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

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 5: Miscellaneous income

Chapter 6: Beneficiaries' income from estates in administration

Overview

2482. This Chapter charges to income tax income paid or payable by personal representatives to residuary beneficiaries from estates in administration. The Chapter rewrites sections 695 to 698 and 699 to 702 of ICTA. Section 698A of ICTA (which deals with rates of tax) and section 700(4), (5) and (6) of ICTA (which deal with administrative matters) have not been rewritten in this Chapter. These provisions will be rewritten together with other provisions dealing, respectively, with rates of tax and administrative matters.

2483. Personal representatives are taxable only at the basic rate, lower rate or the dividend ordinary rate (Schedule F ordinary rate in the source legislation) on any income they receive during the administration period. When the income which arises to the personal representatives is paid to the residuary beneficiaries, it is treated as having borne tax at those rates. So this Chapter ensures that beneficiaries liable at the higher rate are chargeable at the higher rate or, as appropriate, the dividend upper rate (Schedule F upper rate in the source legislation), as well as allowing beneficiaries liable at the lower rate, or not liable to income tax, to reclaim some or all of the tax paid by the personal representatives.

Section 649: Charge to tax on estate income

2484. This section charges estate income to tax. It is based on sections 695, 696, 698 and 701 of ICTA.

2485. The approach of Part 16 of ICTA is to deem sums to have been paid as income for all tax purposes. In the case of UK estates, the income is not charged under a particular Schedule or Case and it is implicit that tax is charged on those sums. For foreign estates, a charge is imposed under Schedule D Case IV. This section applies to both UK and foreign estates. And it has now been made explicit that the charge to tax applies to all estate income which is treated as arising under the Chapter from a deceased person's estate.

2486. *Subsection (2)* provides a definition of "estate" and "estate income". It provides that the charge under this section applies to all estate income. This includes income from both UK and foreign estates.

2487. *Subsection (3)* ensures that estate income is treated as income for income tax purposes. Without the rules in this Chapter (and Part 16 of ICTA for corporate beneficiaries within the charge to corporation tax), payments by personal representatives to residuary beneficiaries would, in law, be payments of capital.

2488. *Subsection (4)* recognises that an estate may be divided into different parts with different residuary dispositions. Where, for instance, a proportion of an estate is subject to different dispositions from the remainder and each set of dispositions involves there being a residue, each part of the estate should be treated for the purposes of this Chapter as if they were separate estates. While this subsection applies where the testator has property abroad which he or she disposes of by a separate will, it can also apply to dispositions in the same will. For example, a testator could leave a limited interest in half his or her residuary estate to one child and half to the other with the capital comprising each half share to their respective issue. This would be treated, for the purposes of this Chapter, as two separate estates.

Section 650: Absolute, limited and discretionary interests

2489. This section defines the three types of interest in the whole or part of the residue of an estate. It is based on sections 698 and 701of ICTA.

2490. *Subsection (1)* defines an absolute interest in the whole or part of the residue of an estate. Subsection (1)(a) refers to the capital being properly payable to the person with the interest if the residue had been ascertained. This simply reflects the fact that the amount of any residue, and the income from it, can only be an estimate until the residue has been ascertained.

2491. *Subsection (2)* defines a limited interest in the whole or part of the residue of an estate. Subsection (2)(b) mirrors subsection (1)(a) of this section.

2492. *Subsection (3)* defines what is referred to as a "discretionary interest" in the whole or part of the residue of an estate for the purposes of this Chapter. The income has to be properly payable to the person with the discretionary interest "if the residue had been ascertained at the beginning of the administration period". Effectively, this imposes a working assumption that there will be sufficient income from the residue to make the discretionary payments when the residue has been ascertained.

2493. *Subsection (4)* covers the following four situations:

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

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

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

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

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

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

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

Section 652: Estate income: absolute interests in residue

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

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

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

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

2502. *Subsection (1)* defines "the administration period" for the purposes of this Chapter. The reference to "the period commencing on the death" in section 695(1) of ICTA suggests that the actual time of death could be important in determining whether income arose before or after death. In general, this will not be the case because income such as earnings, rent, interest and dividends does not arise at a particular time of the day. If such income arises on the date of death, it will be deemed to be income passing to the deceased immediately on the commencement of that day.

2503. But the administration period has not been defined in this Act as beginning the day after the date of death. This is because the possibility cannot be excluded that income will arise after the death, but on the same date, as a result of the efforts of the personal representatives and this should properly be regarded as income of the estate.

