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 5: Settlements: amounts treated as income of settlor

Section 640: Grossing-up of deemed income

2451. This section explains the grossing-up procedure for capital sums treated as the settlor's income and the tax allowed against the settlor's liability. It is based on section 677 of ICTA.

2452. S*ubsection (1)* provides that the settlor is taxed on the grossed up amount of the capital sum treated as his income. Section 877 of this Act explains how sums are grossed up.

2453. *Subsection (2)* then allows a set-off of tax against the settlor's tax liability with the result that only higher rates of tax are chargeable on the settlor. The amount that the settlor may set off against his liability is given in the following subsections.

2454. *Subsection (3)* explains the amount ("the deductible amount") that can be set against the settlor's liability. This is the lesser of the tax at which the capital sum is grossed up at for the tax year (the rate applicable for trusts) or the amount of tax the trustees are deemed to have paid on the available income (irrespective of the fact that the capital sum is grossed up at the rate applicable to trusts for the tax year in which the loan is treated as the settlor's income). This allows for the fact that where available income to cover the capital sum (see section 633(2)) arose in earlier years, that income may have been charged at different rates to those in the tax year in which the capital sum is treated as the settlor's income.

2455. *Subsections (4)* to *(7)* provide that, in order to ascertain the appropriate rates of tax for subsection (3)(c), the capital sum is matched against available income arising in earlier years before later years and the given rates of tax are applied for each tax year in which the available income representing the grossed-up sum arose. This includes a nil rate of tax where the available income would not have been subject to UK tax because the available income arose outside the United Kingdom to a non-UK resident. Subsection (6)(b) reflects the change in the rate applicable to trusts in FA 2004. The net effect of these subsections is that the credit available against the tax charge broadly represents the tax paid on the available income which represents the grossed-up capital sum. The nil rate applies in relation to any income in any tax year which falls within subsection (6)(a)(i) and (ii).

2456. Subsection (5) provides for grossing-up at the appropriate rate, that is to say the rates given in subsection (6), in order to ascertain the tax credit to set against the settlor's income (the "deductible amount"). This is a separate grossing-up exercise to that in subsection (1), which provides that the charge on the settlor's income is always on the amount grossed up at the rate applicable to trusts.