CHAPTER 5

OTHER TAXABLE INCOME

5.1 Other Income

Casual Earnings

S.687 ITTOIA 2005 taxes any income that has not been taxed elsewhere. In practice you will find that most forms of income are already taxed, so there are very few sources of income that are taxed under s.687. ITTOIA 2005, S.687

Casual earnings are earnings from work, but are not from an employment so are not caught under the rules taxing income from earnings. Similarly they are not earnings from self-employment so they are not taxable as trading income. An example of this may be an employee who does a one-off job for somebody else, other than his main employer. This one-off job is not taxable as trading income as he is not carrying out a trade. However, the income is taxable, so the Revenue will tax it under s. 687 as non-savings income

Post-cessation receipts

Any **post-cessation receipts** of a sole trader are taxed under s.242 ITTOIA 2005. If a trader ceases in business, any receipts that he has after his business closes down, are taxed under that section. It is non-savings income. ITTOIA 2005, S.242

Patent rights

Any profit received on the **sale of patent rights** is taxed under s.587 ITTOIA 2005. Again, it is non-savings income. ITTOIA 2005, S.587

5.2 Trust Income

A taxpayer may also receive trust income. The way in which this type of income is taxed depends on what type of trust it comes from.

You may come across a taxpayer receiving income from a discretionary trust. If a taxpayer receives income from a **discretionary trust in 2010/11**, he is deemed to have done so net of **50% tax** deducted at source. ITA 2007, S.494

Therefore, if a taxpayer receives £600 of discretionary trust income, this is received net of a 50% tax credit. In this example the tax credit is £600, leaving the taxpayer with gross trust income of £1,200.

$$£600 \times \frac{100}{50} = £1,200$$

Income from a discretionary trust is always regarded as **non-savings** income. It will therefore be entered into the first column in the income tax computation.

Occasionally you will come across a taxpayer who receives income from some other type of trust, for instance a trust called an **interest in possession trust.**

Where non savings and savings income is received by the trust it will be taxed in the hands of the trustees at 20%. Dividend income will be taxed at a rate of 10%. The income paid out to an individual by the trust retains its nature and therefore is **either non-savings/savings income received net of basic rate tax or dividend income received net of 10% tax.** The income is then treated as any other non savings/savings/dividend income in the hands of the recipient, who is entitled to the associated tax credit.

Where a question deals with income from an interest in possession trust it will state the type of income which has been received. In practice, the recipient will receive a certificate from the trustees (form R185) which **sets out the type of income received and the amount of tax deducted.**

Illustration 1

Andy receives £10,000 from the Broadman Interest in Possession Trust in 2010/11. The form R185 received from the trustees shows the payment is made up as follows:

Type of income	*Net Amount*	*Tax deducted*
	£	£
Savings	6,000	1,500
Dividends	4,000	444

Andy's only other sources of income for 2010/11 were his salary of £40,000 (PAYE deducted £6,500) and bank interest of £500.

Andy's tax due will be calculated as follows:

	Non Savings	*Interest*	*Dividends*
	£	£	£
Employment income	40,000		
Bank interest (500 x $\frac{100}{80}$)		625	
Trust income			
- interest (6,000 x $\frac{100}{80}$)		7,500	
- dividends (4,000 x $\frac{100}{90}$)			4,444
Net Income	40,000	8,125	4,444
Less: Personal allowance	(6,475)		
Taxable Income	£33,525	£8,125	£4,444

Tax	£
£33,525 @ 20%	6,705
£3,875 @ 20%	775
£4,250 @ 40%	1,700
£4,444 @ 32.5%	1,444
	10,624
Less: PAYE	(6,500)
tax on bank interest (625 @ 20%)	(125)
tax on trust income (1,500 + 444)	(1,944)
Tax due	£2,055

5.3 Settlor interested trusts

ITTOIA 2005, S.624

If the person who sets up the trust, (the settlor), has an "interest" in the trust, **i.e. he can benefit from either the trust income or the assets of the trust** - the whole of the income received by the trust is taxed on the individual as if it were received by him. He will be entitled to a tax credit in respect of the tax paid by the trustees in respect of the income.