2504. *Subsection (2)* defines when the administration of the estate is completed for Scotland. A full definition for Scotland is required because the completion of the administration of an estate would otherwise have no meaning under Scottish law (although the definition has been updated by replacing the archaic expression "for behoof of"). In contrast, there are cases under English law which have established that the administration is complete when the residue of the estate is ascertained and is ready for distribution. Case law explains what this means in particular circumstances (see, for example, R v

Special Commissioners ex parte Dr Barnardo's Homes (1921), 7 TC 646 HL, Daw v CIR (1928), 14 TC 58 HC and CIR v Sir Aubrey Smith (1930), 15 TC 661 CA).

2505. *Subsection (3)* defines "the final tax year" to avoid repeating the full meaning throughout the Chapter.

Section 654: Estate income: limited interests in residue

2506. This section deals with estate income relating to limited interests. It is based on section 695 of ICTA.

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

Section 655: Estate income: discretionary interests in residue

2508. This section deals with estate income relating to discretionary interests in residue. It is based on section 698 of ICTA.

2509. The section sets out the basis on which estate income is treated as arising in a tax year for discretionary interests in residue. Estate income is treated as arising if a payment is made in the tax year in exercise of the discretion in favour of the person with the discretionary interest.

Section 656: Income charged: UK estates

2510. This section sets out the amount charged to tax under section 649 for income from UK estates. It is based on sections 695, 696 and 698 of ICTA.

2511. As there are fundamental differences between the basis of charge for income from UK and foreign estates, the rules for foreign estates have been dealt with in a separate section (section 657).

2512. *Subsection (2)* provides that income from a UK estate is charged on the gross amount of the estate income arising in the tax year. This is the basic amount of the income grossed up at the applicable rate. "Basic amount" is a new term. This avoids confusion with the term "net amount" since it is the "net amount" which is actually charged to tax in the case of a foreign estate (except where section 680 (income treated as bearing income tax) applies).

Section 657: Income charged: foreign estates

2513. This section sets out the amount charged to tax under section 649 for income from foreign estates. It is based on sections 65, 68, 695, 696, 698 and 699A of ICTA.

2514. *Subsection (5)* provides that, so far as the income is not within section 680, the charge is on the basic amount of that income. Where the income is within section 680, the charge is on the gross amount of the income calculated in accordance with section 663.

Section 658: Special rules for foreign income

2515. This section is based on sections 695, 696 and 698 of ICTA. It indicates that estate income arising outside the United Kingdom may be subject to the special rules for foreign income in Part 8 of this Act.

2516. *Subsection (2)* provides that the special rules in Part 8 of this Act for "relevant foreign income" only apply to foreign estates. This preserves the effect of the source legislation under which those special rules only apply to income charged under Schedule D Cases IV or V. And under the source legislation, only income from foreign estates is charged under Schedule D Case IV.

Section 659: Person liable

2517. This section states who is liable for any tax charged under section 649. It is based on sections 695, 696 and 698 of ICTA.

2518. The person who is liable will very much depend on the nature of the interest held by the beneficiary. The various interests are set out in the section together with the person liable for each of those interests.

Section 660: Basic amount of estate income: absolute interests

2519. This section explains how to calculate the basic amount of estate income for absolute interests. It is based on section 696 of ICTA.

2520. For years before the final tax year, the basic amount is the total of all sums paid in the tax year in respect of the interest or the person's assumed income entitlement, whichever is the lower. Surplus payments are excluded because an absolute income beneficiary may receive sums which comprise both capital and income but the section taxes only the income element. For the final tax year, it is the person's assumed income entitlement for that year which is taxed.

2521. This section removes all the deeming of amounts to have been paid in Part 16 of ICTA. Instead, it looks at either amounts actually paid or the assumed income entitlement. It then catches all previously untaxed income due to the absolute interest holder by taxing the assumed income entitlement in the final year. This avoids the two stage process inherent in section 696(5) of ICTA.

2522. *Subsection (3)* introduces a new rule allowing excess estate deductions in the final tax year to be set off against the basic amount of estate income for that year. See *Change 106* in Annex 1.

Section 661: Basic amount of estate income: limited interests

2523. This section explains how to calculate the basic amount of estate income for limited interests. It is based on section 695 of ICTA.

2524. Essentially, the basic amount of estate income is all the sums referred to in section 654 falling within a particular tax year added together. It is impossible for there to be sums within both section 654(3)(c) and (4)(c) in the same tax year.

