (4)* prescribes the tax purposes for which the amount received must be taken into account.

2045. Section 704 A(f) of ICTA is redundant and, accordingly, is repealed without replacement.

Section 687: Deductions from profits obtained following distribution or dealings (circumstance B)

2046. This section is based on sections 704 B(1) and 709(3) of ICTA.

¹ [1981] STC 344.

² [1979] STC 244.

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2047. *Subsection (1)* requires that three conditions set out in subsections (2) to (4) must be satisfied if section 687 is to apply to a person.

2048. *Subsection (2)* provides that the person must become entitled to a deduction in calculating profits or gains in respect of securities.

2049. *Subsection (3)* prescribes what the person's entitlement must arise in connection with. See also the commentary on section 686(3).

2050. This section does not rewrite section 704 B(2), which is corporation tax specific.

Section 688: Receipt of consideration representing company's assets, future receipts or trading stock (circumstance C)

2051. This section is based on sections 704 B, 704 C and 709 of ICTA.

2052. *Subsection (1)* requires that three conditions set out in subsections (2), (3) and (6) must be satisfied if section 688 is to apply to a person (A).

2053. *Subsection (2)* is about the receipt of consideration. It prescribes what the consideration must be if section 688 is to apply to A.

2054. *Subsection (3)* requires that, if section 688 is to apply to a receipt, it must be in consequence of a transaction whereby another person (B) – to summarise – either receives an abnormal amount by way of dividend or becomes entitled to a deduction in calculating profits or gains in respect of B's securities. Subsection (3) retains the source legislation's connective "whereby", which has been the subject of judicial comment.

2055. *Subsection (4)* prescribes what B's entitlement (in subsection (3)) must arise in connection with. On the rewrite of section 709(3)(a) and (b) in this context, see the comment on section 686(3).

2056. Section 709(3)(c) of ICTA (meaning of "consideration") is rewritten for the purposes of section 688 in *subsection (8)*. Subsection (8) extends "consideration" to include non-contractual receipts of money or money's worth.

Section 689: Receipt of consideration in connection with relevant company distribution (circumstance D)

2057. This section is based on sections 704 C, 704 D and 709 of ICTA.

2058. *Subsection (1)* requires that three conditions set out in subsections (2) to (4) must be satisfied if section 689 is to apply to a person.

2059. *Subsection (2)* is concerned with the receipt of consideration. It prescribes what the receipt must be in connection with if section 689 is to apply to the person in question. It is based on sections 704 D(1) and 709(3)(a) and (b) of ICTA.

2060. On the rewrite of section 709(3)(a) and (b) in this context, see the comment on section 686(3).

2061. *Subsection (6)* is concerned with "consideration". It is based on section 709(3)(c) of ICTA. It extends "consideration" to include non-contractual receipts of money or money's worth.

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Section 690: Receipt of assets of relevant company (circumstance E)

2062. This section is based on section 704 E and 709(3) of ICTA.

2063. *Subsection (1)* requires that four conditions set out in subsections (2) to (4) and (7) must be satisfied if section 690 is to apply to a person.

2064. *Subsection (8)* defines “security” and (non-exhaustively) “consideration” and “share” in section 690. It extends “consideration” to include non-contractual receipts of money or money’s worth.

Section 691: Meaning of “relevant company” in sections 689 and 690

2065. This section defines the term “relevant company”, which is used in sections 689 and 690. It is based on section 704 D of ICTA.

Section 692: Abnormal dividends: general

2066. This section is the first of three interpretative sections about abnormal dividends. It is based on section 709(4) of ICTA.

2067. *Subsection (1)* provides that a dividend is abnormal if “the appropriate authority” is satisfied either that “the excessive return condition” is met or that “the excessive accrual condition” is met. Signposts are provided to sections 693 and 694, where these conditions are defined.

2068. *Subsection (2)* defines “the appropriate authority”. It replaces the reference to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2069. HMRC’s internal procedures restrict the exercise of the Commissioners for Revenue and Customs’ functions under Chapter 1 of Part 17 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

Section 693: Abnormal dividends: the excessive return condition

2070. This section defines the excessive return condition. It is based on section 709(4) and (6) of ICTA.

Section 694: Abnormal dividends: the excessive accrual condition

2071. This section defines the excessive accrual condition. It is based on section 709(4) and (5) of ICTA.

Section 695: Preliminary notification that section 684 may apply

2072. This section is concerned with preliminary notification that section 684 (person liable to counteraction of income tax advantages) may apply. It is based on section 703(3) and (9) of ICTA.

2073. The section is the first of a group of sections (sections 695 to 700) which lay down the procedure for counteraction of income tax advantages.

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2074. As explained in the note on section 692, section 695 similarly replaces a reference to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

Section 696: Opposed notifications: statutory declarations

2075. This section applies if the person on whom the preliminary notification is served considers that section 684 does not apply. It is based on section 703(9) and (10) of ICTA.

2076. As explained in the note on section 692, this section similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2077. *Subsections (1) and (2)* are about the person’s right to make a statutory declaration that section 684 does not apply and the time limit for doing so.

2078. *Subsection (3)* lays down the legal consequences if the person makes a statutory declaration, sends it to the officer and the officer sees no reason to take further action.

Section 697: Opposed notifications: determinations by tribunal

2079. This section applies if the officer receiving a statutory declaration sees reason to take further action. It is based on section 703(10) of ICTA.

2080. As explained in the note on section 692, section 697 similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2081. *Subsections (2) and (3)* are about what the officer must and may do.

2082. If the taxpayer gives a statutory declaration that section 684 does not apply and the officer sees reason to take further action, subsection (2) requires the officer to send the tribunal a certificate to that effect, together with the statutory declaration.

2083. *Subsection (4)* is about what the tribunal must do.

2084. *Subsection (5)* lays down the legal consequences if the tribunal determines that there is no case for the officer to take further action.

2085. *Subsection (6)* limits those consequences to cases where the transaction or transactions under review are the only ones involved.

Section 698: Counteraction notices

2086. This section is concerned with notices for the counteraction of income tax advantages. It is based on section 703(3), (9), (10) and (12) of ICTA.

2087. As explained in the note on section 692, section 698 similarly replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2088. *Subsection (1)* lays down that the officer can serve a counteraction notice in two circumstances, namely if:

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- the person on whom a preliminary notification has been served has not exercised the right to make a statutory declaration in the time allowed; or
- the person has exercised this right, but the tribunal has determined that there is a prima facie case for counteraction.

2089. Subsection (1), unlike the source legislation, makes it explicit that counteraction can proceed once the tribunal has determined that there appears to be a case for counteraction. This follows a dictum to that effect from Oliver J in Balen v CIR (1978) 52 TC 406³ at page 408.

2090. *Subsection (4)* specifies the kinds of adjustment which a notice may require to be made, including an assessment.

Section 699: Limit on amount assessed in section 689 and 690 cases

2091. This section sets a limit on the amount assessed in cases within sections 689 and 690. It is based on section 703(3A) of ICTA.

Section 700: Timing of assessments in section 690 cases

2092. This section is a special rule for the timing of assessments in section 690 cases. It is based on section 704 E(2) and (3) of ICTA.

Section 701: Application for clearance of transactions

2093. This section is concerned with applications for clearance of transactions. It is based on section 707(1) of ICTA.

2094. This section will apply solely for income tax purposes, and section 707 of ICTA will apply solely for corporation tax purposes. HMRC's operational guidance will tell officers what action they should take if a clearance application is made which appears to refer to the wrong provision.

Section 702: Effect of clearance notification under section 701

2095. This section lays down the legal consequences of HMRC giving a clearance notification under section 701. It is based on section 707 of ICTA.

2096. This section will apply solely for income tax purposes, and section 707 of ICTA will apply solely for corporation tax purposes. If HMRC issue a section 702 or section 707 clearance which refers by mistake to the wrong provision, HMRC will treat it as if it referred to the correct provision.

Section 703: Power to obtain information

2097. This section gives HMRC power to obtain information relevant to this Chapter. It is based on section 708 of ICTA.

³ [1978] STC 420.

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2098. Section 703 changes the 28-day information gathering time limit to 30 days. See *Change 108* in Annex 1.

2099. As explained in the note on section 692, section 703 replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2100. This section will apply solely for income tax purposes, and section 708 of ICTA will apply solely for corporation tax purposes.

Section 704: The tribunal

2101. This section prescribes how the special tribunal for the purposes of this Chapter is to be constituted. It is based on section 706 of ICTA.

Section 705: Appeals against counteraction notices

2102. This section is concerned with appeals against counteraction notices. It is based on section 705(1) and(5) of ICTA.

2103. Section 705(5) of ICTA gives the Special Commissioners the power not only to vary or quash an assessment but also, implicitly, to affirm it: see Browne-Wilkinson J in *Anysz v CIR* (1977), 53 TC 601 ChD at page 630⁴. *Subsection (3)* makes this implication explicit, and similarly makes it explicit that the Special Commissioners have the power to affirm a counteraction notice.

Section 706: Rehearing by tribunal of appeal against counteraction notice

2104. This section is concerned with the tribunal rehearing appeals against counteraction notices. It is based on section 705(2), (3) and (5) of ICTA.

2105. As explained in the note on section 692, this section similarly replaces references to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case) See *Change 5* in Annex 1.

2106. Section 705(3) of ICTA provides that the tribunal shall “have and exercise” the same “powers and authorities” as the Special Commissioners. In the present context, exercising a power is implicit in having it and it is unnecessary to refer to both “powers” and “authorities”. *Subsection (4)*, which is based on this part of section 705(3), therefore merely says that the tribunal have the same powers in relation to the appeal as the Special Commissioners.

Section 707: Statement of case by tribunal for opinion of High Court or Court of Session

2107. This section is concerned with appeals from the tribunal to the High Court (in England and Wales) or the Court of Session (in Scotland). It is based on sections 705(5) and 705A of ICTA.

⁴ [1978] STC 296 at page 321.

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2108. As explained in the note on section 692, this section similarly replaces a reference to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2109. This section removes the requirement in section 705A of ICTA for the dissatisfied party to declare “his or their dissatisfaction” before requiring the tribunal to state a case for the opinion of the court. This is a minor administrative change in the law. See *Change 109* in Annex 1.

Section 708: Cases before High Court or Court of Session

2110. This section is concerned with cases before the High Court or the Court of Session. It is based on section 705A of ICTA.

Section 709: Effect of appeals against tribunal’s determination under section 706

2111. This section sets out the legal consequences if the tribunal have made a determination under section 706 about an assessment and a case has been required to be stated about it under section 707 or is pending before the High Court or the Court of Session. It is based on section 705A(10) to (12) of ICTA.

Section 710: Appeals from High Court or Court of Session

2112. This section is concerned with appeals from the High Court and the Court of Session. It is based on section 705A(8), (9) and (12) of ICTA.

2113. This section refers to “the Supreme Court” rather than “the House of Lords”. This anticipates the substitutions to be made by paragraph 47 of Schedule 9 to the Constitutional Reform Act 2005. This Act includes a transitional amendment substituting “the House of Lords” for “the Supreme Court” for the period before the paragraph 47 amendments come into force.

Section 711: Proceedings in Northern Ireland

2114. This section deals with proceedings in Northern Ireland. It is based on section 705B of ICTA.

2115. Section 705B of ICTA (transactions in securities: proceedings in Northern Ireland) applies the procedures of section 705A of ICTA to Northern Irish appeals. In particular, it provides that “the Taxes Acts (as defined in section 118(1) of [TMA])” shall have effect as if section 705A of ICTA applied with modifications to reflect the court system in Northern Ireland.

2116. Section 118(1) of TMA defines “the Taxes Acts” as “this Act [ie TMA] and (a) the Tax Acts and (b) the Taxation of Chargeable Gains Act 1992 and all other enactments relating to capital gains tax.”

2117. The implicit reference to the enactments relating to capital gains tax is redundant. This section therefore omits it.

2118. This section refers to “the Supreme Court” rather than “the House of Lords”. In this connection see the commentary on section 710.

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Section 712: Application of Chapter where individual within section 684 dies

2119. This section is concerned with the application of this Chapter where an individual within section 684 has died. It is based on section 703(11) of ICTA.

2120. *Subsection (3)* expressly refers not only to the making of a statutory declaration, rights of appeal and the giving of information (like the source legislation) but also to notices and notifications such as are mentioned in *subsection (2)*. This reference is implicit in section 703(11) of ICTA.

Section 713: Interpretation of Chapter

2121. This section is interpretative. It is based on section 709(2) of ICTA.

2122. In CIR v Joiner (1975), 50 TC 449 HL⁵ Lord Diplock said (at page 487):

In the instant case the explanation in [what is now section 709(2) of ICTA] of the expression “transaction in securities”, though introduced by the word “includes”, speaks of “transactions, of whatever description, relating to securities” as well as referring to particular examples of such transactions. This is so extensive as to leave no possibility of there being any transaction which could sensibly be described as a “transaction in securities” without also falling within the longer description in the interpretation clause. So it is no more than a direction to the reader: “Whenever you see the words “transaction in securities” in this Chapter of the Statute you must treat them as being shorthand for the whole of the words in [what is now section 709(2)] that are preceded by the verb “includes” [in the fourth place in which it occurs].”

2123. Buckley J and Lord Simon of Glaisdale had made the same point in Greenberg v CIR (1971), 47 TC 240 at pages 260 and 282.

2124. This section therefore expressly rewrites the definition of “transaction in securities” as exhaustive.

Chapter 2: Transfer of assets abroad

Overview

2125. This Chapter contains provisions directed against tax avoidance by means of transfers of assets.

2126. The sections of this Chapter are arranged in the following order:

- Sections 714 to 719 – introduction;
- Sections 720 to 726 – charge where power to enjoy income;
- Sections 727 to 730 – charge where capital sums received;
- Sections 731 to 735 – charge where benefit received;
- Sections 736 to 742 – exemptions: no tax avoidance purpose or genuine commercial transaction;
- Sections 743 to 747 – general;
- Sections 748 to 751 – supplementary.

⁵ [1975] STC 657.

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Section 714: Overview of Chapter

2127. This section provides an overview of the Chapter.

2128. *Subsection (1)* introduces the three charges that are imposed by the Chapter. It is new.

2129. *Subsection (4)* extends references to individuals to include their spouses and their civil partners. It is based on section 742(9) of ICTA.

Section 715: Meaning of “relevant transaction”

2130. This section defines the expression “relevant transaction”. It is based on section 741B(2) of ICTA.

2131. Either a “relevant transfer” or an “associated operation” may be a “relevant transaction”, and the convenient new label “relevant transaction” is used extensively in this Chapter.

2132. The expressions “relevant transfer” and “associated operation” are defined in sections 716 and 719, to which *subsection (2)* provides signposts.

Section 716: Meaning of “relevant transfer” and “transfer”

2133. This section defines “relevant transfer” and “transfer” for the purposes of this Chapter. It is based on sections 739(1), 740(1) and 742(1A) and (9) of ICTA.

Section 717: Meaning of “assets” etc

2134. This section non-exhaustively defines the term “assets” and makes provision about the interpretation of references to assets representing assets, income or accumulations of income. It is based on section 742(9) of ICTA.

Section 718: Meaning of “person abroad” etc

2135. This section introduces the term “person abroad”, meaning a person who is resident or domiciled outside the United Kingdom. It is based on sections 739(1) to (3), 740(1) and (3), 742(2), (4), (8) and (9A) and 745(3) of ICTA and section 111(1) of FA 1989.

2136. *Subsection (2)* provides that a UK resident body corporate that is incorporated outside the United Kingdom is treated as if it were resident outside the United Kingdom. It forestalls arguments that a non-UK incorporated but UK resident body corporate is somehow domiciled in a part of the United Kingdom and therefore not a person abroad.

2137. *Subsection (2)* also provides that a person treated as neither UK resident nor ordinarily UK resident under section 475(3) (trustees of settlements) and persons treated as non-UK resident under section 834(4) (personal representatives) are treated as resident outside the United Kingdom (and thus persons abroad).

Section 719: Meaning of “associated operation”

2138. This section defines the term “associated operation”. It is based on section 742(1) of ICTA.

2139. This section includes a minor change in the law relating to the references to “assets” in section 742(1) of ICTA. See *Change 110* in Annex 1.

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Section 720: Charge to tax on income treated as arising under section 721

2140. This section imposes the charge to income tax on individuals with power to enjoy income as a result of relevant transactions and indicates the measure of income and the person liable. It is based on sections 739(1), (2) and 743(1) of ICTA. It is the first of a sequence of sections (sections 720 to 726) which deal with this charge.

2141. *Subsection (5)* provides that the individual to whom income is treated as arising is the person liable. This person is defined in section 721.

2142. This section also provides signposts to other sections detailing how the income charged is calculated and when exemption is due.

Section 721: Individuals with power to enjoy income as a result of relevant transactions

2143. This section describes the individual to whom income is treated as arising and the circumstances in which it is treated as arising. It is based on sections 739(1) to (2) and 742(1B) of ICTA.

2144. Sections 739(2) and (3) of ICTA indicate the person liable by using the expression “such an individual” – but do not make it clear how much of section 739(1) is implied by that expression. This section and section 728, which are based on section 739(2) and (3), reproduce the expression “such an individual”, which has been the subject of case law: see, in particular, *Vestey v CIR* (1979), 54 TC 503 HL⁶.

Section 722: When an individual has power to enjoy income of person abroad

2145. This section defines in general terms when an individual has power to enjoy income of a person abroad. It is based on section 742(2) and (3) of ICTA. One of the conditions for liability under section 720 is that the individual has “power to enjoy” income of a person abroad: section 721(2).

2146. *Subsection (1)* introduces the concept of the enjoyment conditions. *Subsection (2)* provides a link to section 723, which sets out those conditions.

Section 723: The enjoyment conditions

2147. This section continues the definition of when an individual has power to enjoy income of a person abroad, by detailing “the enjoyment conditions”. It is based on section 742(2) of ICTA.

Section 724: Special rules where benefit provided out of income of person abroad

2148. This section deals with the quantum of charge where:

- the enjoyment condition is the receipt of a benefit provided out of the income of the person abroad or related money; and
- the individual has not been charged previously to income tax on that income.

⁶ [1980] STC 10.

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It is based on section 743(5) of ICTA.

Section 725: Reduction in amount charged where controlled foreign company involved

2149. This section gives apportionment under the controlled foreign company (CFC) rules in Chapter 4 of Part 17 of ICTA priority over the income treated as arising under section 721. It is based on section 747(4) of ICTA.

2150. The CFC rules address a similar mischief to the transfer of assets abroad legislation (avoidance by companies rather than individuals), but in a different way. This section prevents double taxation and determines which branch of anti-avoidance legislation takes priority.

Section 726: Non-domiciled individuals

2151. This section provides that an individual is not chargeable to tax under section 720 in respect of income treated as arising to the individual under section 721 if two conditions are met. It is based on section 743(3) of ICTA.

2152. This section is similar to sections 831 and 832 of ITTOIA 2005 (claims by non-domiciled individuals for relevant foreign income to be charged on the remittance basis).

Section 727: Charge to tax on income treated as arising under section 728

2153. This section imposes the charge to income tax, on individuals receiving capital sums as a result of relevant transactions, which was previously imposed by section 739(3) of ICTA. It indicates the measure of income and the person liable. It is based on sections 739 and 743 of ICTA. It is one of a sequence of sections (sections 727 to 730) which are based on the former charge under section 739(3).

2154. Sections 727 to 730 defeat schemes designed to avoid liability under sections 720 to 726.

Section 728: Individuals receiving capital sums as a result of relevant transactions

2155. This section largely replicates section 721. It is based on sections 739(1), (1A) and (3), 742(1A) and 747(4) of ICTA.

Section 729: The capital receipt conditions

2156. This section is concerned with the expression “receives or is entitled to receive any capital sum”. It is based on section 739(3) to (6) of ICTA.

2157. This section also makes it clear that where liability arises because an individual has only an entitlement to receive a capital sum, rather than actual receipt, then liability under section 727 continues only for as long as the entitlement to receive a capital sum exists. See *Change 111* in Annex 1.

2158. If the entitlement to the capital sum ceases because the capital sum is actually paid to the transferor (either in whole or in part), then the receipt of the capital sum does result in continuing liability under this section; *subsection (1)* reflects this.

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2159. *Subsection (2)* makes an exception to this rule. If a sum is received by way of loan, this does not give rise to liability if the loan is wholly repaid before the tax year begins. Subsection (2) is based on section 739(6) of ICTA.

2160. *Subsection (4)* comments on the expression “receives or is entitled to receive” in subsection (1).

Section 730: Non-domiciled individuals

2161. This section is the equivalent, for this sequence of sections, of section 726. It is based on section 743(3) of ICTA.

Section 731: Charge to tax on income treated as arising under section 732

2162. This section imposes the charge, on non-transferors receiving a benefit as a result of relevant transactions, previously imposed by section 740 of ICTA. It indicates the measure of income and the person liable. It is based on section 740(2). It is one of a sequence of sections (sections 731 to 735) which are based on the former charge under section 740 of ICTA.

2163. Sections 731 to 735 deem individuals to receive taxable income if (broadly speaking) they receive benefits as a result of transfers of the kind envisaged in sections 720 to 730 but are not liable under those sections.

Section 732: Non-transferors receiving a benefit as a result of relevant transactions

2164. This section sets out the circumstances under which income is treated as arising. It is based on sections 740(1) and (2) and 742(1A) of ICTA.

2165. *Subsection (1)(d)* also makes it clear that persons who are liable to income tax under section 720 or section 727 are not subject to the charge under section 731. See *Change 112* in Annex 1.

Section 733: Income charged under section 731

2166. This section sets out in a method statement the rules for determining the amount (if any) of income treated as arising under section 731. It is based on sections 740(2) and (3) and 741C(7) of ICTA.

2167. It also spells out some implications which involve minor changes to the law. See *Change 113* in Annex 1.

2168. In broad terms, the effect of this section and section 734 is:

- to tax non-transferors on benefits which they receive (but only on the amount or value of those benefits);
- to ensure that tax will only be charged on a benefit to an individual if income has arisen by the use of which such benefits could be provided; and
- to ensure nevertheless that tax will not be avoided merely by conferring the benefit before the “relevant income” is actually available.

2169. The method statement in this section will make no practical difference to taxpayers’ record-keeping obligations.

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2170. The method statement makes it clear that “relevant income” in relation to an individual is not actually taxable income of the individual, but is an element in the calculation of taxable income. “Relevant income” is actual income arising to a person abroad; the income charged under section 731 is income treated as arising to the individual in question. This deemed income may be more or less than “the relevant income of the tax year” in relation to the individual and the tax year identified at Step 3.

2171. The Act will have effect for income tax purposes for 2007-08 and later tax years. But the calculation of income charged under section 731 in (for example) 2007-08 will take account of “relevant income” in relation to the individual, not only of 2007-08 but (if the statutory conditions were satisfied) of earlier tax years – whether or not the individual had any liability under section 740 of ICTA for those tax years.

Section 734: Reduction in amount charged: previous capital gains tax charge

2172. This section supplements section 733; it is directed against the same amount being charged to both income tax and capital gains tax. It is based on section 740(6) of ICTA.

Section 735: Non-domiciled individuals

2173. This section gives a measure of relief to non-domiciled individuals. It is based on section 740(5) of ICTA.

2174. *Subsection (1)* lays down the conditions for this section to apply. If an individual receives a benefit which would otherwise be chargeable to income tax under section 731, this section applies if conditions A to C are met. These conditions are set out in subsections (2), (3) and (4).

2175. If this section applies, *subsection (5)* provides that the benefit does not give rise to an income tax charge on the individual, to the extent that the chargeable amount of this benefit is determined by reference to the relevant income to which condition C applies.

2176. This section is similar to sections 831 and 832 of ITTOIA 2005 (claims by non-domiciled individuals for relevant foreign income to be charged on the remittance basis).

Section 736: Exemptions: introduction

2177. This section introduces sections 737 to 742, a sequence of sections giving exemption from liability under this Chapter. It is based on section 741B(2) to (5) of ICTA.

2178. *Subsection (3)* defines the expressions “post-4 December 2005 transaction” and “pre-5 December 2005 transaction”, which are used extensively in this sequence of sections.

Section 737: Exemption: all relevant transactions post-4 December 2005 transactions

2179. This section sets the purpose test which applies if all the relevant transactions are post-4 December 2005 transactions. It is based on section 741A(1) to (4), (7) and (8) and section 741B(4) of ICTA.

Section 738: Meaning of “commercial transaction”

2180. This section defines the expression “commercial transaction”, which is used in Condition B in section 737(4). It is based on section 741A(5) to (7) of ICTA.

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Section 739: Exemption: all relevant transactions pre-5 December 2005 transactions

2181. This section sets the purpose test which applies if all the relevant transactions are pre-5 December 2005 transactions. It is based on sections 741(1) and 741B(3) of ICTA.

2182. This section replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2183. HMRC’s internal procedures restrict the exercise of the Commissioners for Her Majesty’s Revenue and Customs’ functions under section 741 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

2184. This section continues to use the source legislation’s word “taxation”, which has been the subject of case law. For example, *Sassoon v CIR* (1943), 25 TC 154 CA indicates that “taxation” in this context is not restricted to income tax.

Section 740: Exemption: relevant transactions include both pre-5 December 2005 and post-4 December 2005 transactions

2185. This section lays down how the purpose tests are to be applied if the relevant transactions include both pre-5 December transactions and post-4 December transactions. It is based on sections 741B(5) and 741C(1) to (6) and (8) of ICTA..

Section 741: Application of section 742 (partial exemption)

2186. This section lays down the conditions for section 742 (partial exemption where later associated operations fail conditions) to apply. It is based on section 741D(1) to (5) and (9) of ICTA.

2187. In summary, this section applies if an arrangement originally satisfies the purpose tests but is tainted by later associated operations.

Section 742: Partial exemption where later associated operations fail conditions

2188. This section restricts the income in respect of which the individual is liable to tax under this Chapter. It is based on section 741D(6) and (7) of ICTA.

Section 743: No duplication of charges

2189. This section is directed against multiple taxation. It is based on sections 743(4) and 744(1) of ICTA.

2190. This section replaces references to “the Board” with references to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2191. HMRC’s internal procedures restrict the exercise of the Commissioners for Her Majesty’s Revenue and Customs’ functions under section 744 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

Section 744: Meaning of taking income into account in charging income tax for section 743

2192. This section relates to the interpretation of section 743. It is based on section 744(2) of ICTA.

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Section 745: Rates of tax applicable to income charged under sections 720 and 727 etc

2193. This section deals with rates of tax applicable to income charged under sections 720 and 727. It is based on section 743(1) to (1B) and (5) of ICTA.

2194. *Subsection (1)* retains the expression “by deduction or otherwise”, as it has been the subject of judicial comment: see paragraph 53 of the judgment of Lord Scott in R v Dimsey & Allen (2001), 74 TC 263 HL⁷ at page 312.

Section 746: Deductions and reliefs where individual charged under section 720 or 727

2195. This section applies for the purposes of calculating an individual’s liability to income tax, and is concerned with the availability of deductions and reliefs. It is based on section 743(2) of ICTA.

Section 747: Amounts corresponding to accrued income scheme profits and related interest

2196. This section ensures that any charge made on an individual under this Chapter takes proper account of accrued income when the assets of the person abroad include securities for the purposes of Chapter 2 of Part 12 (accrued income profits). It is based on section 742(4) to (7) of ICTA.

2197. Although section 742(5) of ICTA says “Sections 739 to 741 shall have effect ...”, this section works on the basis that the operation of the other sections in Chapter 3 of Part 17 of ICTA is not excluded.

2198. *Subsections (1), (6) and (7)* include by implication a minor change in the law on accrued income profits; see *Change 101* in Annex 1.

Section 748: Power to obtain information

2199. This section enables HMRC to obtain information which is relevant to the operation of this Chapter. It is based on section 745(1) to (3) of ICTA.

2200. *Subsection (1)* includes two minor changes.

2201. First, it refers to “an officer of Revenue and Customs” (namely, the officer dealing with the case) instead of “the Board”. See *Change 5* in Annex 1. HMRC’s internal procedures restrict the exercise of the Commissioners for Her Majesty’s Revenue and Customs’ functions under section 745 of ICTA to a small group of specialist officers. *Change 5* will have no effect on this practice.

2202. Second, it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

2203. *Subsection (2)* also includes a minor change in the law. It sets the minimum time which HMRC may allow for the particulars to be provided at 30 days rather than 28 days. See *Change 108* in Annex 1.

⁷ [2001] STC 1520.

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Section 749: Restrictions on particulars to be provided by solicitors

2204. This section restricts HMRC's power to require solicitors to provide information under section 748. It is based on section 745(3), (4) and (6) of ICTA.