The settlor is also treated as having an interest in the trust property if his or her spouse can benefit from the trust.

5.4 Parental settlements

ITTOIA 2005, s.629

Anti avoidance rules exist to prevent a parent from diverting income to a minor child in order to utilise the child's personal allowances and/or basic rate band.

Where a parent (or step-parent) provides funds to or for the benefit of a child (or step-child), any income arising from those funds is taxed in the hands of the parent. This will include circumstances where a parent sets up a trust for a child or simply places funds on (say) a building society account for the child.

The parental settlement rules only apply where the funds are settled by a parent (not by a sibling or grandparent) and where the child is under the age of 18 and is unmarried.

There is an exception where the gross annual income generated by the parental funds is £100 or less. In this case, the income would be taxed on the child (and presumably covered by personal allowances).

5.5 Unit trusts

It is common to come across taxpayers who receive distributions from unit trusts. Unit trusts will distribute their profits to the unit holders in the form of either dividends or interest.

If a taxpayer receives a **dividend** from a **unit trust**, we tax that dividend in the normal way - i.e. we treat it as received net of a **10% credit** and **gross up** the net amount in the income tax computation. The gross figure is then entered into the dividend column. ITTOIA 2005, S.389

Similarly, if a unit holder receives an **interest distribution** from a unit trust, we tax this in the same way that we tax normal UK bank interest. This means the interest will be received net of a **20% tax credit** and has to be **grossed up** in the tax computation. Having arrived at the gross figure, we simply treat it as normal bank interest. ITTOIA 2005, s.376

5.6 Joint income

The most common example of joint income is income received jointly by husband and wife. This could be a bank account held in joint names, or shares held in joint names, where the interest or the dividend needs to be split between the two taxpayers.

Illustration 2

A husband and wife jointly own a property. Assume the husband's share is 60% and the wife's share is 40% of the property – so this property is jointly owned between them although not in equal parts. The property is let out and produces rental income which is taxed as property income.

There are two ways of treating joint income. The most common way is to simply split the income **equally** between the two parties regardless of their actual shares in the property. 50% of the income is taxed in the hands of the husband, and goes into his tax computation. The remaining 50% of the rental income is taxed in the hands of the wife and goes into her tax computation. ITA 2007, S.836

It is important to note here, that the UK has a regime known as "Independent Taxation", whereby the income of a husband and wife is always kept separate and is never aggregated together.

The second way to treat joint income is for the taxpayers to make an **election** to split the income in accordance with their **beneficial entitlement** in the property. If the husband and wife make such an election the husband will be taxed on 60% of the income, being equivalent to his ownership of the property; and the wife will be taxed on the remaining 40%. ITA 2007, S.837

If the taxpayers prefer this treatment, they must make an election to this effect. If no election is made, HMRC will simply split the income equally between the two parties. The declaration must be notified to HMRC within 60 days of the date of the declaration and applies to income arising on or after the date of the declaration.

There is a special rule relating to dividends from jointly held shares in certain small companies called close companies. Such dividend income must be split in accordance with the beneficial entitlements of the spouses.

5.7 Pre-owned assets

A special income tax charge came into force in 2005/06. It relates to the use of assets previously owned by the taxpayer.

The pre-owned asset (POA) rules **impose an income tax charge on benefits received by a former owner of property**.

An income tax charge is levied on a **notional amount of income broadly equivalent to the annual rental value of the asset concerned**. This "notional" income will then be declared on the taxpayer's self-assessment return and income tax paid in the normal way. This notional income will be taken into account in determining payments on account for the following tax year. Sch 15 Para 4

If the former owner only benefits from the property for part of the tax year, the charge will be pro-rated accordingly.

