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

# INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

### Part 4: Savings and investment income

### *Chapter 5: Stock dividends from UK resident companies*

### Overview

1649. This Chapter deals with the charge to income tax on stock dividend income.

1650. "Stock dividend" is a term often given to particular form of dividend made by a UK resident company which is subject to a particular charge to income tax.

1651. A bonus issue of non-redeemable shares by a company is not a distribution (see, for example, CIR v Blott (1921), 8 TC 101 HL, CIR v Fisher's Executors (1926), 10 TC 302 HL, and CIR v Wright (1926), 11 TC 181 CA). Without any special provision it would not have any income tax consequences for the shareholder.

1652. A bonus issue of redeemable shares, however, is a distribution (see section 209(2)(c) of ICTA). Without any special provision it would be charged to tax under the source legislation under Schedule F. However, there is a special provision – the charge to tax on stock dividends under section 249 of ICTA. And, under section 230 of ICTA, anything that is a stock dividend:

- is not a distribution for Schedule F purposes;
- is not treated as a distribution for the purposes of section 210 of ICTA (repayment of share capital followed by bonus issue); and
- does not count as a bonus issue for the purposes of section 211 of ICTA (bonus issue followed by repayment).

1653. In this Chapter, the term "stock dividend income" is defined by reference to the issue of the share capital by a UK resident company in two circumstances. These circumstances are set out in section 249(1) and (2) of ICTA. These subsections are not rewritten in this Act because of their relevance to corporation tax.

1654. The first circumstance is where share capital is issued as a result of the shareholder exercising an option to choose whether to receive an ordinary cash dividend or additional share capital (section 249(1)(a) of ICTA).

1655. The second circumstance is where the company issues "bonus share capital" in respect of shares which, under their terms (whether original or otherwise), carry the right to bonus share capital (section 249(1)(b) and (2) of ICTA). (This is distinct from a bonus issue which arises from a specific resolution and not from the terms of the shares themselves.)

1656. Section 249(7) of ICTA is spent and is therefore repealed by this Act. Subsections (8) and (9) of section 249 of ICTA are open-ended and so have been retained in ICTA (but are amended by paragraph 119(4) and (5) of Schedule 1 to this Act).

### *Section 409: Charge to tax on stock dividend income*

1657. This section charges stock dividend income to tax. It is based on section 249 of ICTA.

### *Section 410: When stock dividend income arises*

1658. This section explains when and to whom stock dividend income is treated as arising. It is based on section 249(4) to (6) of ICTA.

1659. If stock dividends are issued to personal representatives during the administration period, stock dividend income is treated as arising (see *subsection (4)*) but that income is not taxed under Chapter 5 of this Part. Instead, that income forms part of the aggregate income of the estate for the purposes of Chapter 6 of Part 5 of this Act or section 701(8) of ICTA. "Personal representatives" is defined in section 878 of this Act.

### *Section 411: Income charged*

1660. This section sets out the amount charged to tax and is based on section 249(4) and (6) of ICTA.

1661. *Subsection (2)* defines the amount charged to tax. It is the cash equivalent of the stock dividends issued (see section 412) grossed up at the dividend ordinary rate (the Schedule F ordinary rate in the source legislation). For the meaning of "grossing up" see section 877 and the commentary on that section.

### *Section 412: Cash equivalent of share capital*

1662. This section explains how to calculate the cash equivalent of the stock dividend (in other words the net amount of the stock dividend income to be grossed up). It is based on section 251 of ICTA. This section also rewrites part of Statement of Practice A8.

1663. The source legislation is complex, particularly where the stock dividend is bonus share capital. Section 412 simplifies the rules for both types of stock dividend (ie, stock dividends in lieu of cash dividends and bonus share capital). See *Change 85* in Annex 1.

1664. *Subsection (1)* deals with stock dividends within section 249(1)(a) of ICTA – an issue of share capital in lieu of a cash dividend. The cash equivalent of such share capital is the amount of the cash dividend alternative unless subsection (2) applies.

1665. *Subsection (2*) applies if the difference between the cash dividend alternative and the share capital's market value equals or exceeds 15% of that market value. In that case, the cash equivalent is not the amount of the cash dividend alternative but rather the market value of the share capital.

1666. *Subsection (3)* deals with stock dividends within section 249(1)(b) of ICTA - bonus share capital. The cash equivalent of such share capital is its market value.

1667. Section 251(2)(a)(ii) and (4) of ICTA have been omitted, making the rule relating to bonus share capital more straightforward. See *Change 85* in Annex 1.

1668. *Subsection (4)* specifies the date on which the "market value" is to be taken for the purposes of these provisions. It is based on section 251(2) and (3) of ICTA.

1669. *Subsection (5)* gives definitions for "listed" and "market value". Section 251(3) of ICTA includes more complicated references to the relevant provisions in TCGA. Subsection (5) instead simply imports the definition of "market value" in sections 272 to 273 of TCGA save for subsection (2) of section 272 of TCGA.

### *Section 413: Person liable*

1670. This section states who is liable for any tax charged and is based on section 249(4) to (6) of ICTA.

1671. *Subsection (2)* deals with individuals who are beneficially entitled to the stock dividend income. Such individuals could include outright owners, a beneficiary of a bare trust or one with an interest in possession, or the beneficial owner under a nominee arrangement.

1672. *Subsection (3)* indicates that the trustees of an accumulation and discretionary trust are the persons liable if:

- stock dividends are issued to them; and
- had the trustees been paid a cash dividend in respect of the shares, any of that cash dividend would be income to which section 686 of ICTA applies (accumulation and discretionary trusts: special rates of tax).

1673. *Subsection (4)* deals with stock dividend income arising to personal representatives during the administration of a deceased person's estate. As personal representatives are not charged to tax under Chapter 5 of this Part they are not "persons liable". This means that they are not treated as having paid income tax under section 414 but see further the commentary on section 680.

1674. *Subsections (5)* and *(6)* deal with joint ownership of share capital and are based on section 249(3) of ICTA.

### *Section 414: Income tax treated as paid*

1675. This section explains how a person's income tax liability is satisfied (in whole or in part). It is based on section 249(4) and (6) of ICTA.

1676. Under *subsection (1)*, the taxpayer is treated as having paid income tax at the dividend ordinary rate (Schedule F ordinary rate in the source legislation) on the amount charged to tax. The words "and where trustees are so liable … the income is treated as if it were chargeable to tax at that rate" are based on section 249(6)(b) of ICTA and have been retained because they were considered significant in Howell and another v Trippier 2004[1] EWCA Civ 885.

1677. *Subsection (2)* provides that the tax treated as paid is not repayable. This applies even if the person liable is a non-taxpayer.

1678. *Subsections (3)* to *(5)* ensure that individual taxpayers cannot be given credit for income tax on more than the amount charged to income tax. So, for example, if the individual's total income is reduced by deductions (for example, personal allowances) such that the stock dividend income is only partially brought into charge to tax, credit will only be given for so much of the stock dividend income as is so taxed.

1679. Section 249(4)(c) of ICTA deals with tax rates and treats the stock dividend income as not brought into charge to tax for the purposes of sections 348 and 349 of ICTA. Section 249(4)(c) of ICTA is not rewritten in this Chapter. But rather than leaving it "stranded" in section 249 of ICTA, it is rewritten in amendments to sections 1A and 348 and 349 of ICTA (see paragraphs 3 and 147(3) of Schedule 1 to this Act respectively).

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**1** STC [2004] 1245