Section 750: Restrictions on particulars to be provided by banks

2205. This section restricts HMRC's power to require banks to provide information under section 748. It is based on section 745(5) to (6) of ICTA.

Section 751: Special Commissioners' jurisdiction on appeals

2206. This section gives the Special Commissioners, on appeal, jurisdiction to affirm or replace officers' decisions in exercise of certain functions under this Chapter. It is based on sections 741(1), 741A(9), 741D(8) and 744(1) of ICTA.

2207. This section replaces references to "the Board" with references to "an officer of Revenue and Customs" (namely, the officer dealing with the case). See *Change 5* in Annex 1.

Chapter 3: Transactions in land

Overview

2208. This Chapter contains a wide-ranging anti-avoidance rule specifically aimed at transactions in land. It is based on sections 776 to 778 of ICTA.

2209. The sections of this Chapter are arranged in the following order:

- Sections 752 to 754 – introduction;
- Sections 755 to 760 – charge on gains from transactions in land;
- Sections 761 to 764 – further provisions relevant to the charge;
- Sections 765 to 767 – exemptions;
- Sections 768 and 769 – recovery of tax;
- Sections 770 and 771 – clearances and power to obtain information;
- Section 772 – interpretation.

Section 752: Overview of Chapter

2210. This section provides an overview of the Chapter. It is based on section 776(1) and (2) of ICTA.

Section 753: Meaning of disposing of land

2211. This section explains the expression "disposing of land". It is based on section 776(4) of ICTA.

Section 754: Priority of other income tax provisions

2212. This section provides for other tax provisions to apply in priority to Chapter 3. It is based on section 777(10) of ICTA.

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Section 755: Charge to tax on gains from transactions in land

2213. This section imposes the charge to income tax on gains from transactions in land. It is based on section 776(3A) of ICTA. It is the first of a group of sections (sections 755 to 760) which form the core of the Chapter.

2214. *Subsection (2)* signposts exemptions from the charge.

Section 756: Income treated as arising where gains obtained from some land disposals

2215. This section sets out the circumstances in which income is treated as arising. It is based on section 776(2), (3), (5), (13) and (14) of ICTA.

2216. *Subsection (1)* specifies the requirements which must all be met if this section is to apply. One of the requirements is that all or any part of the land is situated in the United Kingdom.

2217. HMRC's interpretation of the territorial scope of section 776 of ICTA is summarised in the table below.

<i>Residence of taxpayer</i>	<i>Where land is located</i>	<i>Application of section 776</i>
United Kingdom	Wholly in the United Kingdom	Section 776 applies (assuming all the other conditions are met).
United Kingdom	Wholly outside the United Kingdom	Section 776 does not apply.
United Kingdom	Partly in the United Kingdom, partly outside the United Kingdom	Section 776 applies to the whole of the gain (assuming all the other conditions are met).
Non-UK	Wholly in the United Kingdom	Section 776 applies (assuming all the other conditions are met).
Non-UK	Wholly outside the United Kingdom	Section 776 does not apply.
Non-UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 776 applies (assuming all the other conditions are met), but only to the gain attributable to the UK land.

2218. This section and section 759 reflect this interpretation, and make a minor change in the law (although not in practice). See *Change 115* in Annex 1.

2219. The expression "all *or part* of the land" in subsection (1)(c) is based on section 776(14) of ICTA; it will (for example) cover a case in which several areas of land, some within the UK and some outside the United Kingdom, pass under a single bargain. In

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such a case, if the person liable is non-UK resident, the total consideration will be apportioned, and the provisions will be applied to the separate gain for each area of land in the United Kingdom to arrive at the non-UK resident's deemed income.

2220. If this section applies, *subsection (2)* treats the gain as income and deems it to arise when the gain is realised.

2221. For the sake of consistency with the rest of the section, *subsection (5)* refers to the opportunity of "realising" a gain, rather than (as in the source legislation) the opportunity of "making" it. This difference is verbal not substantive.

Section 757: Person obtaining gain

2222. This section specifies the person obtaining the gain. It is based on section 776(2)(c)(i) and (ii) and 776(5)(b) of ICTA.

2223. *Subsection (3)* indicates when a number of transactions may be regarded as constituting a single arrangement or scheme. Subsection (3) differs from the source legislation in that it is not drafted to apply for the purposes of section 753(1). There is no need for subsection (3) to bring a plurality of transactions within section 753(1)(b), since a plurality of transactions will already be within section 753(1)(a).

Section 758: Income charged

2224. This section defines the measure of income and gives a signpost to section 760 (method of calculating gain). It is based on section 776(3B) of ICTA.

Section 759: Person liable

2225. This section defines the person liable, bringing together a number of previously separate provisions. It is based on section 776(3)(b), (3B) and (8) of ICTA.

2226. *Subsection (1)* states that the person liable for any tax charged under this Chapter on income is the person whose income it is.

2227. *Subsection (2)* then lays down the general rule: that person is the person who realises the gain.

2228. *Subsection (3)* states that the general rule is subject to two exceptions, set out in subsections (4) and (6).

2229. *Subsection (4)* deals with the case where there is a person providing value. If all or any part of the gain accruing to a person ("A") is derived from value provided directly or indirectly by another person ("B"), the income is B's.

2230. *Subsection (5)* makes it clear that it does not matter for the purpose of subsection (4) whether or not the value is put at the disposal of A.

2231. *Subsection (6)* deals with the case where there is a person providing an opportunity to realise a gain. If all or any part of the gain accruing to a person is derived from an opportunity of realising a gain provided directly or indirectly by another person, the income is the other person's.

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2232. There is no equivalent of subsection (5) to back up subsection (6), because none is needed. This is a change in the law but not in practice. See *Change 116* in Annex 1.

2233. *Subsection (8)* makes a minor change in the law, although not in practice. See the commentary on section 756 and *Change 115* in Annex 1.

Section 760: Method of calculating gain

2234. This section lays down how a gain is to be calculated for the purposes of this Chapter. It is based on section 776(6) of ICTA.

Section 761: Transactions, arrangements, sales and realisations relevant for Chapter

2235. Section 761 concerns transactions, arrangements, sales and realisations relevant for this Chapter. It is based on section 777(2) and (3) of ICTA.

2236. This section is the first of a group of supplementary sections (sections 761 to 764). These sections apply for the purposes of the Chapter as a whole; because of their importance, they have been placed immediately after sections 755 to 760, the core sections.

Section 762: Tracing value

2237. This section is about tracing value. It is based on section 777(5) of ICTA.

Section 763: Meaning of “another person”

2238. This section explains the meaning of “another person” in this Chapter. It is based on section 777(7) of ICTA.

Section 764: Valuations and apportionments

2239. This section is about valuations and apportionments. It is based on section 777(6) of ICTA.

Section 765: Exemption: gain attributable to period before intention to develop formed

2240. This section exempts that part of a gain which is fairly attributable to a period before the intention to develop the land was formed. It is based on section 776(7) of ICTA.

2241. It is the first of a group of three exemptions, which are set out in sections 765 to 767.

Section 766: Exemption: disposals of shares in companies holding land as trading stock

2242. This section limits the scope of the charge by providing an exemption for disposals of shares in companies holding land as trading stock. It is based on section 776(10) of ICTA.

Section 767: Exemption: private residences

2243. This section gives exemption in respect of private residences, if certain conditions are met. It is based on section 776(9) of ICTA.

Section 768: Recovery of tax where consideration receivable by person not assessed

2244. This section deals with recovery of tax where consideration is receivable by a person (B) other than the person assessed (A). It is based on section 777(8) and (13) of ICTA.

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2245. Under *subsection (3)* A is entitled to recover from B any part of the tax which A has paid. To assist with this, A may obtain a certificate of tax paid: see the commentary on section 769.

2246. This section also includes a tie-breaker provision. This is a minor change in the law. See *Change 117* in Annex 1.

Section 769: Recovery of tax: certificates of tax paid etc

2247. This section deals with certificates of tax paid for the purposes of section 768(3). It is based on section 777(8) of ICTA.

2248. Section 777(8) of ICTA provides that the certificate is to be furnished by “the Board or an inspector”. In 1969, when this legislation was introduced, section 5 of the Income Tax Management Act 1964 provided that all assessments to income tax at the standard rate were to be made by an inspector and all assessments to surtax were to be made by the Board. The reference to “the Board” in section 777(8) appears to be a missed consequential on the abolition of surtax. This section therefore omits “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2249. *Subsection (3)* gives a signpost to section 944 in Part 15 (Deduction of tax at source) which rewrites section 777(9) of ICTA.

Section 770: Clearance procedure

2250. This section deals with clearances. It is based on section 776(11) and (12) of ICTA.

2251. Section 770 includes a minor change in the law. Section 776(11) of ICTA gives the clearance function to “the inspector to whom [the taxpayer] makes his return of income”. In practice, HMRC do not interpret this restrictively. Section 770 gives the clearance function to the Commissioners for Her Majesty’s Revenue and Customs. This will be consistent with section 707 of ICTA (transactions in securities: clearance procedure), which is rewritten in sections 701 and 702. See *Change 118* in Annex 1.

2252. Section 770 will apply solely for income tax purposes and section 776(11) and (12) of ICTA will apply solely for corporation tax purposes. HMRC’s operational guidance will tell officers what action they should take if a clearance application is made which appears to refer to the wrong provision. If HMRC issue a clearance under section 770 of this Act or under section 776 of ICTA which refers by mistake to the wrong provision, HMRC will treat it as if it referred to the correct provision.

Section 771: Power to obtain information

2253. This section enables HMRC to obtain information which is relevant to this Chapter. It is based on section 778 of ICTA.

2254. Section 778 of ICTA refers to “the Board or an inspector” and “the Board or the inspector”. For the reason given in the commentary on section 769, the references to “the Board” in section 778 appear to be a missed consequential on the abolition of surtax. Section 771 therefore now omits “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

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2255. *Subsection (1)* includes a minor change in the law: it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

Section 772: Interpretation of Chapter

2256. This section is interpretative. It is based on sections 776(13) and 777(13) of ICTA.

2257. Section 777(13) defines “capital amount” to mean any amount, in money or money’s worth, which, apart from the sections 775 and 776, does not fall to be included in any computation of income for purposes of the Tax Acts. It provides that other expressions including the word “capital” are to be construed accordingly. The drafting of subsection (1) reflects the fact that a gain is the result of an arithmetical calculation, arrived at very broadly by deducting receipts from expenses, and cannot itself be said to be in money or money’s worth.

2258. *Subsection (2)* (meaning of “property deriving its value from land”) is based on section 776(13)(b) of ICTA.

Section 776(13)(a) of ICTA: “land”

2259. This section does not rewrite the second limb of the definition of “land” in section 776(13)(a) of ICTA.

2260. In Schedule 1 to the Interpretation Act 1978 land is defined as including “buildings and other structures, land covered with water, and any estate, interest, easement, servitude or right in or over land.” Although the Interpretation Act 1978 was largely a consolidation, the definition of land was new and only applies from the commencement of that Act.

2261. The origin of section 776(13)(a) of ICTA is section 32(12)(a) of FA 1969. This definition therefore predates the definition of land in Schedule 1 to the Interpretation Act 1978.

2262. The definition of “land” in force in 1969 was that contained in the Interpretation Act 1889. In section 3 of that Act land was defined as including “messuages, tenements, and hereditaments, houses and buildings of any tenure”. This section was derived from section 4 of Lord Brougham’s Act of 1850. The definition was never appropriate for Scotland where messuages and hereditaments were unknown to the law.

2263. There is nothing in the definition of “land” in the Interpretation Act 1978 which is not also within the definition of “land” in section 776(13)(a) of ICTA.

2264. The Interpretation Act 1978 refers to “buildings and other structures”. Section 776(13)(a) of ICTA merely refers to “buildings”. But this cannot be read as excluding “structures”, because what is a building is a question of degree and circumstance and case law makes it clear that virtually any kind of structure is capable of being a building.

2265. Adopting the Interpretation Act definition of “land” for the purposes of this Chapter would only be a change in the law if a “structure” (a) was not, as a matter of normal English usage, “land”, (b) was not a “building” (and was therefore not brought within “land” by the second limb of section 776(13)(a) of ICTA), and (c) was nevertheless brought within “land”

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by the provision in the Interpretation Act that “land” includes buildings and other structures. There is no reason to believe that there are such “structures”.

2266. The Interpretation Act 1978 refers to “land covered with water”; section 776(13)(a) of ICTA does not. But there is no doubt that for legal purposes land includes every species of ground as well as waters and marshes. The term “land covered with water” has been used in legislation to distinguish, for rating purposes, land covered by artificial bodies of water such as reservoirs, filter beds belonging to water companies, canals, dry docks etc; no such distinction would be appropriate in the context of section 776 of ICTA, and therefore none was made.

2267. Finally, section 776(13)(a) of ICTA refers to “any estate or interest in land or buildings”, whereas the Interpretation Act 1978 is more specific, referring to “any estate, interest, *easement, servitude or right in or over land*” (emphasis added). Nonetheless, the section 776(13)(a) definition of land includes the rights italicised above. It is couched in generic terms and does not need to mention specific interests in land, including those particular to Scots law.

2268. It is therefore a matter of historical accident that section 776 of ICTA includes its own non-exhaustive definition of “land”, rather than using the standard non-exhaustive definition in the Interpretation Act 1978. The Act therefore omits the second limb of section 776(13)(a) of ICTA as redundant.

2269. The Act does not rewrite the first limb of section 776(13)(a) of ICTA as a Chapter-wide definition. Instead, references to “the land” are expanded to “all or part of the land” where appropriate.

Section 777(13) of ICTA: “receivable”

2270. Section 777(13) of ICTA provides:

For the purposes of the relevant provisions ... any amount in money or money’s worth shall not be regarded as having become receivable by some person until that person can effectively enjoy or dispose of it.

2271. Section 777(1) of ICTA defines “the relevant provisions” as sections 775 to 777 of ICTA. On the face of it, therefore, the qualification of “receivable” in section 777(13) of ICTA applies to section 776 of ICTA. But the word “receivable” is not actually used in section 776.

2272. In Yuill v Wilson (1980), 52 TC 674 HL⁸ and Yuill v Fletcher (1984), 58 TC 145 CA⁹ the courts interpreted “realised” in section 776(3) of ICTA consistently with the explanation of “receivable” in section 777(13) of ICTA. In the House of Lords in Yuill v Wilson, Viscount Dilhorne said (52 TC 674 at page 714):

“I have based my conclusions on the meaning which I think should be given to the expression “the gain is realised”. Section [777] of the Act is as I have said intended to supplement sections [775] and [776]. Subsection

⁸[1980] STC 460.

⁹[1984] STC 401.

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(13) of section [777] is a definition subsection and, *inter alia*, states that for the purposes of sections [775] and [776] “any amount in money or money’s worth shall not be regarded as having become receivable by some person until that person can effectively enjoy or dispose of it.” The operation of [section 776] does not depend on whether money or money’s worth is receivable. One does not find in it any reference to money or money’s worth being receivable. It depends on whether a gain is obtained or realised. So the operation of this definition is, to say the least, obscure in relation to section [776]. It, however, accords with the meaning which I think should be given to the word “realised”, that is to say, that a gain is not realised until it can be effectively enjoyed or disposed of.”

2273. Lord Salmon agreed with Viscount Dilhorne. Other judges interpreted “realised” in the same way as Viscount Dilhorne, but relied on what is now section 777(13) of ICTA to do so¹⁰.

2274. Following Viscount Dilhorne and Lord Salmon, this Act does not rewrite the explanation of “receivable” for the purposes of this Chapter. This omission does not change the law.

Chapter 4: Sales of occupation income

Overview

2275. This Chapter contains an anti-avoidance provision directed against schemes which turn income from an occupation into capital. It is based on sections 775, 777 and 778 of ICTA.

2276. The sections of this Chapter are arranged in the following order:

- Sections 773 to 775 – introduction;
- Sections 776 to 779 – charge on sale of occupation income;
- Sections 780 to 783 – further provisions relevant to the charge;
- Sections 784 and 785 – exemption for sales of going concerns;
- Sections 786 and 787 – recovery of tax;
- Section 788 – power to obtain information;
- Section 789 – interpretation.

Section 773: Overview of Chapter

2277. This section provides an overview of the Chapter, outlining its purpose and the charge it imposes. It is based on section 775(1) of ICTA.

¹⁰ In the Court of Appeal, Buckley LJ and Goff LJ had used the explanation of “receivable” to interpret “realised” and in the House of Lords so too did Lord Russell of Killowen and Lord Keith of Kinkel. Lord Edmund-Davies did not express an opinion on this point. In Yuill v Fletcher, the Special Commissioners noted this difference of approach, and inferred that the application of what is now section 777(13) of ICTA to what is now section 776 of ICTA could “be legitimately regarded as an open question, or at least as containing open questions”: (paragraph 9.9 of the Decision: 58 TC 145 at page 163). Neither the High Court nor the Court of Appeal expressed any view on this point; the Court of Appeal held that the House of Lords’ decision in Yuill v Wilson should be followed as either a binding precedent or of the highest persuasive authority.

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2278. Although section 775(1)(a) and (b) of ICTA refer to “transactions or arrangements”, section 775(1)(c) only refers to “transactions”. The original source legislation, section 31(1)(c) of FA 1969, refers to “transactions or arrangements” and *subsection (2)* restores this phrase.

Section 774: Meaning of “occupation”

2279. This section explains the expression “occupation”. It is based on section 775(3) of ICTA.

Section 775: Priority of other tax provisions

2280. This section provides for other tax provisions to apply in priority to Chapter 4. It is based on section 777(10) of ICTA.

Section 776: Charge to tax on sale of occupation income

2281. This section sets out the scope of the charge. It is based on section 775(2A) of ICTA.

2282. Sections 776 to 779 form the core of the Chapter.

Section 777: Conditions for sections 778 and 779 to apply

2283. This section sets out the circumstances in which income is treated as arising. It is based on sections 775(1), (3), and (7) to (9) and 777(13) of ICTA.

2284. *Subsection (1)* specifies three conditions (labelled A to C) which must all be met if section 778 or, as the case may be, section 779 is to apply.

2285. *Subsection (2)* sets out condition A, which is about location of the occupation carried on by the individual.

2286. *Subsection (3)* sets out condition B, which is about the ways in which transactions are effected or arrangements made to exploit the individual’s earning capacity in the occupation.

2287. *Subsection (4)* is based on the explanation of the meaning of “income or receipts derived from the individual’s activities” in section 775(3) of ICTA.

2288. *Subsection (5)* sets out condition C, which is about the receipt of a capital amount by the individual, either for the individual or for another person.

2289. *Subsection (6)* provides further details about what the previous subsection includes.

2290. *Subsection (7)* defines “capital amount”. It is based on section 777(13) of ICTA. Section 777(13) of ICTA refers to “any amount ... which, apart from the sections 775 and 776, does not fall to be included in any computation of income for purposes of the Tax Acts”. It is not possible for an amount to be treated as income both by section 775 and by section 776 of ICTA, and so subsection (7) does not rewrite the reference to section 776.

Section 778: Income arising where capital amount other than derivative property or right obtained

2291. This section applies if the capital amount mentioned in section 777(5) does *not* consist of either property which derives substantially the whole of its value from the individual’s

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activities or a right which does so. It is based on sections 775(1), (2) and (7) and 777(13) of ICTA.

2292. If section 778 applies, *subsection (2)* treats the capital amount as income.

2293. Subsection (2) omits the reference in section 775(2) to the capital amount being treated as “earned income”. The only place in the Income Tax Acts where the expression “earned income” is used, following the reform of the pensions legislation in FA 2004, is section 282A of ICTA (jointly held property). As explained in the commentary on Chapter 3 of Part 14, section 282A has been rewritten in direct terms without reference to earned income. Accordingly, this section does not refer to earned income either.

2294. HMRC’s interpretation of the territorial scope of section 775 of ICTA is summarised in the table below.

<i>Taxpayer’s residence</i>	<i>Where occupation is carried on</i>	<i>Application of section 775</i>
UK	Wholly in the United Kingdom	Section 775 applies (assuming all the other conditions are met).
UK	Wholly outside the United Kingdom	Section 775 does not apply.
UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 775 applies to the whole of the gain (assuming all the other conditions are met).
Non-UK	Wholly in the United Kingdom	Section 775 applies (assuming all the other conditions are met).
Non-UK	Wholly outside the United Kingdom	Section 775 does not apply.
Non-UK	Partly in the United Kingdom, partly outside the United Kingdom	Section 775 applies (assuming all the other conditions are met), but only to the capital amount attributable to that part of the occupation carried on in the United Kingdom.

2295. The sections reflect this interpretation, and make a minor change in the law (although not in practice) to clarify the territorial scope of section 775. See *Change 115* in Annex 1.

2296. At first sight, section 775(9) of ICTA (“This section shall apply to all persons ...”) seems to apply to the “other person” mentioned in section 775(1)(a) of ICTA. But, to the

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extent that section 775(9) of ICTA applies to the “other person”, it is redundant. To that extent, therefore, it is repealed without replacement.

Section 779: Income arising where derivative property or right obtained

2297. This section applies if the capital amount mentioned in section 777(5) *does* consist of either property which derives substantially the whole of its value from the individual’s activities or a right which does so. It is based on section 775(2) and (7) of ICTA.

2298. The effect of this section replicates that of section 775(7) of ICTA, which imposes a separate charge from section 775(1) to (2A) of ICTA. It may apply in (for example) cases where individuals acquire stock options and subsequently exercise them.

Section 780: Transactions, arrangements, sales and realisations relevant for Chapter

2299. This section concerns transactions, arrangements, sales and realisations relevant for this Chapter; it greatly extends the circumstances in which a charge to tax may arise. It is based on section 777(2) and (3) of ICTA.

Section 781: Tracing value

2300. This section is about tracing the value of any property or right. It is based on section 777(5) of ICTA.

Section 782: Meaning of “other person”

2301. This section explains the meaning of “other person” in this Chapter. It is based on section 777(7) of ICTA.

Section 783: Valuations and apportionments

2302. This section is about valuations and apportionments. It is based on section 777(6) of ICTA.

Section 784: Exemption for sales of going concerns

2303. This section limits the scope of the charge by providing an exemption (itself limited by section 785) for transfers of businesses and companies as going concerns. It is based on section 775(4) and (6) of ICTA.

Section 785: Restriction on exemption: sales of future earnings

2304. This section is directed against abuse of the exemption given by section 784. It is based on section 775(5) of ICTA.

2305. The taxpayer might attempt to avoid the charge under this Chapter by exploiting section 784, namely by transferring a future income stream into a business or company carrying on a going concern and obtaining a capital amount for the disposal of the entire package. In such a case, this section would require an apportionment and restrict the exemption.

2306. Section 785 also includes a minor change in the law, although not in practice. See *Change 119* in Annex 1.

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Section 786: Recovery of tax where consideration receivable by person not assessed

2307. This section deals with recovery of tax where consideration is receivable by a person (B) other than the person assessed (A). It is based on section 777(8) and (13) of ICTA.

2308. Under *subsection (3)* A is entitled to recover from B any part of the tax which A has paid. To assist with this, A may obtain a certificate of tax paid. See the commentary on section 787.

2309. Section 786 also includes a tie-breaker provision. This is a minor change in the law. See *Change 117* in Annex 1.

Section 787: Recovery of tax: certificates of tax paid etc

2310. This section deals with certificates of tax paid for the purposes of section 786(3). It is based on section 777(8) of ICTA.

2311. Section 777(8) of ICTA provides that the certificate is to be furnished by “the Board or an inspector”. In 1969, when this legislation was introduced, section 5 of the Income Tax Management Act 1964 provided that all assessments to income tax at the standard rate were to be made by an inspector and all assessments to surtax were to be made by the Board. A consequential amendment to the reference to “the Board” in section 777(8) appears to have been missed on the abolition of surtax. This section therefore now omits the reference to “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2312. *Subsection (3)* gives a signpost to section 944 in Part 15 (Deduction of tax at source) which rewrites section 777(9) of ICTA.

Section 788: Power to obtain information

2313. This section enables HMRC to obtain information which is relevant to this Chapter. It is based on section 778 of ICTA.

2314. Section 778 of ICTA refers to “the Board or an inspector” and “the Board or the inspector”. For the reason given in the note on section 787, consequential amendments to the references to “the Board” in section 778 appear to have been missed on the abolition of surtax. This section therefore now omits the references to “the Board” as redundant and, following section 7 of CRCA, refers to “an officer of Revenue and Customs” rather than “an inspector”.

2315. *Subsection (1)* includes a minor change in the law: it expressly restricts the particulars to be provided to those which an officer of Revenue and Customs may reasonably require. See *Change 114* in Annex 1.

Section 789: Minor definitions

2316. This section non-exhaustively defines “company” and “share”. It is based on section 777(13) of ICTA.

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Chapter 5: Avoidance involving trading losses

Overview

2317. The Chapter provides for the recovery of certain loss reliefs if regulations apply to reduce an individual's contribution to the firm so that the contribution becomes lower, or even lower, than relief already given to the individual.

2318. This Chapter also sets out provisions about avoidance involving trade losses made by individuals in a trade exploiting a film or licence. The provisions tackle schemes used by individuals to try to convert a tax deferral into a permanent tax gain.

2319. The Chapter is based on Chapter 9 of Part 3 of FA 2004 and Chapter 7 of Part 2 of FA 2005.

Section 790: Overview of Chapter

2320. This section provides an overview of the Chapter. It is new.

2321. *Subsection (1)* signposts the sections dealing with the three sets of circumstances addressed by the Chapter.

2322. The definition of "capital gains relief" refers to section 261B of TCGA, which is inserted by Schedule 1 to this Act.

Section 791: Charge to tax on income treated as received under section 792

2323. This section imposes a charge to tax on income treated as received under section 792. It is based on section 74(4) of FA 2005.

2324. The section follows the approach to charging provisions adopted in ITTOIA.

Section 792: Partners claiming excess sideways or capital gains relief

2325. This section treats an individual as receiving income in certain cases where regulations made under section 114 of this Act result in the individual having claimed excessive sideways relief or capital gains relief for post-1 December 2004 trade losses made by the individual as a limited partner, a member of a limited liability partnership or a non-active partner. It is based on section 74 of FA 2005.

2326. The section specifies that income is treated as arising when a "chargeable event" occurs, and that such an event occurs at any time when the regulations result in the individual having claimed excessive relief. Such excesses (of losses so claimed over the individual's contribution to the firm) arise because the individual's contribution to the firm is treated by the regulations as reduced on the occurrence of certain events. Such an event might be, for example, the release of a loan taken out to finance the individual's contribution to the firm (see Condition 3 of Regulation 4(1) of SI 2005/2017, as consequentially amended by Schedule 2 Part 5 (application of existing regulations under sections 114 and 802)).

2327. *Subsection (2)(b)* refers to "capital gains relief" as part of making explicit the interaction between section 72 of FA 1991 and the provisions in ICTA, FA 2004 and FA 2005 which restrict the giving of sideways relief. See *Change 13* in Annex 1.

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2328. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 793: Calculating the amount of income treated as received

2329. This section specifies how the amount of income treated as received by the previous section is to be calculated. It is based on section 75 of FA 2005.

2330. The basic proposition is that the amount is the reduction in the individual’s contribution to the firm resulting from the application of the regulations. Nevertheless, the amount of income treated as received cannot exceed the amount of post-1 December 2004 trade losses claimed (and not reclaimed). Neither can it exceed the excess of the trade losses claimed (and not reclaimed) over the contribution to the firm.

2331. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 794: Meaning of “the total amount of trade losses claimed” etc

2332. This section defines “the total amount of the trade losses claimed”, “the individual’s contribution to the firm” and other terms. It is based on section 74 of FA 2005.

2333. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 795: Meaning of “post-1 December 2004 loss”

2334. This section defines “post-1 December 2004 loss”. It is based on section 76 of FA 2005.

Section 796: Charge to tax on income treated as received under section 797

2335. This section imposes a charge to tax on income treated as received under section 797. It is based on section 119(4) of FA 2004.

2336. The section follows the approach to charging provisions adopted in ITTOIA.

Section 797: Individuals claiming sideways or capital gains relief for film-related losses

2337. This section sets out circumstances in which an individual, who has claimed sideways or capital gains relief for film-related losses, is treated as receiving income. It is based on section 119 of FA 2004.

2338. The section specifies that income is treated as arising when a “chargeable event” occurs, and that such an event occurs at the time that the last of three conditions (relevant claim, relevant disposal and exit event) become satisfied.

2339. *Subsection (2)* specifies that an exit event will occur every time an individual receives non-taxable consideration for a relevant disposal, as well as certain times when the individual makes a further claim for sideways relief or capital gains relief or the individual’s

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contribution to the firm is reduced. So a number of exit events may occur for any particular relevant disposal. And a number of chargeable events may occur for a particular tax year.