Section 662: Basic amount of estate income: discretionary interests

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

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

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

Section 664: The aggregate income of the estate

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

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

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

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

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

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

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

Section 665: Assumed income entitlement

2534. This section explains the new concept of the "assumed income entitlement". It is based on section 696 of ICTA.

2535. The concept of "assumed income entitlement" has been introduced as a tool for calculating the basic amount of estate income for absolute interests. It is similar to the "aggregated income entitlement" in section 696 of ICTA but applies in a more straightforward way.

2536. *Subsection (1)* sets out the steps to be considered to determine whether a person has an assumed income entitlement for a tax year. The assumed income entitlement is the amount by which the absolute holder's share of residuary income (after, in the case of UK estates, deduction of tax at the applicable rate) for tax years up to and including the tax year in question exceeds the total of the basic amounts for which he is chargeable for all previous tax years. Thus, for example, if the beneficiary receives his share of the residuary income in each tax year up to the year in question, then the assumed income entitlement is the basic amount of his share of the residuary income for that year.

2537. Step 4 in subsection (1) deals also with situations where a corporate beneficiary liable to income tax was, at some earlier point during the administration period, chargeable to corporation tax. It also deals with other situations where a non-UK resident beneficiary becomes UK resident, when the estate is a foreign estate.

Section 666: The residuary income of the estate

2538. This section explains how the residuary income of the estate is calculated. Beneficiaries with absolute interests need to know the residuary income of the estate for a tax year in order to work out their assumed income entitlement. The section is based on section 697 of ICTA.

2539. *Subsection (2)* lists the "allowable estate deductions". This is a new label for the items which may be deducted from the aggregate income of the estate. Subsection (2)(a) refers to "all interest paid in that year by the personal representatives …". Section 697(1)(a) of ICTA refers to "the amount of any annual interest, annuity or other annual payment for that year which is a charge on residue …". The requirements that interest must be annual and also a charge on residue have not been reproduced. See *Change 108* in Annex 1.

2540. In practice, the Inland Revenue allow income from specific dispositions to be deducted from the aggregate income of the estate in calculating the residuary income of the estate in the year of assent and later years. But it is considered simpler for it merely to be excluded from what counts as the aggregate income and not be deducted from it. See *Change 107* in Annex 1.

2541. Subsection (2)(b) deals with annual payments. Because of the restricted meaning given to annual payments, much of the wide definition in section 701(6) and section 702(d) of ICTA is otiose. Any liabilities which are annual payments will now have to meet only the requirement that they are properly payable out of residue and this is also a requirement of section 701(6) of ICTA. Omitting the remainder of the definition removes unnecessary material. As a consequence of the change, section 701(7) of ICTA, which limits the meaning of "charges on residue" in relation to specific dispositions, does not need to be rewritten either.

2542. The section does not contain an ordering rule for allocating allowable estate deductions against different categories of income. It is not considered appropriate to state explicitly that the taxpayer may choose whichever allocation is most advantageous. This is implicit in the section.

Section 667: Shares of residuary income of estate

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

Section 668: Reduction in share of residuary income of estate

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

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

2546. *Subsection (2)* and *(3)* provide that if there is an excess within *subsection (1)*, that excess is available to reduce the person's share of the residuary income in the final tax year.

If that share is reduced to nil then any remaining excess is available to reduce the share of the residuary income in the previous tax year and so on.

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

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

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

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

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

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

2552. *Subsections (7)* and *(8)* are administrative provisions. They provide that the amount of inheritance tax chargeable and the value of the estate cannot be reopened once agreed or settled in proceedings. The reference to "the Board" in section 699 of ICTA has been replaced in this section by "the Inland Revenue" which is defined in section 878(1) of this Act. See *Change 149* in Annex 1.

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

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

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

Section 671: Successive absolute interests

2555. This section explains the position where two or more absolute interests in the residue of an estate are held successively by different people. It is based on sections 697 and 698 of ICTA.

2556. In each tax year in which a payment is made in respect of an absolute interest, it is necessary to calculate the beneficiary's assumed income entitlement. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous tax years are taken into account. In order to give a true picture of the assumed income entitlement of someone who has an absolute interest in succession to another person, the position of the previous holder needs to be brought into the calculations. Otherwise, in certain circumstances, an element of the residuary income might escape taxation.

2557. *Subsections (1)* and *(2)* apply where successively there are different persons with absolute interests in the residue of an estate of a deceased person or in parts of such a residue. They apply primarily for situations where one absolute interest is succeeded by another. This might occur where, for example, an absolute interest holder dies or there is a deed varying the will so that the interest passes for income tax purposes to another beneficiary from the date of the deed etc.