Note that the income tax charge will **only fall upon those taxpayers** who continue to benefit from an asset given away after March 1986, but are **not caught by the Inheritance Tax gift with reservation of benefit (GWR) rules**. If a gift is subject to the GWR rules and is therefore still in the donor's estate for IHT purposes, there will be no POA charge. Sch 15 Para 11

5.8 POA charges on land

A POA charge will apply where a person occupies land if, after 17 March 1986, he had disposed of that land (or an interest in it). The POA rules will also apply if the donor owned other property whose sale proceeds have been used to buy land which the donor now occupies, or if the donor provided the consideration for the owner to buy the land. Sch 15 Para 3(2)

The amount charged to income tax will be:

The appropriate rental value	A
Less: payments made by the "chargeable person" to the owner of the land	(B)
"Notional income"	C

The "appropriate rental value" of the land is the rent that the owner might reasonably be expected to obtain from a letting from year-to-year (i.e. a typical commercial rent). This **commercial rent** is calculated by assuming that the property is let unfurnished, the tenant is responsible for taxes, rates and charges (for instance, utilities, council tax etc) and the landlord bears repair and insurance costs. Sch 15 Para 4(3) Sch 15 Para 5

The rental value will initially be determined **in respect of the first year of assessment** in which the POA rules apply. This value will also apply for the next four tax years. A new valuation will be required **after the first five tax years** and at every five year anniversary. SI 2005/724

For example, if the taxpayer first occupied a property on 6 July 2010 which resulted in a POAT charge, the rental value would need to be established for 2010/11. The taxpayer would only be assessed on 9/12ths of this amount in 2010/11 as he has only occupied the property for 9 months. The 2010/11 rental value would be used to calculate the POAT charge for the next four tax years. In 2015/16 a new rental value will be calculated and will be used for the next five years.

Payments made by the "chargeable person" (i.e. the original donor) to the owner are **deductible if they are in pursuance of a legal obligation** (for example, under the terms of a formal lease). Such rental payments made by the occupier to the owner will be taxable income under the rental income rules. Sch 15 Para 4(1)

A loss cannot be created if payments exceed the rental value.

5.9 POA charges on chattels

Schedule 15 para 6 imposes a POAT charge on chattels (paintings, antiques etc) in a similar way to the charge on land. Once again a charge is imposed if a donor gave away a chattel after 17 March 1986 and is still in a position to enjoy or benefit from the chattel. The rules do not apply if the gift is subject to the IHT GWR rules. Sch 15 Para 6

However, under para 7, the POAT charge is calculated by taking a **notional interest amount** rather than taking the annual rental value of the chattel. This is likely to produce a significantly higher POA charge, as the annual rental value of chattels is typically quite low. Sch 15 Para 7

The amount charged to income tax will be:

Notional interest payable for the period	X
Less: payments made by the chargeable person to the owner of the chattel	(Y)
"Notional income"	Z

The "notional interest" is the interest that would be payable for the tax year if interest was payable at **HMRC's prescribed rate** on an amount equal to the **value of the chattel at the "valuation date".** Sch 15 Para 7(2)

The first "valuation date" is the date on which the taxpayer first becomes liable to the income tax charge. The income tax charge is based on that value for the first and the following four tax years. A **new valuation is required after the first five tax years.**

For example, a taxpayer who became liable to the income tax charge for 2005/06 would value the chattel first at 6 April 2005, then at 6 April 2010 and thereafter every five years, as long as they continue to benefit from the pre-owned asset. A taxpayer who becomes liable to the charge (say) on 6 October 2010, would value the chattel first at 6 October 2010, and then on 6 April 2015 and every five years after that. SI 2005/724

Payments made by the "chargeable person" must again be in pursuance of a legal obligation and will be taxable income for the recipient. A loss cannot be created if payments exceed the notional interest.