2340. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 798: Meaning of “non-taxable consideration” etc

2341. This section defines “non-taxable consideration”. It is based on sections 122(3) and 123(2) of FA 2004.

2342. In particular, the section makes it clear that, if the consideration is received after deduction of costs or any other payment relating to the relevant disposal or exit event, it is the gross amount that is treated as the non-taxable consideration.

Section 799: Meaning of “disposal of a right of the individual to profits” etc

2343. This section specifies a number of things that are to count as a disposal of a right of an individual to profits arising from a trade. It is based on section 120 of FA 2004.

Section 800: Meaning of “film-related losses” etc

2344. This section defines various terms. It is based on sections 121(1) and (1A) and section 123(1) of FA 2004.

2345. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 801: Meaning of “capital contribution”

2346. This section defines “capital contribution”. It is based on sections 121 and 122(1) of FA 2004.

2347. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 802: Exclusion of amounts in calculating capital contribution by a partner

2348. This section enables regulations to be made, which can apply on a retrospective basis, to exclude certain amounts from the calculation of an individual’s capital contribution. It is based on section 122A of FA 2004.

2349. Regulations under this provision are subject to the affirmative resolution procedure.

2350. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

2351. Some regulations have been made under section 122A of FA 2004. See the Partnerships (Restrictions on Contributions to a Trade) Regulations 2005 (SI 2005/2017) and the Partnerships (Restrictions on Contributions to a Trade) Regulations 2006 (SI 2006/1639).

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See also the commentary on Parts 5 and 13 of Schedule 2 about consequential amendments made to these regulations by this Act.

2352. In *subsection (5)*, the reference to Act includes references to Acts of the Scottish Parliament and Northern Ireland legislation. See *Change 152* in Annex 1, section 1018 and the commentary on that section.

Section 803: Prohibition against double counting

2353. This section ensures that consideration is only brought into account once. It is based on section 122(2) of FA 2004.

2354. There is a change from “contribution to the trade” in the source legislation to “contribution to the firm”. See the overview commentary on Chapter 3 of Part 4 (restrictions on relief for certain partners) and *Change 16* in Annex 1.

Section 804: Charge to tax on income treated as received under section 805

2355. This section imposes a charge to tax on income treated as received under section 805. It is based on section 127(2) of FA 2004.

2356. The section follows the approach to charging provisions adopted in ITTOIA.

Section 805: Partners claiming relief for licence-related trading losses

2357. This section sets out circumstances in which an individual, who was a non-active partner in an early year, and who has claimed sideways relief or capital gains relief for a loss deriving from expenditure related to a licence, is treated as receiving income. It is based on sections 126 and 127 of FA 2004.

2358. The meaning of non-active partner is explained in section 809, by reference to provisions in Chapter 3 of Part 4.

2359. There must be a relevant disposal of the licence which requires that the individual receives non-taxable consideration (defined in *subsection (5)*).

2360. Income is treated as arising when a “chargeable event” occurs which could be at any time when an individual receives non-taxable consideration for a disposal or the individual makes a further claim for sideways relief or capital gains relief. So a number of chargeable events may occur for a particular tax year.

Section 806: Calculation of amount of income treated as received by the individual

2361. This section sets out a step calculation for finding the income which the individual is treated as receiving. It is based on section 127(4) to (6) of FA 2004.

Section 807: Supplementary provision relating to calculation in section 806

2362. This section supplements section 806. It is based on section 128 of FA 2004.

Section 808: Meaning of “disposal of the licence” etc

2363. This section specifies a number of things that are to count as a disposal of a licence. It is based on section 129 of FA 2004.

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Section 809: Other definitions

2364. This section includes various definitions used in relation to the restrictions for losses related to a licence. It is based on sections 126, 127(7) and 130 of FA 2004.

Part 14: Income tax liability: miscellaneous rules

Overview

2365. This Part contains four Chapters setting out various miscellaneous rules.

2366. Chapters 1 to 3 contain rules relating to:

- limits on the liability to income tax of non-UK residents,
- residence for income tax purposes of individuals and personal representatives (together with signposts to the income tax residence rules for trustees and companies) and
- liability to income tax in respect of income from property held in the joint names of spouses or civil partners.

2367. Chapter 4 contains a miscellany of other rules.

Chapter 1: Limits on liability to income tax of non-UK residents

Overview

2368. This Chapter brings together the provisions of FA 2003 limiting the liability to income tax of non-UK resident companies (liable otherwise than as trustees) and those of FA 1995 limiting such liability of all other non-UK residents (including companies liable as trustees).

2369. This Chapter is based on:

- section 128 of FA 1995 which limits the liability to income tax of non-UK residents, except the liability of non-UK resident companies liable otherwise than as trustees;
- section 127 of FA 1995 so far as it supplements section 128 of that Act;
- section 151 of FA 2003 which limits the liability to income tax of non-UK resident companies liable otherwise than as trustees; and
- Schedule 26 to FA 2003 so far as it supplements section 151(2)(c) of that Act.

2370. So far as they respectively supplement section 128 of FA 1995 and section 151(2)(c) of FA 2003, section 127 of FA 1995 and Schedule 26 to FA 2003 are in many respects substantially the same. Those provisions have, as far as possible, been combined in this Chapter.

2371. Section 127 of FA 1995 continues in force for the purpose of supplementing section 126 of that Act (UK representatives of non-residents) and Schedule 26 to FA 2003 continues in force for the purpose of supplementing section 148(3) of that Act (meaning of “permanent establishment”).

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Section 810: Overview of Chapter

2372. This section identifies the categories of non-UK residents to which this Chapter applies and provides signposts to the sections applicable to each category. It is new.

Section 811: Limit on liability to income tax of non-UK residents

2373. This section relates to the liability to income tax for a tax year of non-UK residents other than companies and of non-UK resident companies liable as trustees. It is based on section 128(1), (2), (4) and (12) of FA 1995.

2374. This section does not create any liability to income tax but rather sets a limit on the amount of income tax to which the non-UK resident would otherwise be liable.

2375. The combined effect of *subsections (4) and (5)* is that the non-UK resident is not liable to income tax in respect of disregarded income (see section 813), except so far as income tax is deducted or treated as deducted from it or is paid in respect of it, or it carries a tax credit.

2376. Subsection (5)(a) is drafted in terms of the non-UK resident's disregarded income being left out of account, rather than in terms of its being deducted from total income as provided in section 128(1)(a)(i) of FA 1995.

2377. Subsection (5)(b) provides that personal reliefs are to be left out of account. A non-UK resident may be entitled to such reliefs under section 278(2)(a) of ICTA, under section 56 or 460 of this Act or by virtue of a double taxation agreement. See the overview commentary on Part 3 for the interrelation of section 278(2)(a) of ICTA and sections 56 and 460 of this Act.

2378. All the reliefs to which section 278 of ICTA and sections 56 and 460 of this Act apply are listed in *subsection (6)*.

Section 812: Case where limit not to apply

2379. This section provides that the liability of non-UK resident trustees to income tax is not limited, if a beneficiary of the trust has a residence connection with the United Kingdom. It is based on section 128(5) and (6) of FA 1995.

Section 813: Meaning of “disregarded income”

2380. This section sets out the various descriptions of income which are defined as “disregarded income”. It is based on section 128(2) and (3) of FA 1995.

2381. *Subsection (2)* provides that income is not disregarded income if the non-UK resident has a UK representative in relation to the income. This is the case if, for example, the non-UK resident has income within the description of disregarded savings and investment income in section 825 which is brought into account in computing the profits of a manufacturing business carried on by the non-UK resident through a branch in the United Kingdom.

2382. The definition of “disregarded pension income” in *subsection (3)* is based on section 128(3)(cc), (cca) and (cd) of FA 1995. Section 128(3)(cd) of FA 1995 relates to income

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which arises from a source in the United Kingdom and is chargeable to tax under Part 9 of ITEPA because section 609, 610 or 611 of that Act applies to it.

2383. Each of sections 609, 610 and 611 of ITEPA states that the section applies to an annuity which arises from a source outside the United Kingdom only if it is paid to a person resident in the United Kingdom. The definition of disregarded pension income omits the reference to the income arising from a source in the United Kingdom, on the basis that the wording of those sections of ITEPA makes it unnecessary.

Section 814: Meaning of “disregarded transaction income”

2384. This section defines “disregarded transaction income”. It is based on sections 127(1) and (15) and 128(3)(d) of FA 1995.

2385. *Subsections (1) and (2)* relate to income arising from a business carried on through a broker in the United Kingdom and introduce the conditions, referred to as “the independent broker conditions”, which must be met if the income is to be disregarded transaction income.

2386. *Subsections (3) and (4)* relate to income arising from a business carried on through an investment manager in the United Kingdom and introduce the conditions, referred to as “the independent investment manager conditions”, which must be met if the income is to be disregarded transaction income.

2387. The independent broker conditions in section 817 and the independent investment manager conditions in sections 818 to 824 replace for the purposes of subsections (2) and (4) the indirect references in section 128(3)(d) of FA 1995, through section 127(1)(b) and (c) of that Act, to section 127(2) and (3) of that Act.

2388. The words “without being chargeable as mentioned in paragraphs (a) to (ce) above” in section 128(3)(d) of FA 1995 have been omitted in subsections (2) and (4) on the basis that they are unnecessary.

2389. *Subsection (5)* defines the term “transaction income”. This definition includes the provisions of section 127(15)(b) of FA 1995 which explain what is meant by income arising from so much of a business as relates to transactions carried out through a branch or agency on behalf of a non-UK resident.

Section 815: Limit on liability to income tax of non-UK resident companies

2390. This section relates to the liability to income tax for a tax year of a non-UK resident company which is liable otherwise than as a trustee. It is based on section 151(1), (3) and (4) of FA 2003.

2391. This section does not create any liability to income tax but rather sets a limit on the amount of income tax to which the non-UK resident company would otherwise be liable.

2392. The combined effect of *subsections (3) and (4)* is that the non-UK resident company is not liable to income tax in respect of disregarded company income except so far as income tax is deducted or treated as deducted from it or is paid in respect of it, or it carries a tax credit.

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2393. Subsection (4) is drafted in terms of the non-UK resident company's disregarded company income being left out of account, rather than in terms of its being deducted from total income as provided in section 151(1)(a)(i) of FA 2003.

2394. Section 151(1)(a)(ii) of FA 2003, which disregards reliefs to which a company is entitled under section 788 of ICTA, has been omitted. It is not appropriate to companies. See *Change 120* in Annex 1.

Section 816: Meaning of “disregarded company income”

2395. This section sets out the various descriptions of income which are defined as “disregarded company income”. It is based on section 151(2) of FA 2003 and paragraphs 1(1) and (2), 2(1) and 3(1) of Schedule 26 to that Act.

2396. The term “disregarded company income” mirrors the term “disregarded income” defined in section 813 for the purposes of section 811. Section 151(2) of FA 2003 sets out the “income to which this section applies”, but does not make use of a defined term.

2397. *Subsection (1)(c)* relates to income arising from transactions carried out through a broker in the United Kingdom and introduces the conditions, referred to as “the independent broker conditions”, which must be met if the income is to be disregarded company income.

2398. *Subsection (1)(d)* relates to income arising from investment transactions carried out through an investment manager in the United Kingdom and introduces the conditions, referred to as “the independent investment manager conditions”, which must be met if the income is to be disregarded company income.

2399. Subsection (1)(c) and (d) are based on section 151(2)(c) of FA 2003, which refers to a transaction carried out through a broker or investment manager in the United Kingdom “acting as an agent of independent status in the ordinary course of his business”. Schedule 26 to that Act then sets out the conditions which must be met if the broker or investment manager is to be treated as so acting.

2400. This structure has been simplified so that subsection (1)(c) and (d) refer directly to the independent broker conditions in section 817 and the independent investment manager conditions in sections 818 to 824.

2401. The effect of the words “in the course of that company's trade” in paragraph 1(1) of Schedule 26 to FA 2003 has been preserved by including the equivalent words in subsection (1)(c) and (d).

Section 817: The independent broker conditions

2402. This section sets out the independent broker conditions to be met in relation to a transaction carried out on behalf of a non-UK resident by a broker in the United Kingdom for the purposes of sections 813 and 816. It is based on the provisions of sections 127(1) and (2) and 128(3) of FA 1995 and section 151(2) of and paragraph 2(1) and (2) of Schedule 26 to FA 2003.

2403. Three of the conditions, in section 127(2)(a) to (c) of FA 1995 and paragraph 2(2)(a) to (c) of Schedule 26 to FA 2003, are substantively the same. Accordingly, there is a set of

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common conditions, A to C, in *subsections (2) to (4)*, which apply to all non-UK residents, including non-UK resident companies.

2404. The final condition in section 127(2)(d) of FA 1995 is not substantively the same as the final condition in paragraph 2(2)(d) of Schedule 26 to FA 2003. These conditions are, therefore, set out separately.

2405. Condition D in *subsection (5)*, based on the condition in section 127(2)(d) of FA 1995, applies for the purposes of section 813.

2406. Condition E in *subsection (6)*, based on the condition in paragraph 2(2)(d) of Schedule 26 to FA 2003, applies for the purposes of section 816.

2407. In *subsection (5)*, the words “amounts which are chargeable to capital gains tax” reflect the words “other amounts” in section 127(2)(d) of FA 1995. Those other amounts are the “amounts which, by reference to that branch or agency, are chargeable to capital gains tax under section 10 of the Taxation of Chargeable Gains Act 1992 (non-residents)” mentioned in section 126(2)(c) of FA 1995.

2408. In *subsection (5)*, a reference to “transaction income” has been substituted for the reference in section 127(2)(d) of FA 1995 to “taxable sums”. The latter expression includes not only income but also chargeable gains arising from transactions in respect of which the independent broker conditions are met. It is not necessary to include specific reference here to such chargeable gains, as, by virtue of the reference to taxable sums in section 127(2)(d) of FA 1995, the non-UK resident will not, under section 126(2) of that Act, have the broker as the non-UK resident’s UK representative in relation to such chargeable gains.

2409. In *subsection (6)*, it has been made clear that the other transaction carried out in the same accounting period may be of any kind and is not limited to broking transactions.

Section 818: The independent investment manager conditions

2410. This section sets out the independent investment manager conditions to be met in relation to a transaction carried out on behalf of a non-UK resident by an investment manager in the United Kingdom for the purposes of sections 813 and 816. It is based on the provisions of sections 127(1) and (3) and 128(3) of FA 1995 and section 151(2) of and paragraphs 3(1) and (2) and 7(2) of Schedule 26 to FA 2003.

2411. Five of the conditions, in section 127(3)(a) to (e) of FA 1995 and paragraph 3(2)(a) to (e) of Schedule 26 to FA 2003, are substantively the same. Accordingly, there is a set of common conditions, A to E, in *subsections (2) to (6)*, which apply to all non-UK residents, including non-UK resident companies.

2412. The final condition in section 127(3)(f) of FA 1995 is not substantively the same as the final condition in paragraph 3(2)(f) of Schedule 26 to FA 2003. These conditions are, therefore, set out separately.

2413. Condition F in *subsection (7)*, based on the condition in section 127(3)(f) of FA 1995, applies for the purposes of section 813.

2414. Condition G in *subsection (8)*, based on the condition in paragraph 3(2)(f) of Schedule 26 to FA 2003, applies for the purposes of section 816.

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2415. In subsection (7), the words “amounts which are chargeable to capital gains tax” reflect the words “other amounts” in section 127(3)(f) of FA 1995. Those other amounts are the “amounts which, by reference to that branch or agency, are chargeable to capital gains tax under section 10 of the Taxation of Chargeable Gains Act 1992 (non-residents)” mentioned in section 126(2)(c) of FA 1995.

2416. In subsection (7), a reference to “transaction income” has been substituted for the reference in section 127(3)(f) of FA 1995 to “taxable sums”. The latter expression includes not only income but also chargeable gains arising from transactions in respect of which the independent investment manager conditions are met. It is not necessary to include specific reference here to such chargeable gains, as, by virtue of the reference to taxable sums in section 127(3)(f) in FA 1995, the non-UK resident will not under section 126(2) of that Act have the investment manager as the non-UK resident’s UK representative in relation to such chargeable gains.

2417. In subsection (8), it has been made clear that the other transaction carried out in the same accounting period may be of any kind and is not limited to investment transactions.

Section 819: Investment managers: the 20% rule

2418. This section sets out the “20% rule” for investment managers. It is based on section 127(4) of FA 1995 and paragraph 4(1) of Schedule 26 to FA 2003 which are substantively the same.

2419. The 20% rule has two requirements. The first requirement is that the investment manager and connected persons must intend that any interest that they may have in the non-UK resident’s “relevant disregarded income” will not exceed 20% of that income. The second requirement applies if that intention is not fulfilled. The 20% rule will continue to be met if the only reason why it is not fulfilled is because of matters outside the control of the investment manager or connected persons despite their having taken reasonable steps to mitigate the effect of those matters.

Section 820: Meaning of “qualifying period”

2420. This section defines the term “qualifying period”. It is based on section 127(7) of FA 1995 and paragraph 4(2) of Schedule 26 to FA 2003.

2421. *Subsection (2)*, based on section 127(7) of FA 1995, makes use of the term “transaction income”, defined in section 814(5), in substitution for the term “taxable sums” in the source legislation. “Taxable sums” includes not only income but also chargeable gains, but in this context a reference to chargeable gains is otiose and has been omitted.

2422. *Subsection (3)*, based on paragraph 4(2) of Schedule 26 to FA 2003, makes explicit that the accounting period referred to is that of the non-UK resident company.

2423. The separate definitions in subsections (2) and (3) preserve the difference between their respective source provisions and ensure that those subsections remain in line with those provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

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Section 821: Meaning of “relevant disregarded income”

2424. This section defines the term “relevant disregarded income”. It is based on section 127(5) of FA 1995 and paragraph 4(3) of Schedule 26 to FA 2003.

2425. In *subsection (2)*, a reference to “the total of the non-UK resident’s income” has been substituted for the reference in section 127(5) of FA 1995 to “the aggregate of such of the profits and gains of the non-resident”. As section 127(5)(b) of FA 1995 requires that this aggregate falls to be treated (apart from the 20% rule) as excluded income, the reference to “such of the profits and gains” is limited by the source legislation to so much of the profits and gains as is income. The substitution makes this clear.

2426. In *subsection (3)*, a reference to “the total of the non-UK resident company’s income” has been substituted for the reference in paragraph 4(3) of Schedule 26 to FA 2003 to “the aggregate of such of the chargeable profits of the company”. See *Change 121* in Annex 1.

2427. The separate definitions in subsections (2) and (3) preserve the difference between the respective source provisions and ensure that those subsections remain in line with those provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

2428. In *subsection (4)* it is made clear that the transactions referred to are investment transactions. That only investment transactions are referred to in section 127(5) of FA 1995 is clear as the profits or gains there mentioned must be excluded income. But paragraph 4(3) of Schedule 26 to FA 2003 refers only to transactions. That paragraph does not, however, cover any wider class of transactions than section 127(5) of FA 1995.

2429. In subsection (4)(b), the words:

in relation to which the independent investment manager conditions are met, ignoring the requirements of the 20% rule

are substituted both for the words in section 127(5)(b) of FA 1995:

for the purposes of section 128 below would fall (apart from the requirements of subsection (4) above) to be treated as excluded income for any of those chargeable periods

and for the words in paragraph 4(3) of Schedule 26 to FA 2003:

in relation to which the manager does not (apart from the requirements of the 20% rule) fall to be treated as a permanent establishment of the company.

2430. The substituted words do not change the law relating to the limit on the liability of a non-UK resident other than a company in section 811. Only income deriving from investment transactions is measured for the purposes of the 20% rule in section 127(4) of FA 1995. Income arising from any other type of transaction is irrelevant.

2431. Income is only “relevant excluded income” under section 127(5) of FA 1995 if it derives from investment transactions carried out by the manager while acting on the non-resident’s behalf (see section 127(5)(a) where the word “transactions” refers back to “investment transactions” in section 127(1)(c)). Under section 127(5)(b) of FA 1995, it also has to be treated as “excluded income” under section 128(3) of that Act. The only way that income arising from so much of a business as relates to investment transactions can be

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“excluded income” is if the conditions in section 127(3) of FA 1995 (the investment manager conditions) are met.

2432. In relation to the limit on the liability of a non-UK resident company in section 815, this substitution avoids the need for the reader to refer to section 148 of and Schedule 26 to FA 2003 in order to determine whether the investment manager is a permanent establishment. The substituted words do not change the law. If the independent investment manager conditions are met, or would be if the 20% rule were met, the investment manager cannot be a permanent establishment of the company in relation to the transaction.

Section 822: Meaning of “beneficial entitlement”

2433. This section defines the term “beneficial entitlement”. It is based on section 127(6) of FA 1995 and paragraph 4(4) of Schedule 26 to FA 2003, which are substantively the same.

Section 823: Treatment of transactions where requirements of 20% rule not met

2434. This section provides that, if the 20% rule is not met but all the other independent investment manager conditions are met, only the income in relation to which the 20% rule is not met is not relevant disregarded income. It is based on section 127(8) of FA 1995 and paragraph 4(5) of Schedule 26 to FA 2003.

2435. So far as that section and that paragraph differ in approach, the difference is preserved by *subsection (2)* so that those provisions remain in line with their source provisions as they continue to apply for the purposes of section 126 of FA 1995 and section 148 of FA 2003 respectively.

2436. A reference to “transaction income”, which is defined in section 814(5), has been substituted in subsection (2)(a) for the reference to “taxable sums” in section 127(8) of FA 1995. The term “taxable sums”, as defined in section 127(3) of that Act read with sections 127(1) and 126(2)(c) of that Act, includes amounts chargeable to capital gains tax under section 10 of TCGA. But, in relation to section 127(8) of FA 1995 as it has effect for the purposes of determining whether income is excluded income within section 128(3)(d) of that Act, reference to chargeable gains is unnecessary.

2437. In subsection (2)(b), a reference to “the income of the non-UK resident company” has been substituted for the reference in paragraph 4(5) of Schedule 26 to FA 2003 to “the chargeable profits of the non-resident company”. See *Change 121* in Annex 1.

Section 824: Application of 20% rule to collective investment schemes

2438. This section modifies the 20% rule where the non-UK resident is a participant in a collective investment scheme. It is based on section 127(9), (10) and (11) of FA 1995 and paragraph 5 of Schedule 26 to FA 2003, which are substantively the same.

2439. This section applies at the level of the scheme itself, treating it as if it were a non-UK resident company, see *subsection (3)*.

2440. *Subsection (4)* applies to a scheme which, if it was assumed to be a non-UK resident company, would *not* be regarded as carrying on a trade in the United Kingdom. The 20% rule is treated as satisfied in relation to such a scheme.

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2441. *Subsection (5)* applies to a scheme which, if it was assumed to be a non-UK resident company, would be regarded as carrying on a trade in the United Kingdom. The 20% rule applies to such a scheme with the modifications in *subsection (6)*.

2442. The definition of “the appropriate relevant period” in *subsection (7)* links into the meaning of “qualifying period” given by section 820. The reference to the term “transaction income” in paragraph (a) of that definition follows from the reference to that term in section 820(2)(a). See the commentary on section 820(2).

Section 825: Meaning of “disregarded savings and investment income”

2443. This section defines the term “disregarded savings and investment income” which is principally used in sections 813 and 816. It is based on the corresponding parts of paragraph (a) of section 128(3) of FA 1995 and of paragraph (a) of section 151(2) of FA 2003 and on paragraph (aa) of each of those subsections, all of which are substantively the same.

2444. Income chargeable under Chapter 5 of Part 4 of ITTOIA (stock dividends from UK resident companies) has been included in *subsection (1)(a)* as an additional description of disregarded income. See *Change 122* in Annex 1.

Section 826: Meaning of “disregarded annual payments”

2445. This section defines the term “disregarded annual payments” which is principally used in sections 813 and 816. It is based on the corresponding parts of section 128(3)(a) of FA 1995 and section 151(2)(a) of FA 2003 other than those on which section 825 is based.

Section 827: Meaning of “investment manager” and “investment transaction”

2446. This section defines the terms “investment manager” and “investment transactions” which underlie the independent investment manager conditions. It is based on section 127(12) and (13) of FA 1995 and paragraph 3(1), (3) and (4) of Schedule 26 to FA 2003.

2447. *Subsection (1)* is based on the definition of an “investment manager” in paragraph 3(1) of Schedule 26 to FA 2003 rather than the slightly different, but substantively the same, definition of “the manager” in section 127(3)(a) of FA 1995.

2448. The definition of “transaction” in *subsections (2)* and *(3)* is based on section 127(12) and (13) of FA 1995 and paragraph 3(3) and (4) of Schedule 26 to FA 2003, which are identical.

2449. Section 1014 containing general provision for the making of regulations applies for the purposes of *subsection (2)(c)*.

2450. Regulations (SI 2003/2172 and SI 2003/2173) have been made in identical terms under the source legislation, section 127(12)(c) of FA 1995 and paragraph 3(3)(c) of Schedule 26 to FA 2003, designating as investment transactions swap contracts settled in cash or foreign currency (other than contracts relating to land, insurance or capital redemption business).

Section 828: Transactions through brokers and investment managers

2451. This section explains when a person is to be regarded as carrying out a transaction on behalf of another and makes provision for a person part only of whose business is as a broker

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or investment manager. It is based on section 127(14) and (15) of FA 1995 and paragraph 7(1) and (4) of Schedule 26 to FA 2003.

2452. There is a slight difference between the wording of section 127(14) of FA 1995 which refers to:

a person who...provides investment management services

and that of paragraph 7(4) of Schedule 26 to FA 2003 which refers to:

a person who...provides investment services.

2453. The words in paragraph 7(4) of Schedule 26 to FA 2003 are not capable, in practice, of having any different meaning from those in section 127(14) of FA 1995 and *subsection (2)* accordingly applies for all purposes of this Chapter.

Chapter 2: Residence

Overview

2454. This Chapter contains provisions relating to the determination of residence for the purposes of liability to income tax.

2455. The question whether or not a person is UK resident is primarily to be determined in accordance with case law. A limited number of statutory rules either supplement or disapply the case law rules in specific circumstances.

2456. Sections 829 to 833 contain provisions relating to the residence of individuals, section 834 contains provisions relating to the residence of personal representatives and section 835 provides signposts to provisions relating to the residence of trustees and companies.

Section 829: Residence of individuals temporarily abroad

2457. This section provides that an individual who is ordinarily UK resident is not treated as becoming non-UK resident for income tax purposes if the individual has left the United Kingdom for the purpose only of occasional residence abroad. It is based on section 334 of ICTA.

2458. Section 334 of ICTA applies only to a person who is a Commonwealth citizen or a citizen of the Republic of Ireland. This section is not limited in this way. In addition, it is made explicit that the rule in this section applies only if the individual is UK resident, as well as ordinarily UK resident, at the time the individual leaves the United Kingdom. See *Change 123* in Annex 1.

2459. The provisions in section 334 of ICTA can be traced back to the Napoleonic period and have been in continuous existence since the reintroduction of income tax by the Income Tax Act 1842, where the provisions were to be found in section 39. A lengthy discussion of the history of the provisions (then to be found in section 49 of ICTA 1970) can be found in the judgment of Nicholls J in *Reed (HM Inspector of Taxes) v Clark* (1985), 58 TC 528 Ch D¹¹.

¹¹ [1985] STC 323

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2460. This section moves away from the historic language which has caused the effect of section 334 of ICTA and its predecessors to be somewhat obscured. During the course of his judgment in Reed v Clark, Nicholls J stated (at page 552E-G) that:

Section 49 is a puzzling section, in that precisely what was its intended purpose is not at all easy to perceive. This makes interpretation of its terms the more difficult. ...

Despite this I am in no doubt that section 49 is a substantive charging provision.

2461. *Subsection (1)* makes clear that this section applies only to determine the residence status of individuals and the term “individual” is, accordingly, used throughout this section in place of “person” in section 334 of ICTA.

2462. The term “occasional residence abroad” has been retained, as it has been the subject of judicial interpretation in the decided cases on section 334 of ICTA and its predecessors.

2463. *Subsection (2)* replaces the words in section 334 of ICTA providing that the individual to whom the section applies shall:

- (a) ...be assessed and charged to income tax notwithstanding that at the time the assessment or charge is made he may have left the United Kingdom...
- (b) ...be charged as a person actually residing in the United Kingdom upon the whole amount of his profits or gains, whether they arise from property in the United Kingdom or elsewhere, or from any allowance, annuity or stipend, or from any trade, profession, employment or vocation in the United Kingdom or elsewhere.

2464. Unlike the provisions of section 334 of ICTA as interpreted in Reed v Clark, subsection (2) does not impose a separate charge to income tax but treats the individual as UK resident for the purpose of determining the individual’s liability to income tax for a tax year, leaving the charging provisions of the Income Tax Acts to determine whether and to what extent the individual is so liable in respect of any particular source of income. The effect on the liability of the individual is the same.