2558. *Subsection (3)* contains an ordering rule to ensure that all determinations under subsection (2) or section 672(2) are made in relation to the person with the earlier interest before the person with the later interest. This subsection has been inserted to make explicit what is already implicit in the source legislation.

2559. *Subsection (4)* provides a special rule where there are two or more absolute interests in the final tax year. It is intended to ensure that it is the last absolute interest which is charged to tax on the assumed income entitlement, which will comprise all the residuary income, in the final year. This is because the last absolute interest holder will receive the capital of the residue (and also all outstanding income in respect of it).

2560. *Subsections (5)* and *(6)* contain special rules where section 668 (reduction in share of residuary income of estate) applies and there are successive absolute interests. These subsections provide that the calculation under section 668(1)(a) and (b) is to be made by reference to all the absolute interests taken together. Then, after applying the reduction to the last absolute interest under section 668(1) and (2), any remaining excess is applied to the previous absolute interest holders working backwards from the beginning of the last interest. See *Change 109* in Annex 1.

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

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

2562. The section only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death (the position of limited interests which cease on the death of the holder before the final tax year are dealt with in section 654(4)). All sums paid or remaining payable in respect of that interest after the tax year of death are treated as estate income arising in the tax year of death.

2563. Examples of situations, in relation to limited interests, that are covered by the section include:

- the disclaiming of a life interest which accelerates an existing interest under the will; and
- an interest which is only held until marriage or attaining a certain age.

2564. *Subsections (3)* and *(4)* contain the two rules introduced by *subsection (2)*. They deal with the limited interest which ceases otherwise than on death. They also explain how such an interest is brought into the calculation of whether the person with the absolute interest has an assumed income entitlement and, if so, its amount. The assumed income entitlement works on a cumulative basis, so the share of the residuary income of the absolute interest holder and the basic amounts of previous years are taken into account.

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

2565. This section covers the position where the absolute interest holder is entitled to receive payments in respect of a preceding limited interest which has ceased otherwise than on death. It is based on section 698(1A) and (1B) of ICTA.

2566. *Subsection (2)* deals with such payments while the absolute interest holder still has the absolute interest. It provides that a payment made to the absolute interest holder in respect of the limited interest is treated as paid in respect of the absolute interest (and not the limited interest). Thus, such payments may form part of the basic amount of estate income in tax years before the final tax year.

2567. *Subsection (3)* deals with the position where the holder's absolute interest has itself ceased (but the administration period continues). The approach here is to treat any such sum paid in these circumstances as a payment in respect of the earlier limited interest. The result is that such payments are treated as estate income under the limited interests provisions. But *subsection (6)* provides that the payments are treated as paid or payable in respect of the absolute interest for the purposes of section 668 (reduction in share of residuary income of estate).

2568. The taxation of successive interests in the residue of an estate is dealt with in section 698(1A) to (2) of ICTA. Section 698(1B) of ICTA deals with the case where there were successive interests in an estate which ceased otherwise than on death and the earliest or one of the earlier interests was a limited interest (see section 698(1A) of ICTA).

2569. Section 698(1B)(a) of ICTA provides that Part 16 of ICTA applies as if all the interests were the same interest ("the deemed single interest"), so that none of them is to be treated as having ceased on being succeeded by any of the others. Section 698(1B)(b) of ICTA then determines who had the deemed single interest. It is either the person in respect of whose interest or previous interest the payment was made (section 698(1B)(b)(i) of ICTA) or a person who has or had an interest and is entitled to receive the payment (section 698(1B)(b)(ii) of ICTA). So a beneficiary who does not give up his or her entitlement to income which is unpaid at the time the interest ceases is taxable on the payment, rather than the person holding the successive interest at the time when the payment is made. However section 698(1B)(b) of ICTA is made subject to section 698(1B)(c) of ICTA. Section 698(1B)(c)(i) of ICTA provides that, so far as a later interest is an absolute interest, it is to be treated as having always existed and the earlier interest or interests as having never existed for the purposes of the provisions dealing with absolute interests in section 696(3A) to (5A) of ICTA.