Illustration 3

Mr Lord gave away a valuable painting in 2003 to a family trust. The arrangement was structured in such a way so as to avoid falling foul of the GWR rules. The painting continues to hang in Mr Lord's dining room. Mr Lord pays a "rent" of £200 per month to the trustees.

As the painting was given away after 17 March 1986 the POA provisions will be applied to Mr Lord from 2005/06. At 6 April 2005, the painting was worth £500,000.

For 2005/06 to 2009/10 the notional interest will have been based on this valuation.

At 6 April 2010 the painting has increased in value to £590,000. The prescribed rate of interest for 2010/11 is 4%.

The POA charge for 2010/11 will be:

	£
Notional interest payable for the period (£590,000 x 4%)	23,600
Less: payments made by Mr Lord (£200 x 12)	(2,400)
"Notional income"	£21,200

In 2010/11 Mr Lord is deemed to have received income of £21,200. This will be included in his 2010/11 self-assessment return and the income tax thereon paid by 31 January 2012. It will also be considered when calculating payments on account for 2011/12.

5.10 Cash gifts

There are tracing provisions under the POA rules (called the "contribution condition"). Sch 15 para 3(3)

Under Sch 15 para 3(3), a POAT charge will arise where

> "the chargeable person has directly or indirectly provided… any of the consideration given by another person for the acquisition of
>
> (i) an interest in the relevant land, or

(ii) an interest in any other property, the proceeds of disposal of which were (directly or indirectly) applied by another person towards the acquisition of the relevant land….."

Illustration 4

Henry owns a house. For IHT planning purposes, he wishes to give the house to his son Toby, but still be able to live there. He is aware that if he does so, he will make a GWR for IHT purposes. This will make the gift ineffective for IHT as the house will still form part of his estate.

Henry therefore sells the house for £500,000 and gifts the cash to Toby. Toby uses the cash to buy another house which he allows Henry to occupy rent-free.

This is not a GWR for IHT purposes.

However **this is caught under the POA rules** in Sch 15 para 3(3). Henry will therefore have an income tax charge based on the rental value of the land he is now occupying.

There is an **apportionment provision** where a person provides **part** of the funds towards the acquisition of relevant land. Sch 15 para 4(2)(c)

Illustration 5

Henry gifts cash of £500,000 to Toby. Toby uses the cash to buy another house for £750,000 which he allows Henry to occupy rent-free from 6 April 2010. The annual rental value of the house is £4,000 per month.

The POA charge for 2010/11 and subsequent years will be:

	£
Appropriate rental value (£4,000 x 12)	48,000
Apportioned under Sch 15 para 4(2)(c) $£48,000 \times \frac{500,000}{750,000}$	£32,000

Similar rules apply where the asset in question is a chattel.

HMRC has also confirmed that **a loan of cash** (rather than an outright gift) **will not fall within the contribution condition**. This is because the lender will have the asset of the outstanding debt in his estate for inheritance tax purposes and therefore the anti-avoidance POA provisions should not apply.

5.11 Excluded transactions

A POA charge is levied where the chargeable person originally disposed of land and/or chattels "otherwise than by way of an excluded transaction". Therefore if the donor can still benefit from an asset he gave away, but the original gift was "excluded", there is no POA charge. Sch 15 Para 10

Para 10 of Schedule 15 defines an "excluded transaction" as including any of the following:

- **Disposal on an arm's length basis** (e.g. for consideration equal to its market value);
- **Disposal to a spouse** (or interest in possession trust for spouse);
- ***Gift of cash*** more than 7 years before the donor first used the asset purchased.
- Gifts covered either by the **small *gifts* exemption** (£250) or **annual exemption** (£3,000) or a gift for the **maintenance of family** within s.11 IHTA 1984.

5.12 The "£5,000" exemption

No income tax charge will arise if the **aggregate of POA charges** (before payments made by the chargeable person) in the tax year **do not exceed £5,000**. If taxable values exceed £5,000, the full amount is taxed. Sch 15 Para 13

Note that the £5,000 is not pro-rated where an individual is only subject to the POA provisions for part of a tax year.