2465. Subsection (2) also clarifies that the provision continues to apply for any tax year in which the individual remains outside the United Kingdom for the purpose only of occasional residence abroad. See the judgment of the Lord President in Lloyd v Sulley (1884), 2 TC 37 (Court of Exchequer (Scotland) - First Division) at page 42, referring to section 39 of the Income Tax Act 1842:

Now that is a very important provision as extending the meaning of the words in the taxing clause, ‘residing in the United Kingdom’. It extends it to a person who is not for a time actually residing in the United Kingdom, but who has constructively his residence there because his ordinary place of abode and his home is there, although he is absent for a time from it, however long continued that absence may be.

2466. Subsection (2) does not itself determine whether or not the individual’s residence abroad is occasional. That is to be determined in accordance with the principles set out in the cases in which section 334 of ICTA and its predecessors have been considered.

2467. Like section 334 of ICTA, this section does not include anything concerning the ordinary residence of the individual after the individual has left the United Kingdom. The question whether the individual continues to be ordinarily UK resident falls to be determined in accordance with case law.

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Section 830: Residence of individuals working abroad

2468. This section provides that, in the cases to which it applies, the fact that living accommodation in the United Kingdom is available for the individual's use is to be ignored in determining whether or not the individual is UK resident. It is based on section 335 of ICTA.

2469. *Subsection (1)* makes clear that this section relates only to the residence status of individuals and the term "individual" is, accordingly, used throughout this section in place of "person" in section 335 of ICTA.

2470. In *subsection (2)* the phrase "any living accommodation available in the United Kingdom for the individual's use" has been substituted for the phrase "any place of abode maintained in the United Kingdom for his use" in section 335(1) of ICTA. The reference to the availability of living accommodation brings the wording into line with the wording in HMRC booklet IR20 (Residents and non-residents: Liability to tax in the UK) and with the phrase "living accommodation available in the United Kingdom for his use" in section 336(3) of ICTA, on which sections 831(1) and 832(1) are based.

2471. This does not amount to a change in the law. To the extent that there is any difference between "living accommodation" and "place of abode maintained", "living accommodation" is the broader concept. In any event, available living accommodation which does not amount to a place of abode maintained for the use of an individual to whom section 335 of ICTA applies does not fall to be taken into account for the purposes of determining the individual's residence status.

Section 831: Foreign income of individuals in the United Kingdom for temporary purpose

2472. This section provides that an individual who is in the United Kingdom for a temporary purpose and stays there for only a limited period is not to be treated as UK resident for the purposes of certain charges to income tax on income from a source outside the United Kingdom. It is based on section 336(1), (1A) and (3) of ICTA.

2473. The provisions of section 336(2) of ICTA which deals with employment income of individuals in the United Kingdom for a temporary purpose are contained in section 832.

2474. The language of section 336(1) of ICTA dates back to Napoleonic times, while that of section 336(2) dates back only just over 50 years. These differences in language have been preserved where necessary.

2475. *Subsection (1)*, which describes to whom this section applies, makes clear that this section relates only to the residence status of individuals and the term "individual" is used throughout this section in place of "person" in section 336 of ICTA.

2476. Subsection (1)(a) retains the distinction between section 336(1)(a) of ICTA which refers to the person not being in the United Kingdom (emphasis added):

with any *view or intent* of establishing his residence there

and section 336(2) of that Act which refers to the person not being in the United Kingdom (emphasis added):

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with the *intention* of establishing his residence there.

2477. Subsection (1)(a) refers only to “view” and omits reference to “intent” on the basis that “view” is wider than “intent” or “intention”.

2478. Section 336(1)(b) of ICTA refers to the person having:

not actually resided in the United Kingdom at one time or several times for a period equal in the whole to six months in any year of assessment

while section 336(2) of that Act refers to the person having:

not in the aggregate spent at least six months in the United Kingdom in the year of assessment.

2479. Subsection (1)(b) retains the expression “actually resided” rather than adopting the expression “spent”, as “actually resided” may not in every circumstance be synonymous with “spent”. But the language of section 336(1)(b) of ICTA relating to the determination of the period has been modernised, including by substituting reference to 183 days for the reference to six months in section 336(1)(b) of ICTA. See *Change 124* in Annex 1.

2480. *Subsection (2)* restates the provisions listed in section 336(1A) of ICTA. Rule 1 is based on section 336(1A)(b) and (c) and Rule 2 on section 336(1A)(a) of that Act.

2481. The reference in each Rule to treating the individual as non-UK resident follows the approach of section 336(2) of ICTA and replaces the reference in section 336(1) of that Act to the person not being charged “as a person residing in the United Kingdom”.

2482. The words “income arising from a source outside the United Kingdom” in both Rules give effect to the words “profits or gains received in respect of possessions or securities out of the United Kingdom” in section 336(1) of ICTA.

2483. *Subsection (3)* supplements paragraph (e) of Rule 1 with a reminder that a claim has to have been made under section 647 of ITEPA and to have been accepted by the Commissioners for Her Majesty’s Revenue and Customs for the individual to have the benefit of the exemption in section 651 of that Act.

2484. *Subsections (4) and (5)* are based on the final words of section 336(1)(b) of ICTA:

but if any such person resides in the United Kingdom for such a period he shall be so chargeable for that year.

Section 832: Employment income of individuals in the United Kingdom for temporary purpose

2485. This section provides that an individual who is in the United Kingdom for a temporary purpose and stays there for only a limited period is not to be treated as UK resident for the purposes of the rules in Chapters 4 and 5 of Part 2 of ITEPA which determine taxable earnings from employment. It is based on section 336(2) and (3) of ICTA.

2486. *Subsection (1)*, which describes to whom this section applies, makes clear that this section relates only to the residence status of individuals and the term “individual” is used throughout this section in place of “person” in section 336 of ICTA.

2487. In subsection (1)(b), reference to 183 days has been substituted for the reference to six months in section 336(2) of ICTA. See *Change 124* in Annex 1 and the commentary on section 831.

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2488. *Subsections (3) and (4)* are based on the final words of section 336(2) of ICTA:

but shall be treated as resident there if he has.

Section 833: Visiting forces and staff of designated allied headquarters

2489. This section provides that the presence in the United Kingdom of certain individuals who are in the United Kingdom for specific purposes only does not cause the individual to be treated, for income tax purposes, as being UK resident or as changing the individual's residence or domicile (see *subsection (4)*). It is based on section 323 of ICTA.

2490. This section applies to an individual who is in the United Kingdom by reason only of being a member of a visiting force of a designated country or of a civilian component of such a force (see *subsection (1)*) or by reason of falling into one of the categories of individuals mentioned in *subsections (2) and (3)*. But it does not apply to British and certain other citizens (see *subsection (1)(c)*).

2491. As it is clear that this section can only relate to individuals, the term "individual" is used throughout this section in place of "person" in section 323 of ICTA.

2492. *Subsection (1)* sets out in full the description of a member of a visiting force to whom this section applies. This avoids the cross-reference to section 303(1) of ITEPA in section 323(2) of ICTA.

2493. The definitions of "member" (in relation to a visiting force), "visiting force" and "member of a civilian component of a visiting force" are contained in Part 1 of the Visiting Forces Act 1952 (the 1952 Act). Those definitions have not been set out in full in this section - partly for reasons of length and partly to retain the explicit link between this section and the 1952 Act. *Subsection (6)* incorporates them by reference.

2494. This section corrects a minor drafting error in section 323(4) of ICTA. Section 323(4) of ICTA provides that references to a visiting force in section 323(2) apply also to a civilian component of such a force and that "that subsection shall be construed as one with Part 1 of the Visiting Forces Act 1952". As there is no reference to "civilian component" in section 323(2) of ICTA, construing that subsection as one with Part 1 of the 1952 Act does not have the effect of applying the definition of "member of a civilian component of a visiting force" in section 10 of that Act for the purposes of section 323(4) or (5) of ICTA. There is no doubt that the definition is intended to apply.

2495. This section makes the correction by:

- incorporating in *subsection (1)* the provisions of section 323(4) of ICTA applying section 323(2) of that Act to a member of a civilian component of a visiting force; and
- providing in *subsection (6)* not only for *subsection (1)* to be interpreted as if in Part 1 of the 1952 Act, but also for *subsection (2)*, which is based on section 323(5) of ICTA, to be so interpreted.

2496. Section 303 of ITEPA, which is based on part of section 323 of ICTA and applies to the individuals to whom this section applies, provides that earnings paid to such individuals by the government of a designated country or by a designated allied headquarters are exempt from income tax.

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2497. The effect of section 833 of this Act is that an individual to whom it applies is not liable to United Kingdom income tax on income arising from a source outside the United Kingdom.

2498. *Subsection (5)* ensures that an individual to whom this section applies has the benefit of the personal reliefs to which the individual would be entitled if resident in the United Kingdom. Such reliefs will, accordingly, be available in calculating the individual's liability to United Kingdom income tax on such income as, for example, United Kingdom bank interest, dividends from UK resident companies and UK-based earnings which are not exempt under section 303 of ITEPA.

Section 834: Residence of personal representatives

2499. This section sets out rules for determining the residence status of personal representatives, in their capacity as such, where one or more (but not all) of them are UK resident in their own capacity. It is based on section 111(1) and (2) of FA 1989.

2500. Section 111 of FA 1989 was enacted, together with section 110 of that Act (residence of trustees), following the decision in Dawson v CIR (1989), 62 TC 301 HL¹². Section 110 of FA 1989 was repealed by FA 2006 and replaced by similar but extended provisions in section 685E(2) to (7) of ICTA (see the commentary on sections 475 and 476).

2501. In Dawson it was held that under the law then in force trust income from a foreign source could not be assessed on a UK resident trustee whose fellow trustees were non-UK resident. In his speech, with which the other members of the Judicial Committee concurred, Lord Keith of Kinkel stated (at page 329):

The argument for the Revenue accepts that the income of the settlements arose or accrued to the three trustees jointly, and not jointly and severally, so that none of them was entitled in law separately to any particular share or fraction of the income. It is contended, however, that the whole income from the foreign investments did, on a proper construction of para 1(a)(i) of s 108 [of ICTA 1970], arise or accrue to the Respondent as a person residing in the United Kingdom, and that the circumstance that it did so to him jointly with two co-trustees resident abroad is irrelevant. However, the word "person" in that sub-sub-paragraph must include the plural "persons" by virtue of s 6(c) of the Interpretation Act 1978. If all three trustees had been resident in the United Kingdom application of the enactment would have been such the income would have been treated as arising or accruing to all three, and all three would have been jointly assessable to tax. In the situation which prevails here, namely that one of the trustees is resident in the United Kingdom but the other two are resident abroad, the income likewise arises or accrues to all three, but all three cannot be jointly assessed to tax. There can be no justification for assessing to tax the Respondent alone, on the ground that he is resident in the United Kingdom, because the income does not arise or accrue to him personally. He has no right of control over the income. His only interest in it is a right and duty to secure, in conjunction with his co-trustees, that it is applied in accordance with the directions of the trust deeds. Similarly, when one turns to s 114(1) of the Act of 1970 it is found that the persons receiving or entitled to the income are the three trustees jointly. Should the plural "persons" be turned into the singular "person" it is found that the Respondent as an individual cannot properly be described as the person receiving or entitled to the income.

2502. The effect of section 111 of FA 1989 is to determine, in a case where some of the persons who are the personal representatives are in their own capacity UK resident and some

¹² [1989] STC 473

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are not, that the personal representatives, in their capacity as such, are either all UK resident or all non-UK resident.

2503. If all the personal representatives are UK resident, then, as the persons jointly receiving or entitled to the income, the personal representatives are chargeable in that capacity to income tax in respect of all the income so arising, whether from a United Kingdom or a foreign source. If none of them is UK resident, they are only chargeable in that capacity to income tax in respect of any of that income from a United Kingdom source.

2504. This section determines the residence status of all of the personal representatives in that capacity by reference to the residence or domicile of the deceased at the time of death.

2505. If the deceased was UK resident, ordinarily UK resident or domiciled in the United Kingdom at the time of death, any of the deceased's personal representatives who are non-UK resident in their own capacity are to be treated as UK resident in their capacity as personal representatives of the deceased. See *subsections (2) and (3)*.

2506. If the condition in subsection (3) is not met in relation to the deceased, any of the deceased's personal representatives who are UK resident in their own capacity are to be treated as non-UK resident in their capacity as personal representatives of the deceased. See *subsection (4)*.

2507. The provision in section 111(1)(b) of FA 1989 that a personal representative who is treated as non-UK resident under that paragraph is also to be treated as resident outside the United Kingdom is included in Chapter 2 of Part 13 (see the commentary on section 718). The provisions of section 111(7) and (8) of FA 1989, relating to the effect of that rule on liability under sections 739 and 740 of ICTA, are included in Part 14 of Schedule 2.

2508. The definition of "personal representatives" in section 111(3) of FA 1989 has been omitted. Instead, the general Income Tax Acts definition of "personal representatives" in section 989 applies to this section. See *Change 150* in Annex 1 and the commentary on section 989.

Section 835: Residence rules for trustees and companies

2509. This section provides signposts to other provisions relating to residence, not included in this Chapter. It is new.

2510. Those provisions are:

- sections 475 and 476 of this Act which contain rules for determining the residence of trustees and
- sections 66 and 66A of FA 1988 and section 249 of FA 1994 which contain rules for determining the residence of a company.

2511. The provisions in FA 1988 and FA 1994 do not form part of this Act, as they apply not only for the purposes of the Tax Acts but also for the purposes of TMA and of TCGA and all other enactments relating to capital gains tax.

2512. In relation to a company, this section is to be read with section 5 which provides that income tax is not charged on the income of a company if the company is within the charge to corporation tax in respect of the income. That section contains a signpost to sections 6(2) and

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11(1) of ICTA for the circumstances in which a company is within the charge to corporation tax in respect of its income. Those circumstances in turn depend upon the residence of the company.

Chapter 3: Jointly held property

Overview

2513. These sections rewrite the rules in sections 282A and 282B of ICTA that apply to income arising from property held in the joint names of a husband and wife or civil partners who are living together. In general, the effect of the rules is that such income is allocated equally between the parties.

2514. There are no specific rules dealing with the allocation of income arising from property owned jointly by other persons. If assets are held in common so that each party has a specific share, then the allocation of income would normally reflect those shares. And if assets are held by joint tenants, then in law each person owns the whole of the property and is entitled to the whole of the income. But in practice such income is not subject to double assessment and is normally allocated equally.

Relevance of “earned income”

2515. The term “earned income” has a long history. It is defined in section 833(4) to (6) of ICTA, and subsection (6) indicates that there are a number of further provisions under which certain sorts of income are treated as earned.

2516. Following the changes made to pensions tax legislation in FA 2004 which came into force on 6 April 2006, section 282A of ICTA is now the only place in the Income Tax Acts which makes specific use of the term earned income. (And it is not used in relation to national insurance purposes.) There is a single reference to patent income within section 833(5B) of ICTA, in the definition of “relevant UK earnings” in section 189(2)(c) of FA 2004.

2517. Rather than retain this concept, the joint property rule is rewritten in direct terms without reference to earned income, mainly by excluding all income within Part 9 of ITTOIA from the joint property rule. Accordingly, it is no longer necessary to define earned income, and specific provisions treating income as earned are repealed by this Act. In addition, the reference to section 833(5B) of ICTA in section 189 of FA 2004 is amended by Schedule 1 to this Act. See *Change 125* in Annex 1.

Section 277 of ICTA

2518. This section, dating in part from 1842, also relates to income arising from jointly owned property. It is not related to sections 282A and 282B. It is instead about how personal reliefs may be claimed against income arising from jointly owned property. As there is no longer any form of joint assessment of income belonging to more than one person, this provision is otiose and has not been rewritten.

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Section 836: Jointly held property

2519. This section provides the general rule (the 50:50 rule) that income from jointly held property is allocated equally between the spouses or civil partners. It is based on section 282A of ICTA.

2520. *Subsection (1)* explains that the section applies to married couples and civil partners provided that they live together. The meaning of “living together” is explained in section 1011.

2521. *Subsection (2)* gives the general rule and *subsection (3)* provides exceptions.

2522. Exception A relates to income to which neither of the individuals is beneficially entitled. It follows that the 50:50 rule does not apply when the couple hold the property as nominees or trustees.

2523. Exception B applies where the couple own property in common in unequal shares and make a declaration under section 837.

2524. Exception C applies to all income that arises to the individuals as partners. This exception covers not only income arising from a trade or profession carried on in partnership, but any other business income arising to a firm. See *Change 125* in Annex 1 and the overview commentary on this Chapter.

2525. Exception D applies to the commercial letting of furnished holiday accommodation, which is treated as a trade. See *Change 125* in Annex 1 and the overview commentary on this Chapter.

2526. Exception E is based on section 282A(4A) of ICTA. It ensures that if close company shares or securities are held in common, income arising from that property is allocated according to true beneficial ownership rather than equally.

2527. Exception F ensures that the rule in subsection (2) does not apply to income that is treated as the income of the other individual or a third party under any other provision of the Income Tax Acts.

Section 837: Jointly held property: declarations of unequal beneficial interests

2528. This section enables couples to specify that the 50:50 rule does not apply to income arising from particular property held in common, so that the income is then allocated according to each individual’s beneficial interest. It is based on sections 282A and 282B of ICTA.

2529. A declaration can only be made where the entitlement of each individual to a share in the income matches the entitlement to his or her share in the underlying property (*subsection (1)*).

Chapter 4: Other miscellaneous rules

Overview

2530. This Chapter contains miscellaneous income tax provisions.

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Section 838: Local authorities and local authority associations

2531. This section exempts United Kingdom local authorities and local authority associations from income tax. It is based on section 519 of ICTA.

Section 839: Issue departments of the Reserve Bank of India and the State Bank of Pakistan

2532. This section exempts from income tax the income of the issue departments of the central banks of India and Pakistan. It is based on section 517 of ICTA.

Section 840: Government securities held by non-UK resident central banks

2533. This section exempts from income tax certain income arising in the United Kingdom to overseas central banks. It is based on section 516 of ICTA.

2534. The scope of the exemption is specified in an order made by Her Majesty in Council. It does not extend to income arising in the normal course of a bank's trading operations in the United Kingdom.

Section 841: Official agents of Commonwealth countries etc

2535. This section provides an exemption from income tax for certain income arising to official agents of Commonwealth countries and of the Republic of Ireland and of states or provinces of those countries. It is based on section 320(2) to (4) of ICTA.

2536. The exemption is the same as that given to members of the staff of a diplomatic mission under the Diplomatic Privileges Act 1964 which gives force to the United Kingdom's international obligations under the Vienna Convention on Diplomatic Relations. In most cases, provided the agent is not a United Kingdom national and is present in the United Kingdom solely for the purpose of the agent's duties, that is an exemption for the agent's official earnings and other income arising outside the United Kingdom. Private income arising in the United Kingdom remains liable to income tax.

2537. Section 320(1) of ICTA provides an exemption to an Agent-General and section 320(3)(a) an exemption to his or her personal staff. These exemptions have not been rewritten as they merely duplicate exemptions now given under the Commonwealth Countries and Republic of Ireland (Immunities and Privileges) Order SI 1985/1983.

2538. Section 320(3)(c), which provides an exemption to an official agent of a self-governing colony, has not been rewritten because there are no overseas territories now certified as self-governing colonies.

Section 842: European Economic Interest Groupings

2539. This section sets out the basic rules that determine how the members of a European Economic Interest Grouping are to be taxed. It is based on section 510A of ICTA to the extent that it relates to income tax.

2540. Members of a Grouping may be companies, individuals or partnerships.

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Section 843: Restriction of deductions for annual payments

2541. This section prevents annual payments for which the consideration is either a dividend or not taxable from being deducted in calculating a person's income from any source. It is based on section 125(1) of ICTA.

2542. Section 899(5)(f) prevents the annual payments concerned from being qualifying annual payments. So they are not subject to deduction of tax at source, nor eligible for relief under Chapter 4 of Part 8 (annual payments and patent royalties). This section extends the ban on relief so that no annual payment that meets the definition in section 904 is an allowable deduction in calculating income in any circumstances.

Section 844: Letters patent etc: exempting provisions

2543. This section voids the impact of exempting provisions in letters patent. It is based on section 829(4) of ICTA.

2544. The words "to be granted" in the source legislation have been omitted as it is not possible for an exemption to be in point until the letters patent are actually granted.

2545. *Subsection (3)* is drafted on the basis that purported exemptions in all letters patent etc are void.

2546. Section 829(4) of ICTA also contains the rule that any statute which purports to confer income tax exemptions on a particular person or class of persons is void. It is not considered that "statute" can have its modern meaning of "Act of Parliament", since it is always open to Parliament to enact specific tax exemptions if it chooses to do so. It is instead aimed at provisions of a quasi-legislative nature such as bye-laws. But the idea of a local rule overriding an Act of Parliament by providing an income tax exemption is no longer tenable. So this part of section 829(4) is repealed as obsolete.

Section 845: Extra return to be treated as interest etc

2547. This section treats as interest certain "extra returns" that arise in some circumstances if new securities are issued of the same kind as existing securities. It is based on section 587A(1) to (3) of ICTA.

2548. The section applies where new securities are issued which are of the same kind as existing securities, except that at the issue date the existing securities will have accrued a certain amount of interest. In order to pay the same amount of "interest" on all the securities at the next interest payment date, the issue price of the new securities is increased to reflect the accrued interest on the existing securities. This section contains special rules for the treatment of the amount by which the issue price is increased.

2549. *Subsection (1)* sets out the conditions that must be met for the provision to operate. The total amount by which the issue price of the new securities is increased and which is then returned to the holder along with the true interest on the securities at the next interest payment date is called the "extra return".

2550. *Subsection (2)* specifies that the extra return must be equal to the interest that accrued for the relevant period on an equivalent number of existing securities. The relevant period is defined in section 846.

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2551. *Subsection (3)* ensures that the extra return is treated as a payment of interest. It then follows that where deduction of tax applies, it will apply to the whole amount of “interest” including the extra return.

2552. *Subsection (4)* ensures that no relief is given to the issuer for the extra return.

2553. For corporation tax purposes, section 587A of ICTA applies only if the new securities were issued before 1 April 1996. Accordingly, this provision has not been retained for corporation tax purposes.

Section 846: Interpretation of section 845

2554. This section provides definitions for terms used in section 845. It is based on section 587A(3) to (6) of ICTA.

Part 15: Deduction of income tax at source

Overview

2555. This Part concerns the main rules about deduction of income tax at source.

2556. The Part sets out the various duties to deduct, apart from those arising in connection with PAYE (see Part 11 of ITEPA) and the Construction Industry Scheme (see Chapter 3 of Part 3 of FA 2004, which is taking over from Chapter 4 of Part 13 of ICTA).

2557. The Part retains the distinction in the source legislation between the deduction of “sums representing income tax” and the collection of the income tax which those sums represent. This reflects the conceptual distinction between income tax which is charged on a person’s income and income tax which is deducted at source (and not subject to a charge to tax). The Part also contains provisions which make clear the link between the sums deducted and the amount to be collected (eg section 951(2)).

Chapter 1: Introduction

Section 847: Overview of Part

2558. This section provides an overview to the Part. It is new.

Section 848: Income tax deducted at source treated as income tax paid by recipient

2559. This section treats sums representing income tax deducted (or treated as deducted) from a payment under this Part (other than under sections 966 (visiting performers) or 971 (non-resident landlords)) as tax paid by the recipient, and links such amounts with the provisions of TMA concerning payment of income tax. It is based on sections 348(1) and 349(1) of ICTA and sections 426, 550, 602, 618 and 686(1) of ITTOIA.

Section 849: Interaction with other Income Tax Acts provisions

2560. This section provides information about how this Part interacts with other provisions. It is new.

2561. *Subsection (1)* gives a signpost to regulations made under the provisions of ICTA about double taxation relief, such as the Double Taxation Relief (Taxes on Income) (General) Regulations 1970 (SI 1970/488). Under these regulations a duty to deduct may be disapplied or modified.

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2562. *Subsection (3)* provides that anything covered by the general disregard in section 783 of ITTOIA is ignored for the purposes of the duties under this Part, subject to any contrary provision.

2563. *Subsection (4)* gives a signpost to paragraphs 11 to 13 of Schedule 2 to FA 2005 (alternative finance arrangements) inserted by this Act. Alternative finance return and profit share return are treated as interest (and therefore, if the arrangements meet the relevant conditions, yearly interest) for the purposes of this Part.

Chapter 2: Deduction by deposit-takers and building societies

Overview

2564. This Chapter requires the deduction of sums representing income tax from certain payments of interest made by deposit-takers and from certain payments of interest and dividends made by building societies. It is based on sections 477A and 480A to 482 of ICTA.

2565. Banks are the most obvious example of deposit-takers, but the definition of deposit-taker also includes other persons, for example individuals who have permission to accept deposits under Part 4 of FISMA.

2566. Many of the detailed provisions are in regulations, and this will remain the case.

2567. The main source rules for deposit-takers are in primary legislation, but all of the source rules for building societies are in regulations. For historical reasons, the two sets of rules adopt different approaches to identifying the payments subject to deduction of tax.

2568. A common basis for the split between primary and secondary legislation has resulted from the enactment in this Act of certain provisions of the Income Tax (Building Societies) (Dividends and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations). See *Change 126* in Annex 1, which affects sections 852, 853, 871 and 872 in this Chapter and some sections in Chapter 15 of this Part.

2569. And, building on this, a common basis for identifying payments subject to deduction of tax has resulted from aligning the gross payment category rules for building societies with deposit-takers. See *Change 127* in Annex 1, which affects sections 851, 856, 858, 859 and 872.

2570. Those regulations not being rewritten will continue in force, as explained in *Change 126* in Annex 1. HMRC specialists are working on rationalising the remaining regulations.

Section 850: Overview of Chapter

2571. This section provides an overview of the Chapter. It is new.

2572. The section provides signposts to the sections dealing with the main features of the Chapter, including key definitions and rules about when investments are (or are not) relevant investments.

2573. It also makes it clear that:

- references to “interest” include a reference to “dividends” paid by building societies; and

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- crediting interest counts as paying it for all purposes of the Chapter.

2574. Sections 858 to 870 (investments which are not relevant investments) are placed in order of their relative significance.

Section 851: Duty to deduct sums representing income tax

2575. This section sets out the general duty to deduct a sum representing the savings rate of income tax from interest payments made by deposit-takers and building societies on relevant investments. It is based on sections 4 and 480A of ICTA and regulation 3 of the building society regulations.

2576. In accordance with section 850(6), “interest” includes dividend payments made by building societies.

2577. The definition of “relevant investment” for building societies has been aligned to the deposit-taker regime. See *Change 127* in Annex 1 and the overview commentary for this Chapter.

Section 852: Power to make regulations disapplying section 851

2578. This section allows the Commissioners for Her Majesty’s Revenue and Customs to make regulations so that section 851 will not apply in relation to an interest payment where certain prescribed conditions have been met. It is based on sections 477A(1) and (2) and 480B(1) to (3) of ICTA.

2579. As part of the process of enacting some of the building society regulations, the wide powers provided in section 477A(1) of ICTA have been replaced with specific regulation making powers. See *Change 126* in Annex 1 and the overview commentary for this Chapter.

2580. Regulations have been made under sections 477A(1) and 480B of ICTA which allow UK resident individuals to certify that they are not liable to income tax so that they may be paid gross.

2581. The regulations concerned are the Income Tax (Deposit-takers) (Interest Payments) Regulations 1990 (SI 1990/2232), and the building society regulations. The relevant parts of these regulations will continue to have effect under the general continuity of law provisions included in this Act.

Section 853: Meaning of “deposit-taker”

2582. This section defines “deposit-taker”. It is based on section 481(2) of ICTA.

2583. Article 39 of the FISMA (Consequential Amendments) (Taxes) Order 2001 (SI 2001/3629) (FISMA(CA)(T)O), amends the definition of deposit-taker in section 481(2) of ICTA. This amendment has been reflected in the rewritten legislation and consequently article 39 is revoked (see Schedule 3 to this Act).

2584. The persons prescribed as deposit-takers by orders made under the power in section 481(2)(f) of ICTA, namely firms with European Economic Area (EEA) passport rights and certain dealers in financial instruments, have also been included here. The two orders concerned (the Income Tax (Prescribed Deposit-takers) Order 1992 (SI 1992/3234) and the

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Income Tax (Prescribed Deposit-takers) Order 2002 (SI 2002/1968)) will be revoked (see Schedule 3 to this Act). See *Change 126* in Annex 1.