2570. In rare circumstances the later absolute interest may itself have ceased at the time the payment is made. For example, A has a limited interest which is succeeded by absolute interests held first by B and then by C, and a payment is received by B in respect of A's earlier limited interest after B's own interest has ceased but before the end of the administration period. As a result of section 698(1B)(b)(ii) of ICTA, Part 16 of ICTA applies to the payment as if B had the deemed single interest. So section 696(3) of ICTA deems the sum to be paid to B as income in the year in which it is actually paid. That is a tax year in which C had the absolute interest. Under section 698(1B)(c)(i) of ICTA for the purposes of section 696(3A) to (5) of ICTA, Part 16 of ICTA is to apply as if the later interest of C had always existed and the earlier interests had never existed. Section 698(1B)(c)(ii) and (iii) of ICTA then provides that sums paid as income in respect of the earlier interests are deemed to be sums paid in respect of the later interest of C.

2571. The relationship between these particular provisions, where the later interest has itself ceased at the time the payment is made but the administration period continues, is difficult to work out. It would seem that the payment in the above example should be taxed on B because of section 696(3) of ICTA. The payment is then brought into account when the payments made in respect of C's interest are compared to his aggregated income entitlement (in making the final year calculation under section 696(5) of ICTA in respect of C's interest to determine whether any amount should be treated as having been paid to C immediately before the end of the administration period). So although section 698(1A) and (1B) of ICTA operate in a very convoluted way in the above circumstances, the end result appears to be that B, the person with the absolute interest who receives the payment, is taxed on it, but it does not affect B's aggregated income entitlement.

2572. In order to spell out how a payment made in these circumstances should be treated, section 673(3) and (4) provide that where such a payment is made, this Chapter applies as if the earlier limited interest had continued to subsist while the later absolute interest subsisted and had been held by the holder of the later absolute interest. The result is that payments to that holder are treated as estate income under the provisions about limited interests.

2573. Sums to which that holder is entitled that remain payable at the end of the administration period are treated in the same way. They will be basic amounts arising from the limited interest in the tax year in which the absolute interest ceases and are dealt with by sections 654 and 661. The effect of this on later absolute interests is then determined by the successive absolute interests provisions in section 671. Under subsection (6) of section 673, however, these sums are to be treated as paid or payable in respect of the absolute interest for the purposes of the provisions about the reduction in shares of residuary income under section 668.

Section 674: Successive interests: holders of limited interests

2574. This section explains the position of a limited interest holder where successive interests in the residue of an estate are held by different people and the earlier, or if there are more than two, the earliest of the interests is a limited interest. It is based on sections 695 and 698 of ICTA.

2575. The section only applies where the later interests arise or are created on the cessation of the previous interest otherwise than by death.

2576. *Subsections (3)* to *(5)* cover three sets of circumstances described as "cases" where the estate income in respect of successive limited interests is treated as arising. The cases are the equivalent for successive limited interests of the three cases for single limited interests in section 654. But the section recognises that there may be more than one limited interest in the chain of succession, so references are made to "one of the interests" and subsection (5) refers to "the last of the successive interests".

2577. There is also an additional sub-paragraph in each case providing that a limited holder (as defined) is entitled to receive the payment. This reflects the fact that the person who receives the payment in these circumstances is not always the person in respect of whose interest the payment is made. For example, on disclaiming a life interest, a beneficiary may also disclaim any entitlement to income accrued in respect of that interest but not yet paid.

2578. The section does not make it explicit that a new chain of succession begins with the first limited interest (and a previous absolute interest is ignored) for the purposes of this provision. Nor does the section make it explicit that two limited interests which are preceded by a limited interest which ceased on the death of the beneficiary are covered by the section. These conclusions are implicit in the section.

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

2579. This section explains how to calculate the net amount of estate income for successive limited interests. It is based on sections 695 and 698 of ICTA.

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

Section 676: Apportionments

2581. This section applies where successive interests apply to only part of the residue. In other words, the residuary estate is divided up and one or more of the successive interests provisions apply to a part or parts of that estate. It also applies where one of the interests covers the whole estate and the other interest covers part of it.

2582. In such circumstances, it is possible that a subsequent interest does not cover exactly the same part of the residuary estate as the interest which preceded it. For example, a limited interest holder may give up half his or her interest, thus accelerating the interest of the absolute interest holder. Only half the share of the residuary income and half the net amounts of the limited interest holder would be needed for the calculation of whether the absolute interest holder has an assumed income entitlement in accordance with section 672(2). The section provides for just and reasonable apportionments to be made in these circumstances.

2583. The section is new. See *Change 110* in Annex 1.

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

2584. This section provides for relief if income, which has borne UK tax, arises to a person with an absolute interest in the residue of a foreign estate. It is based on section 696 of ICTA. The relief has been expressed as a formula to make it easier to compute.

