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 6: Exempt income

Chapter 7: Purchased life annuity payments

Overview

2741. This Chapter rewrites the purchased life annuity provisions in sections 656 to 658 of ICTA.

2742. Early case law established that the whole of an annuity payment received by an annuitant is chargeable to income tax (see, for example, the speech of the Lord President (Inglis) in Coltness Iron Co v Black (1881), 1 TC 287, 308, HL, which was cited with approval by Lord Wilberforce in CIR v Church Commissioners for England (1976), 50 TC 516, 566) HL. So there was a contrast between income tax law (where the whole of the payment is regarded as taxable income) and the commercial world (where a part of the payment is regarded as a return of capital).

2743. In 1954 the Report of the Committee on the Taxation Treatment of Provisions for Retirement (Cmd. 9063) recommended changing the law so that only the income element in an annuity payment should be charged to income tax. Sections 27 and 28 of FA 1956 therefore provided for purchased life annuities to be regarded as containing both an income element (chargeable to income tax) and a capital element (not chargeable to income tax). The 1956 legislation, with subsequent amendments, appears in the source legislation as sections 656 to 658 of ICTA.

2744. Section 656(1) of ICTA provides:

> "…a purchased life annuity shall, for the purposes of the provisions of the Tax Acts relating to tax on annuities and other annual payments, be treated as containing a capital element and, to the extent of that capital element, as not being an annual payment or in the nature of an annual payment; but the capital element in such an annuity shall be taken into account in computing profits or gains or losses for other purposes of the Tax Acts in any circumstances in which a lump sum payment would be taken into account.

2745. The purpose of treating the annuity payment as containing a capital element and then treating that capital element as not being an annual payment, is to ensure the capital element is not charged to income tax. These propositions are rewritten as an exemption from income tax (see section 717). Additionally, as the annuity payment is not treated as an annual payment or is not in the nature of an annual payment, that part of the payment is outside the scope of the deduction of tax at source rules (sections 348 and 349 of ICTA). This element of section 656(1) of ICTA is dealt with by the general disregard (see section 783).

2746. The purpose of the second limb of section 656(1) of ICTA is to ensure that a trader for whom the annuity would represent a trading receipt cannot exclude the capital element from the trader's Schedule D Case I tax computation. This is dealt with for traders liable to income tax by the combined effect of the priority rule for trading income (see section 366(1) which gives Part 2 of this Act charging priority over Part 4 of this Act) and *subsection (1)* of section 717. Section 717(1) only exempts from income tax annuity payments charged to tax under Chapter 7 of Part 4 of this Act. So if the annuity payments are not charged to tax under Chapter 7 of Part 4 they cannot benefit from the exemption in Chapter 7 of Part 6 of this Act.

2747. The annuity payments made under a purchased life annuity are generally regarded as investment income in the recipient's hands and are therefore charged to tax under Chapter 7 of Part 4 of this Act. This Chapter deals with the exemption from income tax in respect of annuity payments charged under that Chapter. Annuities taxed under another part of the Act such as Chapter 7 of Part 5, or under other legislation are outside the scope of this Chapter.