Section 854: Power to prescribe persons as deposit-takers

2585. This section provides that the Treasury may make orders prescribing persons or a member of a class of persons receiving deposits in the course of business or activities to be treated as a deposit-taker. It is based on sections 481(2)(f) and 482(10) of ICTA.

2586. The following Statutory Instruments made under section 481(2)(f) of ICTA are spent or obsolete and are revoked (see Schedule 3 to this Act):

- the Income Tax (Prescribed Deposit-takers) (No 1) Order 1984 (SI 1984/1801), which included the British Railways Board in the definition of deposit-taker; and
- the Income Tax (Composite Rate) (Prescribed Deposit-takers) Order 1985 (SI 1985/1696), which listed various local authorities as being included in the definition of deposit-taker. The bodies referred to in this Order (and which are still in existence) are covered in the definition of “local authority” in section 999. As local authorities are already included in section 853(4), this Order is obsolete.

Section 855: Meaning of “investment” and “deposit”

2587. This section defines “investment” and “deposit” in preparation for the sections setting out which investments are, or are not, relevant investments. It is based on section 480A(1) and 481(3) of ICTA and regulations 2 and 3 of the building society regulations.

2588. This section also makes clear that, whether or not a deposit bears interest, it will still be treated as a deposit (although deduction of tax will be necessary only where interest is paid). As part of the alignment of the two regimes, the definition of deposit now also applies in relation to building societies.

2589. Under paragraph 6 of Schedule 2 to FA 2005, alternative finance arrangements are treated as if they were deposits for the purposes of the deposit-taker regime. A similar result is achieved for building societies through the operation of paragraph 5 of Schedule 2 to FA 2005.

2590. The alignment of the two regimes (so that the building society gross payment category rules are similar to deposit-takers, see *Change 127* in Annex 1 and the overview commentary for this Chapter), has prompted amendments of Schedule 2 to FA 2005 (see Schedule 1 to this Act).

Section 856: Investments which are relevant investments

2591. This section sets out the main rules about which investments are relevant investments. It is based on section 481(4) of ICTA and parts of regulations 3 and 4 of the building society regulations. See *Change 127* in Annex 1, and the overview commentary on this Chapter, for the effects of the alignment of the regimes.

2592. *Subsection (1)* sets out the four categories of investments which are relevant investments for the purposes of this Chapter. *Subsection (2)* makes clear that subsection (1) is subject to the general rules in sections 858 to 870 about when an investment will not be treated as a relevant investment.

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2593. *Subsections (3) to (6)* set out the detail of the conditions governing the four categories of relevant deposits.

2594. With the exception of the personal representative category, each category is separate and does not overlap. Consequently, an investment will only be a relevant investment where *all* the persons entitled to the interest payment are either:

- individuals (*subsection (3)*),
- a Scottish partnership where all the partners are individuals (*subsection (4)*), or
- trustees of a discretionary or accumulation settlement (*subsection (6)*).

2595. Where a personal representative (*subsection (5)*) is entitled to *any* interest on the investment, the whole investment will be a relevant investment. So, where a personal representative is entitled to part of the interest on a joint account, all interest will be subject to deduction, unless a declaration has been made in accordance with the regulations made under section 852 in respect of the part of the investment which does not vest in the personal representative.

2596. Section 481(4)(c) of ICTA refers to a person receiving interest “as a personal representative [and] in his capacity as such.” As there is no distinction between a person receiving interest *as* a personal representative, and doing so in his capacity as such, the section simply refers to receiving interest “in that capacity”. This is in line with the approach used in relation to trustees.

2597. As a result of aligning the gross payment category rules for building societies with the deposit-taker rules and defining relevant investment by reference to the *beneficial* owner of the payment, many of the gross payment categories in regulation 4 of the building society regulations do not need to be rewritten. This is because certain of those payments do not fall within any category of relevant investment in the first place. See *Changes 127 and 128* in Annex 1.

Section 857: Investments to be treated as being or as not being relevant investments

2598. This section sets out the rules governing when deposit-takers and building societies should treat investments as relevant (depending on the information they hold). It is based on section 482 of ICTA and regulation 11(4) of the building society regulations.

2599. *Subsection (1)* states that deposit-takers and building societies must treat an investment as a relevant investment unless they are satisfied that it is not a relevant investment.

2600. As part of the alignment of the two regimes, building societies will no longer need to obtain declarations from persons previously falling under the gross payment categories mentioned in regulation 4(1)(d) to (g), (k) and (r) of the building society regulations in order that payment can be made gross. See *Change 129* in Annex 1.

Section 858: Declarations of non-UK residence: individuals

2601. This section applies to investments satisfying the individual interest condition set out in section 856(3). It is based on sections 481(5) and 482(2), (2A) and (6) of ICTA and regulations 2, 4(1)(a) and (b) and 11 of the building society regulations.

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2602. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (*subsection (2)*). See *Change 130* in Annex 1.

2603. The section also makes clear that payments will be made gross only where all the individuals are non-UK resident. See *Change 127* in Annex 1.

Section 859: Declarations of non-UK residence: Scottish partnerships

2604. This section applies to investments satisfying the Scottish partnership condition set out in section 856(4). It is based on sections 481(5) and 482(2), (2A) and (6) of ICTA and regulations 2(1), 4(1)(a) and (b) and 11 of the building society regulations.

2605. This section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

2606. The section also ensures that a deposit will not be a relevant investment unless *all the partners* of the Scottish partnership are not ordinarily resident in the United Kingdom. See *subsection (3)* and *Changes 127* and *131* in Annex 1.

Section 860: Declarations of non-UK residence: personal representatives

2607. This section applies to investments satisfying the personal representative condition set out in section 856(5). It is based on sections 481(5) and 482(2) and (6) of ICTA and regulations 2(1), 4(1)(c) and 11 of the building society regulations.

2608. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

Section 861: Declarations of non-UK residence: settlements

2609. This section applies to investments satisfying the settlement condition set out in section 856(6). It is based on sections 481(5) and 482(2) and (6) of ICTA and regulations 2(1), 4(1)(bb) and 11 of the building society regulations.

2610. The section confirms that a declaration of non-UK residence in a prescribed or authorised format containing certain information is required if the investment is not to be treated as a relevant investment (see *subsection (2)*). See *Change 130* in Annex 1.

2611. See *Change 131* in Annex 1 and the commentary on section 859 for information on changes made in respect of Scottish partnerships in *subsections (2)* to *(4)*.

Section 862: Inspection of declarations

2612. This section gives an officer of Revenue and Customs power to inspect any declarations which have been made to the deposit-taker or building society. It is based on section 482(3) and (4) of ICTA and regulation 11(5) and (6) of the building society regulations.

2613. Regulation 8 of the Income Tax (Deposit-takers) (Non-residents) Regulations 1992 (SI 1992/14) and regulation 11(7) of the building society regulations provide a two year time limit for the retention of declarations.

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2614. For deposit-takers, this section is a minor change in law, as the source legislation in section 482(3) of ICTA does not give flexibility in the selection of declarations to be inspected: it is all or none. See *Change 132* in Annex 1.

Section 863: General client account deposits

2615. This section provides that general client account deposits will not be treated as relevant investments and defines the circumstances in which an investment will be treated as a “general client account deposit”. It is based on section 481(5) and 482(6) of ICTA and regulations 2(1) and 4(1) of the building society regulations.

Section 864: Qualifying uncertificated eligible debt security units

2616. This section provides that an investment will not be treated as a relevant investment if a “qualifying uncertificated eligible debt security unit” has been issued in respect of the investment. It is based on section 481(5)(a) of ICTA and regulation 4(1)(j) of the building society regulations.

2617. References to deposit rights in sections 349(4), 477A and 481(5A) of ICTA and regulation 4(1)(j) of the building society regulations have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

Section 865: Qualifying certificates of deposit

2618. This section provides that an investment will not be treated as a relevant investment if a “qualifying certificate of deposit” has been issued in respect of the investment. It is based on section 481(5)(a) of ICTA and regulation 4(1)(j) of the building society regulations.

Section 866: Qualifying time deposits

2619. This section provides that an investment will not be treated as a relevant investment if the deposit is a “qualifying time deposit”. It is based on sections 481(5)(a) and 482(6) of ICTA and regulation 4(1)(j) of the building society regulations.

Section 867: Lloyd’s premium trust funds

2620. This section provides that if an investment forms part of a Lloyd’s premium trust fund it will not be treated as a relevant investment. It is based on section 481(5) of ICTA, sections 183(2) and 184(1) of FA 1993 and regulations 2(1) and 4(1) of the building society regulations.

2621. *Subsection (1)* refers to a “premium trust fund” rather than a “premiums trust fund”, as per the source legislation (section 481(5)(f) of ICTA and regulation 4(1)(o) of the building society regulations). This new defined term follows the amendment made to section 184 of FA 1993 by articles 75 and 79 of FISMA(CA)(T)O, effective from 1 December 2001.

2622. The new definition of “premium trust fund” used in the main Lloyd’s legislation (section 184 of FA 1993) is applied by *subsection (2)*. This means that new rules relating to the Sourcebook made by the Financial Services Authority under FISMA will have effect for the purposes of defining a “premium trust fund” in respect of this Chapter.

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Section 868: Investments held outside the United Kingdom

2623. This section sets out when an investment held outside the United Kingdom will not be treated as a relevant investment. It is based on sections 481(5)(h) and (j) and 482(7) of ICTA and regulation 4(1)(s) of the building society regulations.

2624. For the purposes of the section, *subsection (4)* sets out when an investment is to be treated as being held at a branch. As the source legislation does not define when an investment will be treated as being held at a branch for the purposes of building societies, subsection (4) has been extended to apply to building societies to clarify what is meant.

Section 869: Sale and repurchase of securities

2625. This section ensures that, in relation to building societies, certain investments arising in the context of sale and repurchase transactions are not treated as relevant investments. It is based on regulation 4(1)(t) and (u) of the building society regulations.

2626. The section does not apply in relation to deposit-takers. In the case of *subsection (1)* this is because loans do not fall within the definition of “deposit” (see section 855). So interest paid by deposit-takers on such loans is not subject to the duty to deduct under this Chapter.

2627. In the case of *subsection (2)* it is because the source legislation about deposit-takers does not exempt interest payments made in respect of cash payments made as security for the performance of the sale and repurchase agreements from the duty to deduct tax. Where interest is paid by deposit-takers on such deposits to individuals, Scottish partnerships, personal representatives or trustees of discretionary or accumulation settlement, it will be subject to the duty to deduct under this Chapter.

Section 870: Other investments

2628. This section collects together the remaining instances where an investment is not to be treated as a relevant investment.

2629. *Subsection (1)* sets out various investments with deposit-takers which are not relevant investments. It is based on section 481(5)(b), (c), and (d) of ICTA.

2630. *Subsection (2)* sets out various investments with building societies which are not relevant investments. It is based on section 477A(1A) and (10) of ICTA and regulations 3(2) and 4(1)(h) of the building society regulations.

2631. For the purposes of the section, bank is defined by reference to section 991 which is based on section 840A of ICTA. In the building society regulations, the reference to “bank” in regulation 4(1)(h) is not defined. In order to clarify the position for building society legislation, the definition of “bank” has been extended to apply to building societies.

Section 871: Power to make regulations to give effect to Chapter

2632. This section gives the Commissioners for Her Majesty’s Revenue and Customs power to make regulations in relation to providing information, inspection of records by officers of Revenue and Customs, and generally giving effect to the Chapter. It is based on sections 477A, 482(11), (11A) and (12) of ICTA.

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2633. As a number of the building society regulations will be enacted, the wide powers provided in section 477A(1) of ICTA have been replaced (in part) with specific regulation making powers. See *Change 126* in Annex 1.

2634. *Subsection (2)* has been aligned to the wording of similar provisions. In particular it now includes a reference to supplemental and transitional provision and savings.

Section 872: Power to make orders amending Chapter

2635. This section gives the Treasury power to provide that certain investments are or are not relevant investments. It is based on sections 477A(1), (1A) and (2) and 481(6) and 482(12) of ICTA.

2636. As a number of the building society regulations will be enacted, the wide powers provided in section 477A(1) of ICTA have been replaced (in part) with specific order making powers. The order making power in this section takes the place of the power in section 477A(1) of ICTA in relation to building societies. See *Changes 126 and 127* in Annex 1.

2637. *Subsection (2)* allows the Treasury, in the case of deposit-takers, to specify which deposit-takers an order under this section will apply to.

2638. *Subsection (4)* gives the Treasury power to amend all sections of the Chapter except section 852 (power to disapply section 851).

Section 873: Discretionary or accumulation settlements

2639. This section makes provision about when a settlement is to be regarded as a discretionary or accumulation settlement, and when a person is to be regarded as a beneficiary of such a settlement, for the purposes of the Chapter. It is based on sections 481(4A) and 482(5A) of ICTA and regulation 2 of the building society regulations.

2640. *Subsection (2)* ensures that the section applies in the same way that section 481(4A) of ICTA did before 6 April 2006. See *Change 85* in Annex 1.

2641. In regulation 2(1) of the building society regulations, part of the definition of discretionary and accumulation trust (which, following the enactment of paragraph 37 of Schedule 13 to FA 2006, is now a reference to “settlement”) refers to “income of the settlor applied in defraying expenses of the trustees”. These words have not been included as they are obsolete.

Chapter 3: Deduction from certain payments of yearly interest

Overview

2642. This Chapter requires the deduction of sums representing income tax from certain payments of yearly interest. It is based on section 349(2) and (3) of ICTA.

2643. Many yearly interest payments are not subject to deduction under this Chapter, either because they are subject to different rules (eg those for deposit-takers and building societies in Chapter 2) or because of exceptions (eg those for certain payments made between companies in Chapter 11). Others are excluded from the duty to deduct by sections 875 to 888.

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Section 874: Duty to deduct from certain payments of yearly interest

2644. This section sets out the basic duty to deduct sums representing income tax from certain payments of yearly interest. It is based on sections 4 and 349 of ICTA.

2645. This section does not apply to interest paid by building societies. See the commentary on section 875 and *Change 134* in Annex 1.

2646. *Subsection (1)(d)* concerns payments made to persons whose “usual place of abode” is outside the United Kingdom.

2647. The term “usual place of abode” also occurs:

- in section 887 in this Chapter (industrial and provident societies);
- in section 906 (certain royalties etc); and
- in section 971 (non-resident landlords).

2648. The term “usual place of abode” is consciously retained, because it is a technical term, distinct from residence.

2649. The duty to deduct in *subsection (2)* applies to any yearly interest arising in the United Kingdom, subject to the exceptions mentioned in *subsections (3) and (4)*.

2650. The source legislation in section 349(2) of ICTA identifies yearly interest by referring both to interest falling within Chapter 2 of Part 4 of ITTOIA (income tax) and Case III of Schedule D (corporation tax). But before the amendment to section 349(2) was made by ITTOIA, the yearly interest concerned was identified simply by reference to section 18(3)(a) of ICTA (the income tax definition of interest chargeable under Case III of Schedule D).

2651. Here, in rewriting section 349(2) of ICTA, the opportunity is taken to revert to this single test, which amounts to the requirement that the income arises in the United Kingdom. The reference to “Schedule A” in section 18(3)(a) of ICTA is not included as this applied only to annual payments.

2652. Subsection (2) also makes it explicit that the rate at which deduction must be made is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

Section 875: Interest paid by building societies

2653. This section provides an exception from the duty to deduct under this Chapter when interest is paid by a building society. It is based on section 349(2) of ICTA.

2654. This section removes a drafting defect in section 349(2) of ICTA. It reflects the fact that all duties to deduct sums representing income tax from payments made by building societies are dealt with in Chapters 2 and 4 of this Part (based on sections 349(3A) and (3B) of ICTA and regulations made under section 477A(1) of ICTA). See *Change 134* in Annex 1.

Section 876: Interest paid by deposit-takers

2655. This section provides an exception from the duty to deduct under this Chapter when interest is paid by a deposit-taker and there is a duty to deduct tax under Chapter 2 of this Part, or there would have been such a duty to deduct but for regulations made under section

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852 (no liability to income tax), or the exceptions contained in sections 858 to 861 (non-UK resident declarations). It is based on section 349(3) of ICTA.

Section 877: UK public revenue dividends

2656. This section provides an exception from the duty to deduct under this Chapter for payments of UK public revenue dividends (although there may be a duty to deduct under Chapter 5 of this Part). It is new.

Section 878: Interest paid by banks

2657. This section provides an exception from the duty to deduct under this Chapter for interest paid by a bank in the ordinary course of its business. It is based on section 349(3) and (3AA) of ICTA.

2658. But this does not override any duty to deduct under Chapter 2 of this Part.

2659. Broadly, all interest is paid in the ordinary course of its business (see *subsection (1)*) unless:

- the borrowing relates to the capital structure of the bank; or
- the characteristics of the transaction giving rise to the interest are primarily attributable to an intention to avoid United Kingdom tax.

See in particular Statement of Practice 4/96.

Section 879: Interest paid on advances from banks

2660. This section provides an exception from the duty to deduct under this Chapter for interest payable to a bank in respect of an advance from that bank, if the person entitled to the interest (whether or not the bank itself) is within the charge to corporation tax. It is based on section 349(3), (3AA) and (3AB) of ICTA and articles 3 and 4 of the European Investment Bank (Designated International Organisation) Order 1996 (SI 1996/1179).

2661. If the advance is from the European Investment Bank there is no duty to deduct whether or not the payer is within the charge to UK corporation tax. This provision enacts article 4 of the Order. See *Change 135* in Annex 1. See also section 991 (which enacts article 3 of the Order).

2662. More generally, the section provides that the powers under section 991(2)(e) may, in designating an international organisation as a bank, modify this section. In particular, such an organisation may not be within the charge to UK corporation tax, but a designation may still result in there being no duty to deduct from interest on advances from that organisation.

Section 880: Interest paid on advances from building societies

2663. This section provides an exception from the duty to deduct under this Chapter for interest paid on an advance from a building society. It is based on section 477A(7) of ICTA.

Section 881: National Savings Bank interest

2664. This section provides an exception from the duty to deduct under this Chapter for interest on deposits with the National Savings Bank. It is based on section 349(3) of ICTA.

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Section 882: Quoted Eurobond interest

2665. This section provides an exception from the duty to deduct under this Chapter for interest on quoted Eurobonds. It is based on section 349(3) of ICTA.

Section 883: Interest on loan to buy life annuity

2666. This section provides an exception from the duty to deduct under this Chapter for interest subject to the regime in section 369 of ICTA. It is based on section 349(3) of ICTA.

Section 884: Relevant foreign income

2667. This section provides an exception from the duty to deduct under this Chapter for interest which is chargeable to income tax as relevant foreign income. It is based on section 349(3) of ICTA.

Section 885: Authorised persons dealing in financial instruments

2668. This section provides an exception from the duty to deduct under this Chapter for a person authorised under FISMA whose business wholly or mainly involves dealing in financial instruments as principal. It is based on section 349(3) of ICTA.

Section 886: Interest paid by recognised clearing houses etc

2669. This section provides an exception from the duty to deduct under this Chapter for certain payments of interest made by recognised clearing houses (RCH) and recognised investment exchanges (RIE), as defined in FISMA. It is based on section 349(3) and (6) of ICTA.

2670. In relation to such payments of interest, two conditions have to be met.

2671. The first condition (*subsection (1)(a)*) requires that the RCH or RIE carry on the business of providing a service whereby there are contracts between each of the parties to a transaction and the RCH or RIE, instead of contracts directly between the parties. Such a service is called a “central counterparty clearing service” (as defined in *subsection (3)*).

2672. The second condition (*subsection (1)(b)*) requires that the payment is made in the ordinary course of that business to users of the service in respect of margin or other collateral deposited with the payer.

2673. *Subsection (2)* concerns cases where an RCH or RIE may be a party to contracts involving the sale and repurchase of securities, with or without a put option. In such cases the margins between the sale price and the repurchase price are treated for tax purposes as payments of interest, which may (or may not) be yearly interest.

Section 887: Industrial and provident society payments

2674. This section provides an exception from the duty to deduct under this Chapter where an interest payment is made by registered industrial and provident society to a person whose usual place of abode is in the United Kingdom, and a related requirement to make returns of such payments. It is based on section 486(2), (3), (6) and (12) of ICTA.

2675. For discussion of “usual place of abode”, see the commentary on section 874.

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Section 888: Statutory interest

2676. This section provides an exception from the duty to deduct under this Chapter where statutory interest is paid under the Late Payment of Commercial Debts (Interest) Act 1998. It is new.

2677. Tax Bulletin 42 (August 1999) indicated that where statutory interest is paid, it would not be regarded as yearly and would not therefore be subject to deduction of tax under section 349(2) of ICTA. See *Change 136* in Annex 1.

Chapter 4: Deduction from payments in respect of building society securities

Overview

2678. This Chapter requires building societies to deduct sums representing income tax from payments of dividends and interest on certain securities which are listed or capable of being listed on a recognised stock exchange.

2679. Other payments of dividends and interest made by building societies are dealt with in Chapter 2 of this Part.

Section 889: Payments in respect of building society securities

2680. This section sets out the duty to deduct sums representing income tax from payments made in respect of certain building society shares or securities which are listed or capable of being listed on a recognised stock exchange. It is based on sections 4(1A) and (2) and 349(3A), (3B) and (4) of ICTA.

2681. *Subsection (3)* provides that qualifying certificates of deposit, qualifying uncertificated eligible debt security units and quoted Eurobonds are not subject to the duty to deduct under this Chapter.

2682. The references to qualifying deposit right in section 349(3A) and (4) of ICTA have not been rewritten as they are obsolete. See *Change 133* in Annex 1.

2683. *Subsection (4)* provides the duty to deduct a sum representing income tax, and makes it explicit that the rate at which tax is to be deducted is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

2684. *Subsection (7)* defines “dividend” as including any distribution and defines “security” as including a share, including in particular a “permanent interest bearing share” as defined in section 117 of TCGA.

Chapter 5: Deduction from payments of UK public revenue dividends

Overview

2685. This Chapter requires the deduction of sums representing income tax from payments of UK public revenue dividends. It is based on sections 4, 50 to 51AA, 349(3C) and (4), 350 and 350A of ICTA.

Section 890: Overview of Chapter

2686. This section provides an overview of the Chapter. It is new.

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Section 891: Meaning of “UK public revenue dividend”

2687. This section defines “UK public revenue dividend” as being any income from securities which is paid out of the public revenue of the United Kingdom or Northern Ireland, but excludes interest on local authority stock. It is based on section 349(4) of ICTA.

2688. The reference to “Northern Ireland” in the definition of “UK public revenue dividend” reflects the fact that amounts paid out of the public revenue of the United Kingdom to the Northern Ireland Exchequer Consolidated Fund (from which securities may be issued under section 11(1)(c) of the Exchequer and Financial Provisions Act (Northern Ireland) 1950) are not “public revenue of the United Kingdom”.

Section 892: Duty to deduct from certain UK public revenue dividends

2689. This section sets out the general duty to deduct a sum representing income tax from payments of UK public revenue dividends. It is based on sections 4, 50 and 349(3C) of ICTA.

2690. *Subsection (2)* makes it explicit that the rate at which deduction must be made is the savings rate, that being the rate applicable to income within Chapter 2 of Part 4 of ITTOIA.

Section 893: Payments of UK public revenue dividends which are payable gross

2691. This section sets out an exception to the general duty to deduct in section 892. It is based on sections 50 and 51(1) of ICTA.

2692. *Subsection (1)* provides that there is no duty to deduct if a payment of interest is made in respect of “gross-paying government securities” and no application has been made for the interest to be paid net of tax.

2693. *Subsection (2)* defines “gross-paying government securities” as being “gilt-edged securities” or securities which are the subject of a Treasury direction.

Section 894: Treasury directions

2694. This section is based on sections 50, 51 and 51AA of ICTA.

2695. *Subsections (1) and (2)* allow the Treasury to direct that securities issued under the National Loans Acts 1939 and 1968 are “gross-paying government securities”.

2696. *Subsection (3)* deals with the issue of Northern Ireland securities and allows the Treasury, at the request of the Department of Finance and Personnel, to direct that securities issued under section 11(1)(c) of the Exchequer and Financial Provisions Act (Northern Ireland) 1950 are “gross-paying government securities”.

2697. Section 51(2) of ICTA sets out the provisions of section 11(1)(c) of the 1950 Act by including the words, “for money borrowed by the Department of Finance and Personnel for the purposes of making issues from the Consolidated Fund of Northern Ireland”. These words have not been included as they do not alter the scope of the reference to section 11(1)(c) of the 1950 Act and are, therefore, unnecessary.

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Section 895: Deduction at source application

2698. This section allows the holder of registered gross-paying government securities to make an application for the securities to be subject to deduction of a sum representing income tax under section 892. It is based on section 50 of ICTA.

2699. The application must be made to the Registrar in such form as is prescribed by the Registrar with the approval of the Treasury. It is effective one month after the application has been made and ceases to be effective when the person who made it is no longer the registered owner or when the election ceases to have effect following its withdrawal under section 896.

2700. *Subsections (4) and (5)* confirm that where the registered holders are trustees they can make an application for sums representing income tax to be deducted under section 892 without the consent of any other person and despite anything in the trust instrument.

2701. *Subsection (6)* defines “registered” and “the Registrar” for the purposes of the Chapter (but see also section 894(4)).

2702. The definition of “registered” has been extended to include gilts which are “recorded” in the books of the Registrar. This change provides legislative support for deduction at source applications under this section in respect of gilts held in CREST. See *Change 137* in Annex 1.

Section 896: Withdrawal of application

2703. This section is about the withdrawal of an application for net payment under section 895. It is based on section 50(5) of ICTA.

2704. The section sets out that a withdrawal of an application may be made by the registered holder of the securities only by notice to the Registrar in such form as is prescribed by the Registrar with the approval of the Treasury. Such a withdrawal will have effect one month after the date the Registrar receives the notice.

Section 897: Power to make regulations

2705. This section enables the Commissioners for Her Majesty’s Revenue and Customs to make regulations in relation to the Chapter. It is based on section 350A of ICTA.

2706. *Subsection (2)* allows regulations to be made which differentiate between different kinds of UK public revenue dividends and to make different provision for different circumstances. *Subsection (2)(b)* has been aligned to the wording of similar provisions. In particular it now includes a reference to incidental and consequential amendments.

2707. Section 350A(2)(b) of ICTA, which allowed regulations to be made in respect of the Bank of Ireland, has not been rewritten as it obsolete following the Bank of Ireland’s decision to discontinue its stock registration business.

2708. As a result of that decision, the United Kingdom gilts registers managed by the Bank of Ireland were closed with effect from 25 October 2002 (SI 2002/2521). The holdings were transferred to the main United Kingdom gilts register managed by the Bank of England with effect from 28 October 2002. So the specific provisions in section 350A(2)(b) are no longer necessary. If the Commissioners for Her Majesty’s Revenue and Customs were to wish to

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make similar provision in respect of a particular institution in future (including the Bank of Ireland) they could do so under the general power provided by section 897(2)(a).

Chapter 6: Deduction from annual payments and patent royalties

Overview

2709. This Chapter requires the deduction of sums representing income tax from certain annual payments and patent royalties. It is based on sections 4, 125, 347A, 348 and 349(1) of ICTA and section 727 of ITTOIA.

2710. These rules are coupled with those providing for relief for certain of the payments concerned in computing net income: see Chapter 4 of Part 8 and the related commentary. Together, the rewritten rules replace the scheme of the source legislation relating to charges on income (which owes its origins to the historic concept of alienation of income). See *Change 81* in Annex 1.

2711. Sections 348 and 349(1) of ICTA are at the heart of the material about deduction of tax in the source legislation and have a very long history. The basic structure is that a payment falls within section 348 if it is payable wholly out of income brought into charge on the payer, but falls within section 349(1) if it is not payable wholly out of such income. (Payments which are deductible in computing income from a given source are not made out of income charged to tax and therefore fall into section 349(1).)

2712. The main differences between those sections in relation to deduction of tax are that

- deduction is optional under section 348 of ICTA but mandatory under section 349(1) of ICTA; and
- under section 348 the tax is in effect collected as part of the tax charged on the payer's income, but under section 349(1) the tax is directly assessed (section 350 of ICTA).

2713. As a result of *Change 81* deduction is made mandatory in all cases and the machinery for collecting the sums deducted has been changed, with direct assessment applying in fewer cases.

Section 898: Overview of Chapter

2714. This section provides an overview of the Chapter. It is new.

Section 899: Meaning of “qualifying annual payment”

2715. This section defines “qualifying annual payment”. It is based on sections 7(1), 125(1), 348(1A), 349(1A) and 687(1) of ICTA.

2716. Under the source legislation, for an annual payment to be within the scope of sections 348 and 349 of ICTA it had to be charged to tax:

- under Schedule D Case III;
- under Chapters 7 or 10 of Part 4, section 579, or Chapters 4 or 7 of Part 5 of ITTOIA (and not be relevant foreign income); or
- under sections 609 and 611 of ITEPA.