Illustration 6

Mr Earl gave away some land in 2003 to his son. The arrangement was structured in such a way so as to avoid falling foul of the GWR rules. The land is used by Mr Earl to graze his horses. The rental value of the land is £6,000. Mr Earl pays rent of £100 per month to his son.

The POA charge for 2010/11 will be:

	£
The appropriate rental value	6,000
Less: payments made by Mr Earl (£100 x 12)	(1,200)
"Notional income"	£4,800

The £4,800 is taxable and will be reported on Mr Earl's 2010/11 return. The £5,000 de-minimis rule does not apply as the annual rental value exceeds £5,000.

5.13 Territorial scope

The POA charge will **not apply** in a tax year in which the individual is **not resident** in the UK. Therefore if a non-resident becomes UK resident, the POA charge will apply from the time he becomes UK resident. Sch 15 Para 12(1)

If the individual is resident in the UK but is **not UK domiciled**, the POA charge will **only apply to assets situated in the UK**. If the donor subsequently acquires a UK domicile, the scope of the POA charge will thereafter be extended to his worldwide assets. Sch 15 Para 12(2)

5.14 Electing out of the POA charge

Where an individual is caught by the POA rules, he **can make an election** under Schedule 15 para 21. The effect of the election is that: Sch 15 Para 21

1. **No income tax charge** will arise under the POA rules in respect of land or chattels he previously owned but continues to benefit from; but

2. The donor will **instead be treated as having made a GWR** under the inheritance tax rules, such that the asset now forms part of his estate for IHT.

The election should be made no later than 31 January following the tax year in which the individual first becomes liable to a POA charge. However, HMRC have discretion to accept a late election in a particular case. The **election can be revoked or varied at any time** until the filing date (but cannot be withdrawn thereafter). The election applies on an **asset-by-asset basis.** Sch 15 Para 23

Example 1

Jonathan received the following income in 2010/11:

	£
Income from a discretionary trust	13,000
Casual earnings	4,000
Interest on NS&I Easy Access account	1,430
Dividend from unit trust	14,400

Calculate Jonathan's repayment.

Example 2

Francesca gave £100,000 cash to her daughter Lydia in 2007. In 2008 Lydia used the cash to buy a diamond ring for £150,000. Lydia allows her mother to wear the ring which she does continually. Francesca does not make any payment for the use of the ring, although the annual rental value for such an asset is £100 per month.

HMRC's official rate of interest is 4%.

Calculate the amount chargeable to income tax on Francesca in 2010/11 under the Pre Owned Assets rules.

Answer 1

	Non Savings	Interest	Dividends
	£	£	£
Discretionary trust			
$(13{,}000 \times \frac{100}{50})$	26,000		
Miscellaneous income	4,000		
NS&I account		1,430	
Unit trust dividend			
$(14{,}400 \times \frac{100}{90})$			16,000
Net Income	30,000	1,430	16,000
Less: Personal allowance	(6,475)		
Taxable Income	£23,525	£1,430	£16,000

Tax	£
23,525 @ 20%	4,705
1,430 @ 20%	286
12,445 @ 10%	1,244
37,400	
3,555 @ 32½%	1,155
Tax liability	7,390
Less: tax on trust income (50%)	(13,000)
tax on dividends (10%)	(1,600)
Tax repayable to Jonathan	**£(7,210)**

All repayable as deemed to come from tax deducted on trust income.

Answer 2

There is a charge under the Pre Owned Assets rules as Francesca has provided funds which have been subsequently used in acquiring a chattel which she is now using.

As the asset is a chattel, the charge is calculated using HMRC's interest rate.

	£
£150,000 x 4%	6,000
Apportioned:	
$£6{,}000 \times \frac{100{,}000}{150{,}000}$	£4,000
Below £5,000 threshold, therefore charge =	NIL