2585. *Subsection (2)* contains the formula for calculating the relief where a claim is made. The labels in section 696(7)(a) and (b) of ICTA – "the deemed income" and "the aggregate income" respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.

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

2586. This section provides for relief if income, which has borne UK tax, arises to a person with a limited or discretionary interest in the residue of a foreign estate. The section is based on sections 695 and 698 of ICTA. The relief has been expressed as a formula to make it easier to compute.

2587. *Subsection (2)* provides for a reduction to be made from the tax charged on the person following a claim for relief. The tax is to be reduced by an amount equal to the appropriate fraction of that tax. The fraction here (based on section 695(5) of ICTA) is slightly different to the fraction used for absolute interests (based on section 696(7) of ICTA). The labels in section 695(5)(a) and (b) of ICTA – "the deemed income" and "the aggregate income" respectively – were added as explanatory aids in the course of the 1988 consolidation. These labels are not retained.

2588. Section 695(6) of ICTA is not rewritten. The meaning of this provision, which was introduced when surtax was still charged, is now obscure and it is difficult to see how it could operate in the context of Self Assessment. See *Change 111* in Annex 1.

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

2589. This section sets out the rules for determining from which part of the aggregate income of the estate a basic amount is treated as paid. It is based on sections 699A and 701 of ICTA.

2590. Personal representatives may receive such income from a number of sources. And different rates of tax apply to different types of income. Some of the income is taxed in the hands of the personal representatives at "the applicable rate" (the basic rate, the lower rate or the dividend ordinary rate; see section 680).

2591. The basic amounts of estate income do not always correlate precisely with the income received by the personal representatives. It is therefore necessary to attribute payments out of the residuary estate in the form of basic amounts to particular types of income received by the personal representatives.

2592. *Subsections (4)* to *(6)* deal with situations where some of the aggregate income of the estate is income treated under section 680 as bearing tax. In such circumstances, a third assumption is introduced. That third assumption is to be applied before the two assumptions referred to in *subsections (2)* and *(3).*

Section 680: Income treated as bearing income tax

2593. This section deals with income which is treated as bearing income tax. It is based on section 699A of ICTA.

2594. For certain types of income (for example, stock dividend income) the amounts treated as received by individuals are gross amounts on which they are treated as having paid tax at the dividend ordinary rate (the Schedule F ordinary rate in the source legislation) or the lower rate (as appropriate). They may then be chargeable to tax at the dividend upper rate or the higher rate on that income. Where such income forms part of the aggregate income of the estate (as a result of section 664(2)), this section treats the income as having borne tax at either the dividend ordinary rate or the lower rate (as appropriate) for certain provisions within the Chapter.

2595. *Subsection (1)* sets out the provisions within the Chapter affected by the section. The provisions in question all affect the aggregate income of the estate (see section 664).

2596. *Subsection (5)* provides that no repayment shall be made of any income tax which is treated as having been borne under section 656(3) or section 657(4) so far as the basic amount comes from sums within this section.

2597. Section 699A(1)(b) of ICTA is not rewritten in this Act. This provision provides that the sums to which section 699A(1)(a) of ICTA applies must be sums in respect of which the personal representatives are not directly assessable to UK income tax. Of the income referred to in section 699A(1)(a) of ICTA to which section 699A(1)(b) of ICTA applies, none appears to be directly assessable. So section 699A(1)(b) of ICTA serves no useful purpose.

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

Section 681: Transfers of assets etc. treated as payments

2599. This section is concerned with the appropriation of assets by personal representatives to themselves, any other transfer of assets and the set off or release of a debt. The section is based on section 701 of ICTA.

2600. *Subsections (1)* and *(2)* provide that the relevant events are treated as payments when they occur.

2601. *Subsections (3)* and *(4)* provide that where the relevant events have not happened by the end of the administration period, amounts equal to the value of the assets or debt are treated as payable.

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

2602. This section deals with adjustments after the end of the administration period. It is based on section 700 of ICTA.

2603. *Subsections (1)* and *(3)* deals with adjustments where the person previously appeared to be chargeable to either a greater or lesser amount.

2604. *Subsections (2)* and *(4)* make provision for all necessary adjustments and repayments to be made (and where a person has been allowed too much relief, for tax to be charged). They also make provision for the person to be assessed and taxed (and where, for example, the beneficiary is a charity, for relief or additional relief to be allowed).