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2717. This takes account of the amendments made by paragraph 62 of Schedule 10 to FA 2005 (pension schemes etc) with effect from 6 April 2007.

2718. *Subsection (2)* specifies that the payment must arise in the United Kingdom. This follows from the fact that historically Case III was limited to United Kingdom sources and it is necessary to introduce this specific condition because United Kingdom sources and foreign sources are dealt with together in ITTOIA.

2719. *Subsection (3)* addresses the case where the recipient is a person other than a company and identifies all the provisions in ITEPA and ITTOIA under which annual payments formerly within Case III may be chargeable.

2720. *Subsection (4)* addresses the case where the recipient is a company. If the company is liable to income tax then the income must be within the provisions set out in subsection (3). But if the company is liable to corporation tax Case III still applies.

2721. *Subsection (5)* excludes a number of types of payment from the provisions in this Chapter.

2722. Payments treated as made to unit holders from unauthorised unit trusts are not specifically excluded here. That is because they are dealt with in Chapter 13 of this Part and, following the approach adopted in Chapter 10 of Part 4 of ITTOIA, such amounts are no longer treated as annual payments. So it is irrelevant to consider whether they are “qualifying”.

2723. If an annual payment is made by a building society, it is subject to the rule that payment includes crediting: see the Income Tax (Building Societies) (Annual Payments) Regulations 1991 (SI 1991/512).

Section 900: Deduction from commercial payments made by individuals

2724. This section requires that individuals deduct sums representing income tax from qualifying annual payments made for commercial reasons. It is based on sections 4, 347A(2), 348(1) and 349(1) of ICTA and sections 727 and 728 of ITTOIA.

2725. These are the only qualifying annual payments made by individuals not taken out of taxation by section 347A(2) of ICTA and section 727 of ITTOIA.

2726. The section makes deduction mandatory and provides for the tax to be collected as part of the individual’s self-assessment (see Chapter 17), so there will be no direct assessments in such cases in future. See *Change 81* in Annex 1.

2727. It is made explicit that the rate at which deduction must be made is the basic rate.

2728. It is also provided that the basic rate concerned is to be the basic rate for the year of payment. See *Change 138* in Annex 1, which also affects sections 901, 902 and 903.

2729. The source legislation differentiates between cases where the individual is “liable to make the payment”, and cases where payments are made on behalf of someone else (through the formula “the person by or through whom the payment is made”). Since the tax in respect of all payments by individuals will in future be accounted for through the individual’s own self-assessment, this section simply says “the individual must, on making the payment, ...”.

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2730. ESC A16 gives relief to a payer who fails to make a payment from which tax was deductible in the year in which it was due to be paid (and in which the payer had income to at least partly cover the payment), but who makes the payment in a later year. This gave rise to an assessment under section 350 of ICTA. The concession will be amended to reflect the new legislative structure relating to annual payments.

Section 901: Deduction from annual payments made by other persons

2731. This section requires persons other than individuals to deduct sums representing income tax from annual payments. It is based on sections 4, 347A(3), 348(1) and 349(1) of ICTA and sections 727 to 728 of ITTOIA.

2732. For persons other than individuals the range of payments within sections 348(1) and 349(1) of ICTA is wider than it is for individuals because the provision that certain payments are not to be charges on income (section 347A(1) of ICTA and section 727 of ITTOIA) applies only to payments by individuals. Accordingly, while section 900 applies only to commercial payments, this section applies to any annual payment that is a qualifying annual payment within section 899.

2733. This section does not apply to a payment made by an individual's personal representatives unless it would have constituted a commercial payment within section 900 if paid by the individual before the individual's death.

2734. *Subsections (3) to (5)* set out the conditions that determine which method is used to collect the tax. Deduction at the applicable rate (see the commentary on section 902) is mandatory in all cases, but the method of recovery depends on whether the payer does, or does not, have any modified net income in the year in which payment is made.

2735. If the payer has some modified net income, then the tax is collected as part of the payer's self-assessment by virtue of Chapter 17. If the payer has no modified net income, then the tax is collected under Chapter 15 if the payer is a UK resident company, and otherwise under Chapter 16. See *Changes 81* and *138* in Annex 1 and the commentary on section 900.

2736. Where the payer is not an individual and will not be accounting for the tax under Self Assessment, the term "the person by or through whom the payment is made" has been retained.

Section 902: Meaning of "applicable rate" in section 901

2737. This section defines "applicable rate" in section 901. It is based on section 4 of ICTA.

2738. Payments within section 900 are all subject to deduction at the basic rate. Deductions from annual payments made by persons other than individuals are also normally at the basic rate. The only exceptions, where the savings rate applies instead, are certain payments under purchased life annuities, namely those charged to tax under Chapter 7 of Part 4 of ITTOIA.

2739. *Subsection (4)(b)*, which is based on section 4(1A) of ICTA, caters, for example, for the case where the recipient is a company within the charge to corporation tax.

2740. This section is subject to provisions requiring or permitting deduction at special rates - see Chapter 8 of this Part. It is also subject to regulation 3 of the Double Taxation Relief

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(Taxes on Income) (General) Regulations 1970 (SI 1970/488) which provides for a different rate of tax to be deducted from a gross payment if a notice under regulation 2(2) has been given.

2741. In all cases, the rate is determined by the year in which the payment is made. See *Change 138* in Annex 1 and the commentary on section 900.

Section 903: Deduction from patent royalties

2742. This section requires the deduction of sums representing income tax from patent royalties. It is based on sections 4, 7, 125, 348(2) and 349(1) of ICTA.

2743. In addition to annual payments, deduction applies to any royalty or other sum in respect of the use of a patent under sections 348(2) and 349(1)(b) of ICTA.

2744. If a payment in respect of a patent is also a qualifying annual payment then this section does not apply (*subsection (2)(a)*). This clarifies that deduction does not apply to a patent royalty which is an annual payment and is paid by an individual otherwise than in connection with the individual's trade. See *Change 139* in Annex 1.

2745. In the case of annual payments, the source legislation states explicitly that to be caught by the deduction rules a payment has to be assessable under Schedule D Case III. That rule carries with it the requirement that the payment should arise in the United Kingdom. There is no such explicit statutory rule covering patent payments that are not annual payments. Normally those payments are not assessable under Case III. But in practice it has always been the case that, for such a payment to be subject to the deduction rules, it must arise in the United Kingdom. *Subsection (3)* makes this explicit.

2746. *Subsection (4)* makes explicit that deduction is to apply only where the payment is charged to income or corporation tax. See *Change 140* in Annex 1.

2747. This section applies to payments by any person, but otherwise largely follows the format of section 901. If the payer is an individual or has some modified net income, then the tax is collected as part of the payer's self-assessment under Chapter 17. If the payer is not an individual and has no modified net income, then the tax is collected under Chapter 15 if the payer is a UK resident company, and under Chapter 16 otherwise. See *Changes 81* and *138* in Annex 1 and the commentary on section 900.

Section 904: Annual payments for dividends or non-taxable consideration

2748. This section provides a definition of "annual payment for dividends or non-taxable consideration". It is based on section 125 of ICTA.

2749. With certain exceptions, *subsection (3)* has the effect of excluding from the duties to deduct under this Chapter any annual payment that is made for consideration that is either:

- for a dividend or the right to receive a dividend; or
- not taxable.

2750. The exceptions to that general rule are given in *subsections (4) to (7)*.

2751. The source legislation specifies that the payment must not be interest (section 125(2)(a) of ICTA). Annual payments within *subsection (2)* do not include interest,

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so this does not need to be stated explicitly. In addition, no specific reference is made to annuities (also mentioned in the source legislation) as these are simply one type of annual payment.

Section 905: Interpretation of Chapter

2752. This section clarifies that the references to an individual in this Chapter include a Scottish partnership if at least one partner is an individual. It is based on section 347A(6) of ICTA.

Chapter 7: Deduction from other payments connected with intellectual property

Overview

2753. This Chapter requires the deduction of sums representing income tax from certain payments connected with intellectual property. It is based on sections 4, 349(1), 349ZA, 524(3), 532, 533 and 536 to 537B of ICTA.

2754. The payments concerned are:

- royalties or periodical payments in respect of copyright and design rights, and payments in respect of public lending rights (“relevant intellectual property rights”) where the usual place of the owner or seller is outside the United Kingdom; and
- proceeds of sale by a non-UK resident of patent rights, if the proceeds of sale are, or include, a capital sum.

Section 906: Certain royalties etc where usual place of abode of owner is abroad

2755. This section requires the deduction of sums representing income tax from certain payments in respect of a “relevant intellectual property right” (see section 907). It is based on sections 4(1) and (2), 536(1) and (2), 537 and 537B(1) and (2) of ICTA.

2756. *Subsection (1)(b)* makes explicit that deduction is to apply only where the payment is charged to income or corporation tax. See *Change 140* in Annex 1.

2757. The payments concerned are those where the owner of the intellectual property right, or a past owner who has assigned the right but receives payments in respect of it, has a usual place of abode outside the United Kingdom.

2758. For discussion of “usual place of abode”, see the commentary on section 874.

2759. But the duty to deduct does not apply in cases where the payment is for copies of works or articles that have been exported from the United Kingdom for distribution elsewhere.

2760. *Subsection (5)* makes it explicit that the rate at which deduction must be made is the basic rate and imposes the duty to deduct on the person by or through whom the payment is made. But see the commentary on section 908 for special rules affecting some paying agents.

Section 907: Meaning of “relevant intellectual property right”

2761. This section defines “relevant intellectual property right” for the purposes of section 906. It is based on sections 536(1) and (2), 537 and 537B(1) and (2) of ICTA.

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2762. *Subsection (2)* qualifies the basic categories by excluding copyrights in films and expanding the definition of “right in a design” to reflect the fact that although *registered* designs were protected in UK law from 1949, by the Registered Designs Act 1949, “design rights” in *unregistered* designs were not protected until Part III of the Copyright, Designs and Patents Act 1988 came into force in 1989.

Section 908: Royalty payments etc made through UK resident agents

2763. This section addresses issues that arise when a payment is made, not by the owner of the right, but by an agent who in turn is entitled to deduct a commission from the payment. It is based on sections 536(3) and (4) and 537B(3) and (4) of ICTA.

2764. The normal rule is that the payment is to be reduced by the amount of commission before calculating the amount that is to be deducted.

2765. But if the agent does not know the amount of commission, or does not know that it is payable, the sum representing income tax must be calculated on the gross amount of the payment, and that amount must be accounted for.

Section 909: Royalty payments: further provision

2766. This section supplements the provisions in section 906. It is based on sections 536(1), (5) and (6) and 537B(1), (5) and (6) of ICTA.

Section 910: Proceeds of a sale of patent rights: payments to non-UK residents

2767. This section requires the deduction of sums representing income tax from the proceeds of sale of patent rights where the seller is non-UK resident and the proceeds are, or include, a “capital sum”. It is based on sections 4, 349(1), 349ZA, 524(3), 532 and 533 of ICTA.

2768. Section 524(3) of ICTA will continue to apply for corporation tax.

2769. *Subsections (2) and (3)* give details of the duty to deduct, and make it explicit that the rate at which deduction must be made is the basic rate. Expenses of the sale, if deducted before payment is made, reduce the amount of the proceeds, as does any element of those proceeds not consisting of a capital sum. The income tax must then be calculated on the amount of the proceeds, as so reduced.

2770. *Subsection (4)* extends the provisions of this section to licences connected with patents, and rights to acquire future patent rights. This subsection is based on the interpretative provisions of section 533 of ICTA.

2771. *Subsection (5)* defines “capital sum” by reference to section 4 of CAA. It does not include any sum that is taken into account in computing trading profits or that constitutes earnings from an employment or office.

2772. Under section 588 of ITTOIA a seller of patent rights who originally paid a capital sum on acquisition of those rights (the capital sum on acquisition) can deduct it from the capital sum on which income tax is charged on the sale. But under section 595 of ITTOIA, when computing the amount of income tax to be deducted from the capital sum on sale, the capital sum on acquisition cannot be deducted from it (*subsection (6)(a)*).

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2773. Nor is the amount of income tax to be deducted affected by the provisions about spreading of the capital sum, and payment of it by instalments, under section 524(9) of ICTA (*subsection (6)(b)*).

Chapter 8: Chapters 6 and 7: Special provision in relation to royalties

Overview

2774. This Chapter deals with two international aspects relating to the deduction of sums representing income tax from royalties paid by companies. It is based on section 349E of ICTA and section 101 of FA 2004.

2775. The first aspect concerns double tax arrangements (as defined in section 1023), whose provisions may lay down a rate other than the basic rate as the one to be applied to such payments. The Chapter provides that the paying company may deduct a sum representing income tax at the treaty rate (which in some cases is 0%) if it reasonably believes that the payee (as defined in section 913(2)) is entitled to double taxation relief on the payment.

2776. The second aspect concerns the provisions implementing the European Union Savings and Royalties Directive (Council Directive 2003/49/EC) in sections 757 to 767 of ITTOIA. These provide that a UK resident company, or a UK permanent establishment of a European Union company, may pay without deduction if it reasonably believes that the income arising from the payment will be exempt under section 758 of ITTOIA.

Section 911: Double taxation arrangements: deduction at treaty rate

2777. This section sets out the conditions under which a company may deduct sums representing income tax on the royalty payment at the treaty rate. It is based on section 349E(1), (2) and (5) of ICTA.

2778. *Subsection (3)* states that if, despite the reasonableness of the company's belief, the payee is not in fact entitled to double tax relief, the right to deduct at the treaty rate is treated as never having existed.

Section 912: Power to make directions disapplying section 911

2779. This section gives power to an officer of Revenue and Customs, if not satisfied that the payee will in fact be entitled to double taxation relief on a royalty payment, to direct that section 911 is not to apply. It is based on section 349E(3) and (4) of ICTA.

2780. If an officer so directs, the paying company will then have to deduct a sum representing income tax at the basic rate as required under Chapter 6 or 7.

2781. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 913: Interpretation of sections 911 and 912

2782. This section gives interpretations of "royalty" and "payee" in relation to sections 911 and 912. It is based on section 349E(1) and (5) of ICTA.

2783. *Subsection (1)* defines "royalty" widely, including in particular any proceeds of a sale of patent rights.

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Section 914: EU companies: discretion to make payment gross

2784. This section provides that, if the paying company reasonably believes that section 758 of ITTOIA (exemption for certain interest and royalty payments) applies to the payment, it may pay without deducting a sum representing income tax. It is based on section 101(1) and (2) of FA 2004.

2785. Section 758 of ITTOIA gives exemption in respect of royalty payments by UK resident companies, or by a UK permanent establishment of a European Union company, to a European Union company (see sections 757 to 767 of ITTOIA).

2786. *Subsection (3)* states that if, despite the reasonableness of the company's belief, the payment is not in fact exempt under section 758 of ITTOIA, the right to pay without deduction is treated as never having existed.

Section 915: Power to make directions disapplying section 914

2787. This section gives power to an officer of Revenue and Customs, if not satisfied that payments will in fact be exempt under section 758 of ITTOIA, to direct that section 914 is not to apply. It is based on section 101(3) and (4) of FA 2004.

2788. If an officer so directs, the paying company will then have to deduct a sum representing income tax if this is required under sections 903(7) or 906.

2789. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 916: Duty of payee to notify if payment not exempt

2790. This section imposes a duty on the payee to notify an officer of Revenue and Customs and the paying company if it becomes aware that a condition for exemption under section 758 of ITTOIA is no longer met. It is based on section 101(5) of FA 2004.

2791. The reference in the source legislation to "the Board" is replaced with a reference to "an officer of Revenue and Customs". See *Change 5* in Annex 1.

Section 917: Supplementary

2792. This section supplements the provisions in sections 914 to 916. It is based on section 101(8) and (9) of FA of 2004.

Chapter 9: Manufactured payments

Overview

2793. This Chapter deals with deduction of income tax at source from manufactured property income dividends, manufactured interest and manufactured overseas dividends (MODs). It is based on paragraphs 3 to 4 of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

Section 918: Manufactured dividends on UK shares: Real Estate Investment Trusts

2794. This section imposes an obligation to deduct income tax at source on payers of manufactured dividends (manufactured property income dividends or MPIDs) which are representative of dividends (property income dividends or PIDs) paid by Real Estate

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Investment Trust companies or by principal companies of Real Estate Investment Trust groups. It is based on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

2795. *Subsection (1)* sets the conditions for the section to apply. First, the person must pay a “manufactured dividend” as mentioned in section 573. Second, the manufactured dividend must be representative of a PID.

2796. A dividend may be partly but not wholly a PID. *Subsection (2)* provides that the section applies only so far as the manufactured dividend is representative of a PID.

2797. *Subsection (3)* ensures that, if the payer of the MPID is either UK resident or paying the MPID through a UK branch or agency, the rules on deducting income tax at source from PIDs apply, with any necessary modifications, to the MPID.

2798. *Subsections (4) and (5)* enable regulations to be made subjecting MPIDs, if they fall outside subsection (3) to a reverse charge. This provision is analogous to sections 920 and 923, which impose reverse charges on manufactured interest on UK securities and MODs and are discussed in detail below.

2799. *Subsections (6) and (7)* provide that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the payment had been an actual PID.

Section 919: Manufactured interest on UK securities: payments by UK residents etc

2800. This section imposes an obligation on payers of manufactured interest to deduct income tax at source. It is based on section 4(1A) of, and paragraph 3 of Schedule 23A to, ICTA.

2801. It is the first of a group of sections about manufactured interest on UK securities (sections 919 to 921).

2802. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay “manufactured interest” as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). Third, the payer must be either (a) UK resident or (b) paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2803. *Subsection (2)* is based on paragraph 3(2) of Schedule 23A to ICTA. Paragraph 3(2)(a), so far as relevant, provides that “the manufactured interest shall be treated ... as if it (i) were an annual payment to the recipient, but (ii) were neither yearly interest nor an amount payable wholly out of profits or gains brought into charge for income tax.” This deeming provision brings the manufactured interest within section 349(1)(a) of ICTA.

2804. Section 349(1)(a) of ICTA is rewritten in Chapter 6 of this Part (deduction from annual payments and patent royalties). But paragraph 3 of Schedule 23A to ICTA applies section 349(1)(a) to manufactured interest with important modifications: see paragraph 3(2)(b), (4) and (5). This Chapter therefore rewrites paragraph 3 of Schedule 23A separately from Chapter 6.

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2805. This is done without the use of deeming. Subsection (2) spells out that the payer of the manufactured interest must, on making the payment, deduct from the gross amount of the manufactured interest a sum representing income tax on it.

2806. The rate applicable under subsection (2) is the savings rate in force for the tax year in which the payment is made (and not, as in Chapter 6, the basic rate). This follows from section 4(1A) and (2)(b) of, and paragraph 3(2)(b)(ii) of Schedule 23A to, ICTA.

2807. *Subsection (3)* defines the “gross amount” of manufactured interest.

2808. *Subsection (4)* explains that this section is subject to certain other provisions:

- sections 583 and 585 in Part 11 (Manufactured payments and repos);
- section 921 (cases where interest on underlying securities paid gross) in this Chapter; and
- Chapter 11 of this Part (payments between companies etc: exception from duties to deduct) – see section 930(2)(g), which is based on section 349A(3) of ICTA.

2809. *Subsection (5)* is a signpost to the collection provisions. If the payer has to deduct tax from the manufactured interest under section 349(1)(a) of ICTA, and the payer is a company, the tax is collected under section 350(4) of, and Schedule 16 to, ICTA. Under paragraph 3(7) of Schedule 23A to ICTA, this applies whether or not the company is UK resident. These provisions are rewritten in Chapter 15 of this Part. Chapter 15 includes some minor changes to the law which are potentially relevant to payments within section 919:

- *Change 143* makes it clear that a return need be submitted only where a relevant payment was made in that particular return period. It also clarifies related points.
- *Change 144* brings into line the information required to be included on a return where a payment is made otherwise than in an accounting period with the information which is required where the payment is made in an accounting period.
- *Change 147* removes the charging provision in section 350(1) of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in cases falling within Chapters 3 to 7, 10, 12, 13 and 18 of this Part.

2810. If the payer is not a company, the tax is collected under section 350(1) of ICTA, which is rewritten in Chapter 16 of this Part. Chapter 16 also includes *Change 147*.

Section 920: Foreign payers of manufactured interest: the reverse charge

2811. This section imposes an obligation on certain recipients to account for and pay income tax on manufactured interest received. It is based on paragraphs 3 and 3A of Schedule 23A to ICTA.

2812. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this obligation as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

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2813. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2814. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay “manufactured interest” as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). These conditions are identical to those in section 919(1). The third condition contrasts with the third condition in section 919(1): the payer must be non-UK resident and not paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2815. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the manufactured interest.

2816. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 919.

2817. *Subsection (4)* provides that, if the payer would not have been required to deduct any sum under section 919, the recipient is not required to account for and pay any income tax under subsection (3). For the convenience of users, *subsection (5)* highlights important cases in which subsection (4) applies.

2818. The collection rule for all recipients, whether or not they are companies and whether or not they are UK resident, is given by secondary legislation: regulation 3(1) and (2) of SI 1997/992, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586, which refers to this Chapter.

Section 921: Cases where interest on underlying securities paid gross

2819. This section is an exception to the withholding provisions of sections 919 and 920. It is based on paragraphs 1 and 3A of Schedule 23A to ICTA. Broadly speaking, if the interest itself mentioned in *subsection (1)* is payable gross, the manufactured interest representative of it is also payable gross.

Section 922: Manufactured overseas dividends: payments by UK residents etc

2820. This section imposes an obligation on the payer of a MOD to deduct income tax from the gross amount of the MOD. It is based on paragraphs 4(1) and 4(2) of Schedule 23A to ICTA. It is the first of a group of sections concerned with MODs (sections 922 to 925).

2821. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as defined in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). Third, the payer must be either (a) UK resident or (b) paying the MOD in the course of a trade carried on through a branch or agency in the United Kingdom.

2822. Paragraph 4(2) of Schedule 23A to ICTA deems the MOD to be an annual payment within section 349 of ICTA. This section avoids the use of deeming. *Subsection (2)* spells out that the payer of the MOD must, on making the payment, deduct from the gross amount of the manufactured overseas dividend a sum equal to the relevant withholding tax on the gross amount.

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2823. *Subsection (3)* explains that this section is subject to certain other provisions. Unlike section 919, this section is not subject to Chapter 11 of this Part (payments between companies etc: exception from duties to deduct), because section 349A(4)(b) of ICTA excludes MODs from the provisions of sections 349A to 349D of that Act.

2824. *Subsection (4)* is a signpost to the powers in sections 586 and 925 to make regulations about collection of tax. The collection rules about MODs, and the rules about tax vouchers for MODs, are given by secondary legislation: regulations 11 and 15 respectively of SI 1993/2004, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586.

Section 923: Foreign payers of manufactured overseas dividends: the reverse charge

2825. This section imposes an obligation on certain recipients to account for and pay income tax on MODs received. It is based on paragraphs 4 and 3A of Schedule 23A to ICTA. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

2826. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2827. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as mentioned in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). These conditions are identical to those in section 922(1). The third condition contrasts with the third condition in section 922(1): the payer must be non-UK resident and not paying the MOD in the course of a trade carried on in the United Kingdom through a branch or agency.

2828. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the MOD.

2829. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 922.

Section 924: Power to reduce section 923 liability

2830. This section supplements section 923. It is based on paragraph 4(3B) of Schedule 23A to ICTA.

Section 925: Power to provide set-off entitlement

2831. This section is a power to make regulations dealing with the interaction between Chapter 9 and double taxation relief. It is based on paragraph 4(3), 4(7) and 4(7AA) of Schedule 23A to ICTA.

2832. This section also brings into line with practice the law on the periods by reference to which overseas dividend manufacturers may set amounts of overseas tax off against their UK tax liabilities. See *Change 141* in Annex 1.

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2833. This section uses the labels “relevant amounts of tax suffered” and “relevant tax liabilities”. These labels are defined in *subsections (3) and (4)* respectively.

2834. *Subsection (5)* makes it clear that the credit mentioned in *subsection (1)* which a person can claim includes credit against corporation tax. So paragraph 4(7) and (7AA) of Schedule 23A to ICTA are repealed.

Section 926: Interpretation of Chapter

2835. This section provides that expressions used both in this Chapter and in Chapter 2 of Part 11 (manufactured payments and repos: manufactured payments) have the same meaning in this Chapter as they do in the earlier Chapter, so avoiding the need to duplicate definitions. It is based on paragraphs 1(1), 2(1), 3(1) and (10), 4(1) and (2A) and 7(1) of Schedule 23A to ICTA and section 153(2) of FA 2003.

2836. *Subsection (2)* provides that references in this Chapter to a trade carried on through a branch or agency are to be read, in relation to a company, as references to a trade carried on through a permanent establishment. This may make a difference in some cases as it is possible for a non-UK resident company to be trading in the UK through a branch or agency but not through a permanent establishment.

Section 927: Regulation-making powers: general

2837. This section provides that regulations under this Chapter may make different provision for different cases. It is based on paragraph 8(4) of Schedule 23A to ICTA.

Chapter 10: Deduction from non-commercial payments by companies

Section 928: Chargeable payments connected with exempt distributions

2838. This section requires the deduction of sums representing income tax from chargeable payments connected with exempt distributions. It is based on sections 4, 214(1) and 349(1) of ICTA.

2839. Section 214(1) of ICTA makes provision concerning payments made by a company after an exempt distribution (such as a demerger that meets the conditions in section 213 of ICTA). The other provisions of sections 213 and 214 of ICTA are basically concerned with corporation tax.

2840. The section makes it explicit that the rate at which deduction must be made is the basic rate.

Chapter 11: Payments between companies etc: exception from duties to deduct

Overview

2841. This Chapter allows “excepted payments” made by companies, local authorities and “qualifying partnerships” to be made without deducting a sum representing income tax. It is based on sections 349A to 349D of ICTA.

2842. Power is given to officers of Revenue and Customs to reimpose a duty to deduct if they have reasonable grounds for believing that the conditions for payment to be made without deduction are not met. The Chapter also provides that, if a paying company

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reasonably believes that a payment is excepted but that proves not to be true, the duty to deduct is treated as always having existed.

Section 929: Overview of Chapter

2843. This section provides an overview of the Chapter. It is new.

Section 930: Exception from duties to deduct sums representing income tax

2844. This section disapplies various duties on companies, local authorities and qualifying partnerships to deduct sums representing income tax if they reasonably believe that the payments concerned are “excepted payments”. It is based on section 349A of ICTA.

Section 931: Power to make directions disapplying section 930

2845. This section gives power to an officer of Revenue and Customs to direct that section 930 is not to apply if the officer has reasonable grounds for believing that the payment will be an excepted payment. It is based on section 349C of ICTA.

2846. The reference in the source legislation to “the Board” is replaced by a reference to “an officer of Revenue and Customs”. See *Change 5* in Annex 1.

Section 932: Meaning of “qualifying partnership”

2847. This section defines “qualifying partnership” for the purposes of the Chapter. It is based on sections 349A(6), 349C(4) and 349D(2) of ICTA.

Section 933: UK resident companies

2848. This section is the first of a number of sections setting out those payments which are excepted payments and provides that a payment is an excepted payment if the beneficiary is a UK resident company. It is based on section 349B(1) of ICTA.

Section 934: Non-UK resident companies

2849. This section states the conditions under which a payment to a non-UK resident company is an excepted payment. It is based on section 349B(2) of ICTA.

Section 935: PEP and ISA managers

2850. This section provides that a payment to a plan manager of a personal equity plan or an individual savings account, or to the manager’s nominee, is an excepted payment if it is received in respect of investments under the plan. It is based on section 349B(4) of ICTA.

Section 936: Recipients who are to be paid gross

2851. This section provides that payments to various specific types of recipient are excepted payments. It is based on section 349B(3) and (8) of ICTA.

2852. The Treasury may by order amend the list of such recipients.

Section 937: Partnerships

2853. This section sets out the conditions under which payments made to certain partnerships are excepted payments. It is based on section 349B(6), (7) and (8) of ICTA.

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2854. The Treasury may by order vary the types of recipient covered by this section, other than those mentioned in section 936 (which is covered by the power provided in that section).

Section 938: Consequences of reasonable but incorrect belief

2855. This section provides that if, despite the reasonableness of the payer's belief, the payment is not an excepted payment at the time it is made, the right to pay without deduction is treated as never having existed. It is based on section 349D of ICTA.

Chapter 12: Funding bonds

Overview

2856. This Chapter adapts the requirement to deduct sums representing income tax from certain payments of interest to deal with cases where the debtor has issued securities ("funding bonds") instead of paying the interest. It is based on section 582 of ICTA.

2857. Sections 582(1) of ICTA and 380 of ITTOIA provide that the recipient of such bonds is treated as receiving an amount of interest equal to the market value of the bonds. This Chapter deals with the effect of that provision on the duty to deduct at source. This is usually to require the debtor to retain bonds to cover the amount of the deduction. But if that is impracticable, there is alternative provision.

Section 939: Duty to retain bonds where issue treated as payment of interest

2858. This section requires a debtor who issues funding bonds to retain bonds instead of deducting sums representing income tax. It is based on section 582(2), (2A) and (4) of ICTA.

2859. *Subsection (2)* makes it explicit that the rate by reference to which bonds are to be retained is the savings rate. The debtor is then treated as having complied with the duty to deduct at source (*subsection (3)*).

2860. The bonds themselves may be tendered in satisfaction of any income tax due from the debtor under Chapter 15 or 16 of Part 15 of this Act. Because the source legislation links into the deduction and collection requirements of sections 349 and 350 of ICTA, this provision is affected by the removal of the charge to income tax in section 350(1) of ICTA. See *Change 147* in Annex 1 and the commentary on section 963.

Section 940: Exception from duty to retain bonds

2861. This section makes provision for cases where it is impracticable for the debtor to retain bonds. It is based on section 582(2) of ICTA.

2862. The duty to deduct (which under section 939 becomes a duty to retain bonds) does not apply if the debtor notifies the Commissioners for Her Majesty's Revenue and Customs of the details required by *subsection (2)*.

Chapter 13: Unauthorised unit trusts

Overview

2863. This Chapter provides the rules about deduction of tax at source in relation to distributions treated as made from unauthorised unit trusts (UUTs) to their unit holders. It is based on sections 348, 349(1) and (1A) and 469 of ICTA.

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2864. A unit trust is “unauthorised” if it does not have authorisation under FISMA to seek investment directly from members of the public. Nor is such a trust regulated under FISMA. “Unauthorised unit trust” is defined in section 989.

2865. The rules for UUTs differ from the rules relating to annual payments (with which they are related in the source legislation) in that the amount shown by the trust’s accounts as income for a distribution period is treated as having been paid to unit holders on the date prescribed by Chapter 10 of Part 4 of ITTOIA, regardless of whether it has been so paid in whole or in part. Any actual payments to unit holders are ignored.

2866. Chapter 10 of Part 4 of ITTOIA does not deal with these amounts treated as paid to unit holders by charging them as a type of annual payment. Instead, that Act imposes a separate charge to income tax on the unit holder. In accordance with that approach, Chapter 9 of Part 9 of this Act gives relief to the trustees of the UUT for such amounts.

2867. This Chapter deals with the payments treated as having been made as regards the deduction at source rules. In particular, such amounts are treated as having been paid under deduction of a sum representing income tax at the basic rate for the applicable tax year; there is no actual duty to deduct as in other Chapters of this Part.

2868. This Chapter also requires the tax to be collected under Self Assessment. Since the trustees of the UUT will have obtained relief by deduction from their taxable income for the amount of any grossed-up amounts treated as paid to unit holders, this tax will normally be most of the tax that they have to pay.

2869. Additionally, if the deemed payments in a tax year cannot be fully relieved because their taxable income is insufficient, there is provision for the trustees to take account of any excess of modified net income (defined in section 1025) in earlier tax years over the payments they are treated as having made in those years.

Section 941: Deemed payments to unit holders and deemed deductions of income tax

2870. This section sets out the framework of the deduction at source regime for UUTs. It is based on sections 348(1A), 349(1A) and 469 of ICTA.

2871. If the unit holder is subject to income tax, the section:

- treats as a payment by the UUT trustees to the unit holder any grossed-up amount (for which see section 548 of ITTOIA) which is charged to tax on the unit holder under Chapter 10 of Part 4 of ITTOIA (*subsection (2)*); and
- treats the trustees as having deducted, at the basic rate for the tax year, a sum representing income tax (*subsection (3)*).

2872. If the unit holder is subject to corporation tax, the section treats the trustees as having deducted, at the basic rate for the year, a sum representing income tax from the deemed annual payment to the unit holder (see section 469(4A) to (4D) of ICTA, inserted by Schedule 1 to this Act) (*subsections (4) and (5)*).

Section 942: Income tax to be collected from trustees

2873. This section sets out the method of collection, and the amount of income tax to be collected. It is based on sections 348(1), 349(1), and 469(5A) and (5B) of ICTA.

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2874. *Subsection (2)* requires the tax to be collected through the self-assessment tax return of the trustees of the UUT. The source legislation refers (section 469(5A)(a) of ICTA) to a charge under section 350 of ICTA. But in practice the tax is collected through the trustees' self-assessment return, and the law is now brought into line with that practice, in keeping with the approach in relation to charges on income generally. See *Change 81* in Annex 1.

2875. So, where the source legislation provides for the amount to be charged under section 350 of ICTA, this and the following sections are drafted in terms of an amount of income tax to be collected.

2876. The default rule is that the amount to be collected under Self Assessment is the amount treated as deducted under section 941, which refers to the formula given in section 548(2) of ITTOIA.

2877. *Subsections (4) and (5)* deal with the adjustment for the "income pool". This applies when, in a tax year, the gross amounts of the payments treated as made exceed the trustees' modified net income (so that, under the source legislation, not all the tax treated as deducted could be retained by way of relief under section 348 of ICTA).

2878. In that case, the income pool as at the start of the tax year (for the computation of which see section 943) is deducted from the total of the amounts treated for the tax year as having been paid to unit holders, but not so as to reduce it below the amount of the trustees' modified net income. The resulting amount is then multiplied by the basic rate of income tax for the year, and that constitutes the amount of income tax payable by the trustees.

Section 943: Calculation of trustees' income pool

2879. This section prescribes the method of calculating the "income pool", which is to be applied in any tax year in which the grossed-up amounts treated as paid to unit holders by the trustees exceed their modified net income. It is based on section 469(5C) of ICTA.

2880. An income pool consists of a running total of the amount by which, taking one tax year with another, the trustees' modified net income has exceeded the grossed-up amounts treated as paid by them. In each tax year when this has occurred, the amount of any such excess is to be calculated. And if in any tax year the amounts treated as paid exceed the modified net income, any such excess must be deducted from the income pool.

2881. So the income pool as at the start of any tax year ("the current tax year") is calculated according to whether in the previous tax year the trustees' modified net income exceeded the amounts treated as paid (*Case 1*), was less than them (*Case 2*) or equalled them (*Case 3*).

2882. The amount so calculated is available to set against any excess of payments treated as made over modified net income in the current tax year.

2883. *Subsections (2) and (3)* deal with cases where the UUT trustees have been non-UK resident. For any year of non-residence there may be modified net income, but there is no adjustment to the income pool.

2884. *Subsection (3)* also provides that the income pool is nil as at the start of the tax year in which a UUT is established.

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Chapter 14: Tax avoidance: directions for duty to deduct to apply

Section 944: Directions for deduction from payments to non-UK residents

2885. This section enables HMRC to require certain payments to non-UK residents to be paid under deduction of basic rate income tax. It is based on section 777(9) of ICTA.

2886. In Pardoe v Entergy Power Development Corporation (2000), 72 TC 617 ChD¹³, the High Court held that a direction under section 777(9) of ICTA could be given if, and only if, at the time of the direction, HMRC were satisfied that there was a present entitlement to a relevant payment; a direction could not be given where there was only a prospect (however imminent) of future entitlement.

2887. But, following Pardoe, it is still open to HMRC to give a direction under section 777(9) of ICTA in a case in which a non-UK resident is entitled to payment of consideration by instalments. It is therefore rewritten in this Part.

2888. Section 777(9) of ICTA deems the payment in question to be an annual payment within section 349(1) of ICTA. This section spells out the implications of this.

2889. This section replaces the references to “the Board” with a reference to “an officer of Revenue and Customs” (namely, the officer dealing with the case). See *Change 5* in Annex 1.

2890. The HMRC Business Income Manual tells officers (BIM 60390):

No attempt to invoke [section 777(9) of ICTA] in a working case should be made without prior specific reference to Business Tax (Technical), who will consider such cases on an individual basis and decide whether to seek a direction from the Board.

2891. *Change 5* will have no effect on this practice.

2892. The collection mechanisms of section 350(1) of, and Schedule 16 to, ICTA apply to tax deducted at source under section 349(1) of that Act from payments subject to section 777(9) directions. Schedule 16 and section 350(1) are rewritten in Chapters 15 and 16 respectively of this Part, and *subsection (5)* gives signposts to those Chapters.

2893. In rewriting Schedule 16, Chapter 15 makes some minor changes to the law. Three of them are potentially relevant to the collection of tax deducted at source under section 777(9) directions:

- *Change 143* makes it clear that a return need be submitted only where a relevant payment was made in that particular return period. It also clarifies related points.
- *Change 144* brings into line the information required to be included on a return where a payment is made otherwise than in an accounting period with the information which is required where the payment is made in an accounting period.
- *Change 147* removes the charging provision in section 350(1) of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of

¹³ [2000] STC 286.

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income tax deducted at source. So a person will not be chargeable in cases falling within Chapters 3 to 7, 10, 12, 13 and 18 of this Part.

Chapter 15: Collection: deposit-takers, building societies and certain companies

Overview

2894. This Chapter provides for the collection of income tax deducted at source from the payments listed in section 946. It is based on sections 350, 477A and 480A of, and Schedules 16 and 23A to, ICTA, Schedule 11 to FA 1991 and regulation 10 of the Income Tax (Building Societies) (Dividend and Interest) Regulations 1990 (SI 1990/2231) (the building society regulations).

2895. See Schedule 1 to this Act for commentary explaining why paragraph 8 and part of paragraph 10(2) of Schedule 16 to ICTA are otiose and have accordingly not been rewritten.

Section 945: Overview of Chapter

2896. This section provides an overview of the Chapter and also defines “section 946 payments”. It is new.

Section 946: Payments within this section

2897. This section sets out which payments are subject to the collection mechanism described in this Chapter. It is based on sections 350, 477A(1) and 480A of, and Schedules 16 and 23A to, ICTA and regulation 10 of the building society regulations.

2898. As part of the alignment of the building society and deposit-taker regimes for deduction of tax at source, various regulations in the building society regulations are enacted. See *Change 126* in Annex 1 and the overview commentary on Chapter 2 of this Part.

2899. Under the provisions of this Act, tax deducted from certain annual payments and other patent royalty payments made by individuals will be collected through the individual’s self-assessment return (see Chapter 17 of this Part), rather than by direct assessment (see Chapter 16 of this Part, based on section 350(1) of ICTA). See in particular the commentary on section 900. As a result, where such payments are made by companies on behalf of individuals they will not be subject to collection under the provisions of this Chapter. See *Change 81* in Annex 1 and the overview commentary on Chapter 4 of Part 8 of this Act.

2900. Because the source legislation links into the collection requirements of section 350 of ICTA, this provision is affected by the removal of the charge to income tax in section 350(1) of ICTA. See *Change 147* in Annex 1 and the commentary on section 963.

Section 947: Return periods

2901. This section sets out the return periods which fall into an accounting period by reference to “quarter dates”. It is based on paragraph 2(2) of Schedule 16 to ICTA, paragraph 3(1) of Schedule 11 to FA 1991 and regulation 10(3) of the building society regulations. See *Change 126* in Annex 1 and the overview commentary on Chapter 2 of this Part.

2902. The quarter dates are the last days of March, June, September and December except where the payer is a building society, in which case they are the last days of February, May, August and November.

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2903. Under the source legislation, all section 946 payments made by building societies are accounted for by reference to the February, May, August or November quarter dates by virtue of paragraph 3(1) of Schedule 11 to FA 1991 (in respect of payments caught by section 350(4) of ICTA) and regulation 10 of the building society regulations (in respect of payments caught by section 477A of ICTA).

2904. In keeping with the alignment of the rules on deduction of tax at source for deposit-takers and building societies, *subsections (2) to (4)* embrace building societies. See *Change 142* in Annex 1 and the overview commentary on Chapter 2 of this Part.

Section 948: Meaning of “accounting period”

2905. This section defines “accounting period” for deposit-takers who are not companies. It is based on section 480A(4) of ICTA.

Section 949: Payments in an accounting period

2906. This section contains the main provisions regarding the delivery of returns for section 946 payments made in an accounting period. It is based on paragraphs 2 and 3 of Schedule 16 to ICTA.

2907. This section sets out when a return needs to be delivered and the information which must be included (the amount of any section 946 payment and the amount of income tax payable).

2908. This section clarifies that a return needs to be delivered for a return period only when a section 946 payment is made in the return period. See *Change 143* in Annex 1.

2909. As part of this change, other sections clarify when and how a set-off claim can be made (see sections 952 and 953), when an assessment may be made (see section 957(1)) and when the payer is under a duty to correct a return (see section 958(1)).

Section 950: Payments otherwise than in an accounting period

2910. This section contains the main provisions regarding section 946 payments made otherwise than in an accounting period. It is based on paragraphs 3 and 9 of Schedule 16 to ICTA.

2911. *Subsection (3)* specifies the information required to be included in such a return, bringing this requirement into line with the position for returns where a section 946 payment is made in an accounting period. See *Change 144* in Annex 1.

Section 951: Collection and payment of income tax

2912. This section sets out when income tax is due and that the amount is payable without the making of an assessment. It is based on paragraphs 4(1) and 9 of Schedule 16 to ICTA.

Section 952: Conditions for a set-off claim

2913. This section sets out the conditions for a claim to be made to set off income tax suffered by deduction at source against income tax payable under this Chapter. It is based on paragraph 5 of Schedule 16 to ICTA and paragraph 4 of Schedule 11 to FA 1991.

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2914. *Subsection (2)* clarifies that in order for a set-off claim to be made at the end of a return period, the payer must have either made a section 946 payment or received a payment on which it has suffered deduction of income tax during the return period. Under the source legislation it is unclear whether a set-off claim can only be made when a section 946 payment has been made in the return period concerned. See *Change 143* in Annex 1 and the commentary on section 949.

2915. Further, at the end of the return period, there must be both a net amount of income tax suffered and a net amount of income tax payable in order for a set-off claim to be made.

2916. There is a net amount of income tax suffered or payable if, on a cumulative basis running from the beginning of the accounting period to the end of the return period in question, there is an excess amount of one over the other. *Subsections (4) and (5)* explain how to calculate the net amounts.

Section 953: How a set-off claim works

2917. This section sets out the effects of a claim to set off income tax suffered against income tax payable. It is based on section 480A(3) and (4) of, and paragraphs 5 and 7 of Schedule 16 to, ICTA, and paragraph 4 of Schedule 11 to FA 1991.

2918. *Subsection (2)* confirms that, to the extent of the set-off, income tax which has been suffered is treated as repaid. This ensures that the amount of income tax suffered and used in the set-off claim cannot be used again in another claim. Further, to the extent of the set-off, income tax payable is treated as paid.

2919. *Subsection (3)* sets out further results of any set-off claim. Where a claim is allowed, the liability to pay income tax treated as paid is discharged. Where income tax has already been paid and the set-off is allowed, the amount will be repaid.

2920. *Subsections (4) and (5)* require the claim to be made on a return for the return period under section 949 whether or not a section 946 payment has been made in the return period in question. See *Change 143* in Annex 1 and the commentary on section 949.

2921. *Subsection (7)* confirms that a claim for set-off by a deposit-taker can be made only where the claimant is subject to corporation tax. So set-off claims cannot be made by deposit-takers who are not companies.

Section 954: Proceedings begun after a set-off claim is made

2922. This section makes provision about what happens when proceedings for collection of income tax are brought after a set-off claim is made. It is based on paragraph 6 of Schedule 16 to ICTA.

Section 955: Proceedings begun before a set-off claim is made

2923. This section makes provision about what happens when proceedings for collection of income tax or interest are brought before a set-off claim is made. It is based on paragraph 6 of Schedule 16 to ICTA.

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Section 956: Assessments where section 946 payment included in return

2924. This section allows assessments to be made where income tax has not been paid by the date by which the return must be delivered. It is based on paragraph 4(1) of Schedule 16 to ICTA.

2925. *Subsection (3)* confirms that an assessment may be made whether or not the tax due has been paid by the time the assessment is made.

Section 957: Assessments in other cases

2926. This section deals with assessments made because of incomplete or incorrect returns. It is based on paragraph 4(2) of Schedule 16 to ICTA.

2927. *Subsection (1)* makes it clear that an assessment may be made in relation to any returns made under the Chapter (including returns made only in order to make a set-off claim). See *Change 143* in Annex 1 and the commentary on section 949.

Section 958: Payer's duty to deliver amended return

2928. This section sets out the payer's duty to deliver an amended return when an error is discovered. It is based on paragraph 7A of Schedule 16 to ICTA.

2929. *Subsection (1)* clarifies the point that the payer is under a duty to correct all returns made under the Chapter for a return period, including those made only in order to make a set-off claim. See *Change 143* in Annex 1 and the commentary on section 949.

2930. *Subsection (1)(c)* goes further than paragraph 7A of Schedule 16 to ICTA, so that it applies to any return made under the Chapter, rather than just those relating to return periods. See *Change 145* in Annex 1.

Section 959: Application of Income Tax Acts provisions about time limits for assessments

2931. This section confirms that, for the purposes of the time limits set out in the Income Tax Acts applying to assessments, assessments made under this Chapter should be treated as made for the tax year in which the return period ends or, in the case of payments made outside an accounting period, the date on which the payment is made. It is based on paragraphs 10(1) and 11 of Schedule 16 to ICTA.

2932. Paragraph 10(1) of Schedule 16 to ICTA contained a specific reference to section 36 of TMA. But this section makes no such reference. This is because the reference has been unnecessary since the time limit in section 36 of TMA was amended, and section 37 of TMA repealed, by FA 1989.

Section 960: Further provisions about assessments

2933. This section sets out further provisions about assessments, in particular that income tax assessed is due on the date it was due under section 951. It is based on paragraph 10 of Schedule 16 to ICTA.

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Section 961: Relationship between Chapter and Income Tax Acts powers

2934. This section confirms that nothing in the Chapter affects any powers in the Income Tax Acts about the recovery of income tax. It is based on paragraph 11 of Schedule 16 to ICTA.

2935. This section applies both to the payer and the recipient. This point was confirmed in Grosvenor Place Estates Ltd v Roberts (1960), 39 TC 433 CA where it was held that the recipient could be assessed to tax where the payer failed to deduct tax, notwithstanding the express rights of Her Majesty's Revenue and Customs to assess the payer (Donovan LJ at page 453).

Section 962: Power to make regulations modifying Chapter

2936. This section allows the Commissioners for Her Majesty's Revenue and Customs to make regulations for the collection of income tax in respect of section 946 payments. It is based on sections 350 and 477A of ICTA.

2937. The section also confirms that this power applies to payments made by deposit-takers and building societies. See *Change 146* in Annex 1.

2938. *Subsection (4)* has been aligned to the wording of similar provisions. In particular it now includes a reference to incidental and consequential amendments.

Chapter 16: Collection: certain payments by other persons

Overview

2939. This Chapter provides the main collection procedure for income tax deducted at source by persons other than those catered for by Chapter 15.

Section 963: Collection of income tax on certain payments by other persons

2940. This section is based on section 350 of ICTA.

2941. The source legislation makes payers "assessable and chargeable". But charging a payment is a step that many other collection mechanisms for income tax deducted at source, such as PAYE, do not use. This charge to tax has been removed to bring this provision into line with parallel collection mechanisms. See *Change 147* in Annex 1.

2942. *Subsection (2)* requires the payer to give details of the payment to an officer of Revenue and Customs. There is no authorised return form on which the details are to be supplied. The subsection also requires the account of the payment to be delivered "without delay". This corresponds to "forthwith" in the source legislation.

2943. Section 350(2) of ICTA has not been rewritten. That subsection makes provision about the cases in which a payment is, or is not, made out of taxed income, in order to impose a duty on the Crown to deduct income tax in appropriate cases. It was introduced by section 39 of FA 1960 to deal with a lacuna which came to light in CIR v Whitworth Coal Co Ltd (1959), 38 TC 531 HL. Under the approach adopted in relation to the provisions about charges on income (see *Change 81* in Annex 1), it is no longer necessary.

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Chapter 17: Collection through self-assessment return

Overview

2944. This Chapter provides for collection of income tax, in certain cases, through the self-assessment return of the person making the payment concerned.

Section 964: Collection through self-assessment return

2945. This section is based on sections 348 and 350 of ICTA.

2946. The section arises as a direct result of *Change 81* in Annex 1. See the commentary on Chapter 6 of this Part.

2947. See also *Change 147* in Annex 1 and the commentary on section 963.

2948. The amount to be collected is equal to the sums required to be deducted under the provisions referred to in *subsections (1)(b)* and *(2)*.

2949. *Subsections (3) to (5)* make related provision to ensure that TMA provisions apply as necessary to support this.

2950. The liability does not arise in respect of a person's own income tax affairs, but in relation to sums representing income tax deducted from payments a person makes. That is why, as indicated in *subsection (4)*, it does not form part of the calculation of a person's own liability to income tax as such.

Chapter 18: Other regimes involving the deduction of income tax at source

Overview

2951. This Chapter deals with three further deduction of income tax at source regimes.

2952. The first provides for a duty to deduct and account for "sums representing income tax" from certain prescribed payments and transfers to non-UK resident entertainers, sportsmen and sportswomen. It is based on sections 555 and 558 of ICTA. The Income Tax (Entertainers and Sportsmen) Regulations 1987 in SI 1987/530 have been made under these sections.

2953. The second enables the Commissioners for Her Majesty's Revenue and Customs to make regulations providing for the collection, assessment and recovery of "prescribed amounts of income tax" in respect of Schedule A and UK property business income of persons whose usual place of abode is outside the United Kingdom. It is based on section 42A of ICTA. The Taxation of Income from Land (Non-residents) Regulations 1995 (SI 1995/2902) have been made under this section.

2954. The third enables the Treasury to make regulations providing for the assessment, collection and recovery of income tax from distributions made by a Real Estate Investment Trust in respect of a property rental business. It is based on sections 105, 122, 134 and 144 of, and paragraphs 3, 19 and 32 of Schedule 17 to, FA 2006. The Real Estate Investment Trusts (Assessment and Recovery of Tax) Regulations 2006 (SI 2006/2867) were made on 1 November 2006 and are effective for accounting periods beginning on or after 1 January 2007.

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Section 965: Overview of sections 966 to 970

2955. This section gives an overview of sections 966 to 970, which provide for the payment of sums representing income tax to the Commissioners for Her Majesty's Revenue and Customs where certain payments and transfers are made in connection with United Kingdom performances by non-UK resident entertainers, sportsmen and sportswomen (visiting performers).

2956. Following the House of Lords decision in *Agassi v Robinson* [2006 UKHL 23]¹⁴, Schedule 1 to this Act amends section 556 of ICTA and section 13 of ITTOIA to make explicit that these sections will have effect regardless of whether there is a duty to deduct income tax under section 555 of ICTA. See *Change 156* in Annex 1.

2957. Section 48(2)(b) of ITEPA has been amended by Schedule 1 to this Act to make it explicit that a transfer which is subject to deduction under the rules about visiting performers, is not also subject to the rules about the provision of services through intermediaries in Chapter 8 of Part 2 of ITEPA. See *Change 161* in Annex 1.

Section 966: Duty to deduct and account for sums representing income tax

2958. This section sets the general duty to deduct and account for sums representing income tax where a payment or transfer is made in connection with a "relevant activity" carried out by a prescribed visiting performer. It is based on section 555(1), (2), (3) and (6) of ICTA.

Section 967: Calculation of sums representing income tax

2959. This section sets out how to calculate the sums which are required to be deducted and or accounted for under section 966. It is based on sections 555(4) and 558(2) and (3) of ICTA.

2960. *Subsection (2)* provides that the sums cannot exceed a maximum proportion equivalent to basic rate income tax.

2961. *Subsections (3) and (4)* allow the Treasury to make regulations in order to calculate the value of a transfer to which section 966 applies. In particular, the regulations may provide for that amount to be treated as a net amount corresponding to a gross amount from which income tax at the basic rate has been deducted.

Section 968: Treatment of sums representing income tax

2962. This section sets out the income tax treatment of any sums paid to the Commissioners for Her Majesty's Revenue and Customs under section 966(3) or (4). It is based on section 555(8) to (11) of ICTA.

2963. *Subsections (2) and (3)* confirm that any payment made to the Commissioners is treated as made on account of the liability of another person to income tax or corporation tax and that the liability and the other person are to be found in accordance with prescribed rules.

¹⁴ [2006] STC 1056

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2964. The regulations (regulation 12(1) of SI 1987/530) provide that the other person is the recipient of the payment or transfer. But where the recipient is of a “prescribed description” (for example the recipient is connected with the performer, see regulation 7 of SI 1987/530) then, under section 13(5) of ITTOIA, the other person will be the performer.

2965. *Subsection (4)* confirms that if the sum paid to the Commissioners exceeds the liability of the other person, then the Commissioners will repay so much of the amount as is appropriate to the other person. Again, the regulations provide that the other person is the recipient of the payment or transfer or, if the recipient is connected with the performer, the other person is the performer.

2966. *Subsections (5) and (6)* confirm that if there is no liability to make a payment under section 966 then the Commissioners will repay the sum to the recipient of the payment or transfer.

Section 969: Regulations

2967. This section provides that the Treasury may make various regulations regarding the sums to be paid, in particular provision for information, collection, assessment and recovery. It is based on sections 555(7) and 558(5) of ICTA.

Section 970: Supplementary

2968. This section sets out various supplementary provisions and is based on sections 555(5) and 558(1), (4), and (6) of ICTA.

2969. *Subsections (2) and (3)* state that an officer of Revenue and Customs may disclose certain information to others, without being precluded from doing so by any obligation as to secrecy.

2970. Under the source legislation (section 558(4) of ICTA) it is “the Board” who must decide whether to make any disclosure. But in practice it is an officer of Revenue and Customs who takes the decision. The references in section 558(4) of ICTA to “the Board” (and to “authorised” officer) have therefore been omitted. See *Change 5* in Annex 1.

Section 971: Income tax due in respect of income of non-resident landlords

2971. This section enables regulations to be made about the collection of “prescribed amounts of income tax” in relation to “non-resident landlord income”. It is based on section 42A(1) to (3) of ICTA.

2972. *Subsection (1)* allows the Commissioners for Her Majesty’s Revenue and Customs to make regulations for the collection, assessment and recovery of “prescribed amounts of income tax” from “non-resident landlord representatives” in respect of “non-resident landlord income”. Regulation 8 of SI 1995/2902 provides that the amount is to be calculated at the basic rate of tax.

2973. *Subsection (2)* defines “non-resident landlord income” as income of a person whose usual place of abode is outside the United Kingdom, which is or may be chargeable to corporation tax under Schedule A or to income tax as profits of a UK property business under Chapter 3 of Part 3 of ITTOIA. This section applies regardless of whether any payment is actually made to the non-resident landlord.

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2974. As the tax deducted will, in all cases, be income tax, all these regulation-making powers have been rewritten together, in this Act.

2975. Currently the regulations in SI 1995/2902 do not provide for payments to be made to the Commissioners in respect of Schedule A income (see regulations 8(3) and 9(3)). If in the future regulations were to be made, requiring amounts to be paid to the Commissioners in respect of Schedule A income, the amount paid would be a “prescribed amount of income tax” and would be capable of being set off against the non-resident landlord’s corporation tax liability by virtue of section 11(3) of ICTA.

2976. The source legislation makes reference to the charging of prescribed amounts. This reference to charging is removed to bring the rewritten version of section 42A of ICTA into line with other collection mechanisms. See *Change 147* in Annex 1 and the commentary on section 963.

2977. For discussion of “usual place of abode”, see the commentary on section 874.

Section 972: Regulations under section 971

2978. This section makes further provisions about the regulations which can be made. It is based on section 42A(4) to (7) of ICTA.

2979. *Subsection (3)(b)* has been aligned to the wording of similar provisions. In particular it now includes a reference to savings.

Section 973: Income tax due in respect of distributions

2980. This section enables the Treasury to make regulations about the assessment, collection and recovery of income tax where a distribution is made by Real Estate Investment Trusts in respect of property rental business. It is based on sections 105, 122 and 134 of, and paragraphs 2, 3, 19 and 32(8) of Schedule 17 to, FA 2006.

Section 974: Regulations under section 973

2981. This section makes further provision about the regulations which can be made under section 973. It is based on sections 122 and 144 of, and paragraph 19 of Schedule 17 to, FA 2006.

2982. *Subsection (1)(a)* provides that regulations may be made requiring Real Estate Investment Trusts to deduct sums representing income tax at the basic rate.

2983. Paragraph 19(2) of Schedule 17 to FA 2006 has not been rewritten as it is unnecessary. Paragraph 19(2) modifies section 122(2) of FA 2006. Since this section is purely illustrative of the extent of the powers provided by section 973 (based on section 122(1) of FA 2006) it is not necessary to expand the provisions in this section.

2984. Previously, the power to make regulations in respect of a principal company was in Schedule 17 to FA 2006 (not in section 122). But as all the regulation making powers have been rewritten in one place (in section 973) it is not necessary to have a specific reference to a principal company of a group in this section. By not including a specific reference to the principal company (in this section), the power to make regulations in respect of such principal companies (under section 973) will not be limited.

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Chapter 19: General

Overview

2985. This Chapter brings together a number of supplementary provisions relating to deduction at source, and gives definitions of certain terms used in this Part.

Section 975: Statements about deduction of income tax

2986. This section imposes a duty on certain persons who are required to make payments under deduction of income tax to provide, on request, a statement of the gross amount of the payment, the sum deducted and the net amount paid. It is based on section 352 of, and paragraph 3(8) and (9) of Schedule 23A to, ICTA.

2987. The section brings the rules for statements about manufactured interest on UK securities into line with the rules for statements about actual interest on UK securities. See *Change 148* in Annex 1.

2988. The section also contains specific provisions of a similar nature relating to unauthorised unit trusts.

2989. *Subsection (5)* requires that the statement be in writing. Electronic statements are provided for by regulations 3 and 4 of the Income and Corporation Taxes (Electronic Certificates of Deduction of Tax and Tax Credit) Regulations 2003 (SI 2003/3143).

2990. Section 352 of ICTA is theoretically capable of applying to MODs within paragraph 4(2) of Schedule 23A to ICTA, as they are treated as annual payments within section 349 of ICTA. But specific rules for statements about MODs are given by regulation 15 of the Income Tax (Manufactured Overseas Dividends) Regulations 1993 (SI 1993/2004). So this section has not been extended to cover payments within section 922, which rewrites paragraph 4(2). See the commentary on that section.

Section 976: Arrangements for payments of interest less tax or at specified net rate

2991. This section clarifies how a provision for the payment of interest “less tax” is to be interpreted if there is no duty to deduct a sum representing income tax. It is based on section 818 of ICTA.

2992. In this section the word “provision” relates to arrangements for the payment of interest as well as to any other context. It applies very widely to primary and secondary legislation, contracts, wills, deeds and any other arrangements, whether in writing or not.

2993. If any such provision is for the payment of interest “less tax”, the words “less tax” are to be ignored.

2994. If the provision is for payment of interest chargeable as mentioned in *subsection (6)*, any provision that purports to require grossing up from a prescribed net rate of interest is to be interpreted as requiring payment at the “gross rate”.

Section 977: Payments to companies

2995. This section provides that, even if the payment is not chargeable to income tax in a company’s hands, this does not affect whether a payment to a company should be subject to deduction of a sum representing income tax. It is based on section 7(1) and (4) of ICTA.

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2996. *Subsection (2)* clarifies that receipt by another person on behalf of, or in trust for, the company is to be treated as receipt by the company. Conversely, if a company receives a payment on behalf of, or in trust for another person, that does not require that the payment be treated as received by that company. If company A receives a payment on behalf of company B, the payment is treated as received by company B.

Section 978: Application to public departments

2997. This section ensures that the rules in this Part regarding deduction at source and collection of income tax apply to payments made by United Kingdom government departments. It is based on section 829(1) and (3) of ICTA.

2998. Without this section, the principle of Crown exemption would apply so that annual payments by UK government departments would not be subject to the provisions of this Part.

2999. *Subsection (2)* ensures that the section is limited to United Kingdom government departments.

3000. Section 829(2) of ICTA has not been rewritten. That subsection was only necessary because section 829(1) was widely drafted and could have imposed liability on income received by a department. As this section is restricted to annual payments made by departments, section 829(2) of ICTA is unnecessary and is repealed.

3001. No deduction is required from annual payments by one government department to another. In the source legislation, section 829(2) of ICTA addressed this point. But specific provision is not necessary.

3002. Crown exemption does not apply if it is clear from the legislation in question that the provisions concerned do apply to the Crown. For example, it is clear from the legislation about PAYE that the Crown must operate PAYE. Accordingly, section 829(2A) of ICTA is unnecessary and is repealed.

Section 979: Designated international organisations: exceptions from duties to deduct

3003. This section provides that certain payments made by international organisations which are designated by the Treasury are not subject to deduction at source under this Part. It is based on section 582A ICTA.

3004. This section applies to:

- payments of yearly interest under section 874 by such a designated organisation or a partnership of which such an organisation is a member;
- annual payments, patent royalties and other payments connected with intellectual property under Chapters 6 or 7 of this Part (see *Change 81* in Annex 1);
- payments under Chapter 14 of this Part (tax avoidance); and
- payments of manufactured interest or overseas dividends under sections 919(2) and 922(2).

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Section 980: Derivative contracts: exception from duties to deduct

3005. This section provides that nothing in this Part imposes a duty on a company to deduct at source if it is making a payment under certain derivative contracts. It is based on paragraph 51 of Schedule 26 to FA 2002.

3006. The derivative contracts concerned are those to which the calculation rules in Schedule 26 to FA 2002 apply, which are those the company either enters into or acquires. See paragraph 53 of that Schedule.

Section 981: Foreign currency securities etc: exception from duties to deduct

3007. This section provides that nothing in this Part imposes a duty to deduct at source on interest payments within section 755(1) of ITTOIA. It is based on section 581A of ICTA.

Section 982: Income tax is calculated by reference to gross amounts

3008. This section provides that the amount on which tax is to be calculated is the gross amount in each case. It is new.

Section 983: Meaning of “deposit”

3009. This section defines the meaning of “deposit” for the purposes of this Chapter. It is based on section 481(3) of ICTA.

3010. Section 481(3) of ICTA applies to deposit-takers and is also rewritten in Chapter 2 of this Part (deduction by deposit-takers and building societies). By including the definition of “deposit” in this Chapter the application of the definition has been extended to building society deposits. This will ensure that the definitions of “qualifying certificate of deposit” (section 985) and “qualifying uncertificated eligible debt security unit” (section 986) are the same for deposit-takers and building societies.

Section 984: Meaning of “financial instrument”

3011. This section gives the definition of “financial instrument” which occurs in the context of this Part in relation to persons authorised under FISMA who deal in financial instruments as principal. It is based on section 349(5) and (6) of ICTA.

Section 985: Meaning of “qualifying certificate of deposit”

3012. This section defines “qualifying certificate of deposit”. It is based on sections 349(4) and 482(6) of ICTA.

3013. Interest (and, in the case of building societies, dividends) paid by a deposit-taker or building society in respect of a deposit in respect of which a “qualifying certificate of deposit” has been issued is payable gross (see sections 865 and 889).

3014. In order for a “certificate of deposit” (defined in section 1019) to be a “qualifying certificate of deposit”, the certificate must require the issuer to pay an amount of at least £50,000 (or equivalent if made in a foreign currency) at a specified time within five years of the deposit being made.

3015. The definition of “qualifying certificate of deposit” has been aligned to the wording of the definition of “qualifying time deposit” (see section 866) so that it is clear that a

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“qualifying certificate of deposit” can only be paid in one tranche “at a specified time”. See *Change 149* in Annex 1.

Section 986: Meaning of “qualifying uncertificated eligible debt security unit”

3016. This section defines “qualifying uncertificated eligible debt security unit”. It is based on sections 349(4) and 482(6) of ICTA and section 552(2) of ITTOIA.

3017. Interest (and, in the case of building societies, dividends) paid by a deposit-taker or building society in respect of qualifying uncertificated eligible debt security units is payable gross. See sections 864 and 889.

3018. For an uncertificated eligible debt security to be “qualifying” there has to be a right to receive an amount of at least £50,000 (or equivalent if made in a foreign currency) at a specified time within five years of the deposit being made.

3019. The definition of “qualifying uncertificated eligible debt security unit” has been aligned to the wording of the definition of “qualifying time deposit” (see section 866) so that it is clear that a “qualifying uncertificated eligible debt security unit” can only be paid in one tranche “at a specified time”. See *Change 149* in Annex 1.

3020. *Subsection (4)* defines various terms in the definition of “uncertificated eligible debt security units” by reference to the Uncertificated Securities Regulations 2001 (SI 2001/3755).

Section 987: Meaning of “quoted Eurobond”

3021. This section defines “quoted Eurobond”. It is based on the definition in section 349(4) of ICTA.

3022. Interest on a quoted Eurobond is not subject to deduction at source. See sections 882 and 889.

Part 16: Income Tax Acts definitions etc

Overview

3023. This Part sets out definitions and related material applying for the purposes of the Income Tax Acts generally. It is mainly based on provisions in Part 19 of ICTA.

3024. Many of these definitions apply in relation to corporation tax as well as income tax. Some of them also apply to capital gains tax, or in relation to capital allowances, either by cross-reference or by virtue of parallel provision.

3025. The definitions have been rewritten for income tax using the following principles:

- if definitions are relatively short or straightforward, they are duplicated in the legislation about each of the taxes to which they apply;
- if a definition is longer and more complicated, and is mainly concerned with one tax, it is set out in full in the legislation about that tax and defined by cross-reference for the purposes of any other taxes that are relevant;
- if a definition is longer and more complicated and is made substantial use of in relation to more than one tax, it is normally duplicated.

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3026. As a result, the rewrite of the definitions in these sections is closely bound up with the related consequential amendments in Schedule 1.

Chapter 1: Definitions

Overview

3027. This Chapter contains definitions which apply for the purposes of the Income Tax Acts, except where the context otherwise requires.

Section 988: Overview of Chapter

3028. This section provides an overview of the Chapter. It is new.

3029. Section 989 sets out the terms which are defined, and either contains or sign-posts the definitions concerned.

3030. Some definitions do not apply for the purposes of specified provisions. And some definitions only have effect for the purposes of specified provisions.

Section 989: The definitions

3031. This section sets out the definitions in alphabetical order. It is based on section 832 of ICTA and a variety of other provisions.

3032. Section 832 of ICTA, and other provisions, consequentially amended, continue to provide parallel definitions for corporation tax purposes.

3033. The definition of “capital allowance” no longer makes reference to allowances under enactments which under ICTA are treated as contained in CAA. This is because the only such enactment is section 532 of ICTA, and the only provision to which it remains potentially relevant (section 527 of ICTA) is rewritten in section 461 of this Act.

3034. The definition of “interest” (as including yearly interest and interest other than yearly interest) has been omitted, both from this section and from the amended section 832, as it adds nothing to the general meaning of “interest”. It was originally enacted in paragraph 20 of Schedule 13 to FA 1969.

3035. The definition of “personal representatives” is new. It follows the approach adopted in ITTOIA. See *Change 150* in Annex 1.

3036. The definition of “trade” has been streamlined in line with the drafts included as clause 3.1.4 of ED1 (July 1997) and clause 3.1.5 in Exposure Draft No 10 (May 2000). Adopting this approach in this Act, rather than in ITTOIA, has enabled it to be done for all income tax purposes at the same time.

3037. Parallel definitions of “tax year” and “year of assessment” are provided, in order to support those provisions of the Income Tax Acts, including those in TMA, that have not been rewritten.

3038. Section 832(5) of ICTA is not rewritten in this Act, or retained in ICTA in relation to corporation tax, as this provision has been overtaken by the Adoption and Children Act 2002 (if it was not redundant before). See *Change 151* in Annex 1.

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Section 990: Meaning of “Act”

3039. This section is based on section 832(1) of ICTA.

3040. The reference to Northern Ireland legislation has been updated. See *Change 152* in Annex 1.

3041. See also section 1018, about the meaning of references to Northern Ireland and Scottish legislation in provisions in this Act, and the commentary on that section.

Section 991: Meaning of “bank”

3042. This section is based on section 840A of ICTA.

3043. The definition operates only where it is specifically applied.

3044. In *subsection (2)*, Article 3 of the European Investment Bank (Designated International Organisation) Order SI 1996/1179 has been enacted. See *Change 135* in Annex 1 and the commentary on section 879.

3045. Section 840A of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 992: Meaning of “company”

3046. This section is based on section 832(1) and (2) of ICTA.

Section 993: Meaning of “connected” persons

3047. This section is based on section 839 of ICTA.

3048. The definition operates only where specifically applied.

3049. Section 839 of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

3050. Section 575 of CAA defines “connected” by cross-reference to section 839. CAA is important both in the income tax and corporation tax contexts. Rather than continuing to operate by cross-reference to section 839 or to this section, this Act amends section 575 of CAA so that it contains the text of the definition. See Schedule 1.

Section 994: Meaning of “connected” persons: supplementary

3051. This section is based on section 839 of ICTA.

Section 995: Meaning of “control”

3052. This section is based on section 840 of ICTA.

3053. The definition operates only where specifically applied. The drafting has largely followed the approach adopted in section 574 of CAA.

3054. Section 840 of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

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Section 996: Meaning of “farming” and related expressions

3055. This section defines “farming” and “market gardening” and clarifies the meaning of “forestry” and “woodlands”. It is based on sections 397(5) and 832(1) of ICTA, section 154(1) and (3) of FA 1995 and section 876 of ITTOIA.

3056. Section 876 of ITTOIA provides a definition for the purposes of that Act. This section follows the pattern of section 876 of ITTOIA but applies for the purposes of the Income Tax Acts. So section 876 of ITTOIA is no longer needed and this Act repeals it.

3057. *Subsection (3)* provides that the cultivation of short rotation coppice is to be regarded as husbandry. In strictness this means that the cultivation must involve the occupation of land to be regarded as farming. But as it is impossible to cultivate short rotation coppice without occupying land the cultivation will also be regarded as farming.

3058. As with section 876 of ITTOIA there is no territorial restriction in the definitions in this Act. This means that there is no need to apply the definition of farming to activities outside the United Kingdom in the rewrite of section 397 of ICTA as section 67. Also, the cultivation of short rotation coppice on land outside the United Kingdom will be regarded as husbandry and therefore as farming.

3059. Again following the pattern in ITTOIA if a territorial restriction is required it is applied to a particular section. So *subsection (7)* restricts the definitions to farming or market gardening in the United Kingdom in the rewrite of section 297(2) of ICTA as section 192(1) and paragraph 4(2) of Schedule 28B to ICTA as section 303(1).

Section 997: Meaning of “generally accepted accounting practice” and related expressions

3060. This section is based on the definition of “for accounting purposes” in section 832(1) of ICTA and on section 50 FA 2004.

3061. Those sections, consequentially amended, continue to provide the definitions for corporation tax purposes.

Section 998: Meaning of “grossing up”

3062. This section is new.

3063. The section follows the pattern of section 877 of ITTOIA which (along with similar existing provisions) is repealed now that there is a general definition for the purposes of the Income Tax Acts.

Section 999: Meaning of “local authority”

3064. This section is based on section 842A of ICTA.

Section 1000: Meaning of “local authority association”

3065. This section is based on sections 519(3) and 832(1) of ICTA.

Section 1001: Meaning of “offshore installation”

3066. This section is based on section 837C of ICTA.

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3067. Section 837C of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1002: Regulations about the meaning of “offshore installation”

3068. This section is based on section 837C(5) and (6) of ICTA.

Section 1003: Meaning of “oil and gas exploration and appraisal”

3069. This section is based on section 837B of ICTA.

3070. Section 837B of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1004: Meaning of “property investment LLP”

3071. This section is based on sections 832(1) and 842B of ICTA.

3072. Section 842B of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

3073. Section 842B, as amended, does not contain a definition of “investment LLP” because the term is not used in corporation tax legislation. This section does not contain such a definition either, because section 399 of this Act contains the only reference to it in income tax legislation.

Section 1005: Meaning of “recognised stock exchange”

3074. This section is based on section 841(1) and (2) of ICTA.

3075. The corporation tax definition in section 841 of ICTA, consequentially amended, operates by cross-reference to this definition. This guards against any risk of orders being made which might inadvertently result in the two definitions getting out of step.

Section 1006: Meaning of “research and development”

3076. This section is based on section 837A of ICTA.

3077. Section 837A of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes. And it ensures that any regulations made for income tax purposes are also taken account of for corporation tax purposes.

Section 1007: Meaning of “unit trust scheme”

3078. This section is based on sections 469(7) and (8) and 832(1) of ICTA.

3079. The corporation tax definition is located in section 832(1) of ICTA, as consequentially amended.

Chapter 2: Other Income Tax Acts provisions

Overview

3080. This Chapter contains provisions (other than definitions) which apply for the purposes of the Income Tax Acts.

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Section 1008: Scotland

3081. This section is based on sections 363(3) and 832(1) of ICTA and section 879 of ITTOIA.

Section 1009: Sources of income within the charge to income tax or corporation tax

3082. This section is based on section 832(1) of ICTA.

Section 1010: Application of Income Tax Acts to recognised investment exchanges

3083. This section is based on section 841(3) of ICTA.

3084. Section 841(3) of ICTA, consequentially amended, continues to provide the definition for corporation tax purposes.

Section 1011: References to married persons, or civil partners, living together

3085. This section is based on section 282 of ICTA.

3086. It explains that married couples and civil partners are treated as living together unless they are separated under a court order, under a deed of separation or in fact separated in circumstances where the separation is likely to be permanent.

3087. This rule applies in particular in relation to married couple's allowance (Chapter 3 of Part 3) and to jointly held property (Chapter 3 of Part 14).

Section 1012: Relationship between rules on highest part of total income

3088. This section brings together a number of provisions about the relationship between the rules about which particular income is to be treated as the highest part of a person's total income. It is based on sections 1A(6) and 833(3) of ICTA.

3089. These rules affect section 16 and a number of provisions inserted by this Act including section 404A of ITEPA and section 465A of ITTOIA.

3090. The section remedies an omission in section 833(3) of ICTA by providing a rule as to which of section 404A of ITEPA and section 465A of ITTOIA takes the very highest slice in a case where both are present. In practice, if both arise it will be to the taxpayer's advantage if the chargeable event gains are treated as the very top slice. Accordingly, section 404A of ITEPA defers to section 465A of ITTOIA. See *Change 153* in Annex 1.

3091. *Subsection (5)* makes it clear that the rules in this section override any other provision that purports to treat a given type of income as the top slice. The effect is that the income concerned will simply form the top slice of income within its category of savings, dividend or other income.

Section 1013: Territorial sea of the United Kingdom

3092. This section is based on section 830(1) of ICTA.

Section 1014: Orders and regulations

3093. This section is based on section 828 of ICTA.

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Section 1015: Territorial scope of charges under certain provisions to which section 1016 applies

3094. This section is based on section 827A of ICTA.

Section 1016: Table of provisions to which this section applies

3095. This section is based on section 836B of ICTA.

3096. The table in section 836B of ICTA includes two provisions (section 804(5B)(a) of ICTA and paragraph 11(3) of Schedule 20 to FA 1994) which are in substance about the recovery of double taxation credit relief that has been over-allowed, although both operate by converting the tax to be recovered to an amount charged to income tax at the basic rate.

3097. Amounts charged under those two provisions are not regarded as income for any other purpose and none of the other provisions which invoke the table (for example, to utilise losses under section 152 of this Act) could have any application in relation to these amounts. As it is misleading for them to be included in the table, they have been omitted.

3098. Amendments are made to both provisions by Schedule 1 so that they operate as charges to amounts of income tax.

Part 17: Definitions for purposes of Act and final provisions

Overview

3099. This Part sets out definitions which are specific to this Act and a number of other supplementary and general provisions.

Section 1017: Abbreviated references to Acts

3100. This section lists the abbreviated references to other Acts. It is new.

Section 1018: “Act” to include Scottish and Northern Ireland legislation in some cases

3101. This section defines “Act” for the purposes of certain provisions of this Act. It is based on section 832(1) of ICTA.

3102. The definition means that “Act” includes Scottish and Northern Ireland legislation in the provisions concerned. See *Change 152* in Annex 1.

3103. See also section 990 and the commentary on that section, in relation to the meaning of “Act”, and in particular the updating of references to Northern Ireland legislation, in other provisions of the Income Tax Acts.

Section 1019: Meaning of “certificate of deposit”

3104. This section defines “certificate of deposit” for the purposes of this Act. It is based on sections 56(5), 349(4) and 482(6) of ICTA and section 552(2) of ITTOIA.

Section 1020: Claims and elections

3105. This section provides a general rule concerning the making of claims and elections. It is based on section 42(11) of TMA and paragraphs 1 and 2 of Schedule 1A to TMA.

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3106. In the source legislation some provisions specify that a claim or election has to be in writing while others are silent. But the effect of paragraph 2(3) to (5) of Schedule 1A to TMA is that a claim or election has to be in writing (unless a specific provision says otherwise).

Section 1021: Application of definitions of “connected” persons and “control”

3107. This section applies these definitions for the purposes of the Act. It is based on a variety of provisions in the source legislation.

3108. The application of the definition of control in section 995 in relation to section 560(8) is new and arises as a consequence of including detailed provisions on approved charitable investments in Part 10. See *Change 100* in Annex 1 and the commentary on section 560.

Section 1022: Meaning of “debenture”

3109. This section defines “debenture” for the purposes of certain provisions of this Act. It is based on sections 312(1) and 481(5) of, and paragraph 13(1) of Schedule 28B to, ICTA.

Section 1023: Meaning of “double taxation arrangements”

3110. This section defines “double taxation arrangements”. It is new.

Section 1024: Meaning of “gilt-edged securities”

3111. This section defines “gilt-edged securities”. It is based on sections 50(7) and 722A(5) of, and paragraph 3A(2) of Schedule 23A to, ICTA.

Section 1025: Meaning of “modified net income”

3112. This section explains how the amount of a person’s “modified net income” is calculated for the purposes of certain provisions of this Act. It is based on sections 348(1) and (2) and 349(1) of ICTA.

3113. The provisions concerned are those providing for:

- certain adjustments in calculating gift aid relief under Chapter 2 of Part 8;
- the deduction allowed for annual payments and patent royalties under Chapter 4 of Part 8; and
- the similar deduction allowed to the trustees of an unauthorised unit trust for payments treated as made by them, under Chapter 9 of Part 9.

3114. The way in which tax deducted from payments within Chapter 4 of Part 8 is recovered sometimes depends on whether the payer has any modified net income in the year in which the payment is made. See *Change 82* in Annex 1.

3115. *Subsections (2) to (4)* provide the details of the calculation of the amount of a person’s modified net income. Starting with net income, the following items are to be excluded:

- any non-qualifying income included in the person’s charged income. See section 1026, which details the types of income that in the source legislation are to be regarded as being paid “out of” income not brought into charge to income tax;
- any relief due under Chapter 4 of Part 8 (annual payments and patent royalties); and

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- reliefs or adjustments that, under Schedule 1B to TMA, are stated to “relate to a later year”.

See *Change 154* in Annex 1.

3116. Similar calculations also must be made for the purposes of gift aid. See section 427 (meaning of “charged amount”). Gift aid is not given as a deduction from total income, so the deduction for annual payments and patent royalties takes priority. So for those purposes subsection (2)(c) is ignored (*subsection (3)*).

3117. Trustees of unauthorised unit trusts are treated under the source legislation as making annual payments equal to the grossed-up amount of their income. In this Act this is a separate relief under Chapter 9 of Part 9. So in this case that relief is substituted for the relief for annual payments and patent royalties (*subsection (4)*).

Section 1026: Meaning of “non-qualifying income” for the purposes of section 1025

3118. This section sets out the types of income that are “non-qualifying income” for the purposes of section 1025. It is based on sections 348(4) and 804(6) of ICTA. See *Change 82* in Annex 1.

Section 1027: Minor and consequential amendments

3119. This section gives effect to Schedule 1.

Section 1028: Power to make consequential provision

3120. This section confers power on the Treasury to make consequential amendments, additional to those contained in Schedule 1 to this Act. It is new.

3121. The scope of the power is in substance the same as that in section 882 of ITTOIA.

3122. As with that power, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project’s Consultative and Steering Committees.

3123. *Subsection (2)* provides that the power may not be used after 5 April 2010. There was no provision of this kind in section 882 of ITTOIA, but it is sensible to enable additional consequential amendments to be made in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 5 April 2010 takes account of this while giving a reasonable amount of time for missed consequential amendments to come to light.

3124. *Subsection (4)* provides that the power may contain provision having retrospective effect, making explicit something which was implicit in relation to the power in section 882 of ITTOIA. As the power can be used only to make provision in consequence of this Act, any retrospective effect is limited to provision having effect from the date the Act comes into force.

Section 1029: Power to undo changes

3125. This section confers power on the Treasury to undo changes in the law made by the Act, for the purpose of restoring the effect of the law to what it was immediately before 6 April 2007 (the date on which this Act will come into effect). It is new.

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3126. The power will make it possible for any errors made in rewriting the source legislation to be corrected without recourse to a Finance Bill.

3127. The power provided by this section will, in particular, enable errors in making consequential amendments to be corrected.

3128. For example, had ITEPA contained such a power, it would have been possible to use it to reverse its mistaken repeal of section 108 of FA 1995. In the absence of such a power, it was necessary for the error made by ITEPA to be corrected in a Finance Act (see paragraph 6 of Schedule 17 to FA 2004).

3129. Depending on the nature of the error, corrections made to restore the effect of the pre-6 April 2007 law could be taxpayer-favourable or taxpayer-adverse.

3130. *Subsection (2)* provides that the power may not be used after 5 April 2010. It is sensible to enable errors to be corrected in this way only over a limited period, and it would in any case become progressively more difficult to do so accurately as subsequent Finance Bills are enacted. The date of 5 April 2010 takes account of this while giving a reasonable amount of time for errors to come to light.

3131. *Subsection (4)* provides that the power may contain provision having retrospective effect. Whether that was appropriate would need to be considered on a case-by-case basis.

3132. As with the power in section 1028, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project's Consultative and Steering Committees.

Section 1030: Transitional provisions and savings

3133. This section gives effect to Schedule 2 and confers power on the Treasury to make transitional or saving provisions additional to those contained in that Schedule.

3134. *Subsection (2)* is in substance the same as section 883(5) of ITTOIA.

3135. *Subsection (3)* provides that the power may contain provision having retrospective effect. As there is likely to be only a short period between the date on which the Act receives Royal Assent and the date on which it comes into force, it is possible that the need for additional transitional provision will not have come to light before the Act comes into force. *Subsection (3)* therefore ensures that the power can be exercised after the Act comes into force.

3136. As with the power in section 883(5) of ITTOIA, it is intended that this power will not be exercised without the agreement of the Tax Law Rewrite project's Consultative and Steering Committees.

Section 1031: Repeals and revocations

3137. This section gives effect to Schedule 3.

Section 1032: Index of defined expressions

3138. This section gives effect to, and introduces, Schedule 4.

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Section 1033: Extent

3139. This section ensures that the Act applies to the whole of the United Kingdom.

Section 1034: Commencement

3140. This section provides for the commencement of the Act.

3141. *Subsection (1)* deals with the position both for income tax and corporation tax. This Act is in substance an income tax only Act. But it makes many consequential amendments to corporation tax legislation. Those consequential amendments also require a commencement provision.

3142. *Subsection (3)* deals with the enterprise investment scheme (EIS). EIS has some distinctive features which could result in very complicated transitional and savings provisions. In contrast to venture capital trusts (VCTs) where there are two sorts of investments, those made in the VCT and those made by the VCT, in EIS there is no intermediate investor. This makes it possible for EIS to have the different commencement basis, expressed in terms of “shares issued”, provided in this subsection.

3143. These features are:

- many of the conditions on which eligibility for relief hinge need to be met for the whole of the period prescribed for that particular requirement;
- the commencement date for that period is dependent on the date when shares are issued; and
- EIS relief is given in the tax year in which the shares are issued and, if the relief is reduced or withdrawn, it is that year which is affected.

3144. It may not be clear in relation to all the sections in Part 5, that the commencement provision in section 1034(1) applies only to new share issues. So section 1034(3) provides that Part 5 does not have effect in relation to shares issued before 6 April 2007.

3145. This means, for instance, that it will be necessary to refer to the provisions of ICTA to determine whether and to what extent relief is to be withdrawn or reduced on a disposal on or after 6 April 2007 of shares acquired before that date.

3146. Section 1034(3) also extends to consequential amendments and repeals. For this reason both Schedules 1 and 3 have a separate Part which has effect in relation to EIS shares issued on or after 6 April 2007.

3147. Section 1034(3) is subject to the general provisions in Part 1 of Schedule 2 (Transitionals and savings). Also there is a specific transitional provision in Part 7 of Schedule 2 which preserves the effect of the FA 2006 amendment of section 293(6A) of ICTA.

Section 1035: Short title

3148. This section specifies the short title of the Act.