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**Double taxation relief (DTR) avoidance using  
manufactured overseas dividends (MODs)**

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Draft Legislation and Explanatory Note  
3 November 2009

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## Introduction

On 21 October 2009, the Government announced it was taking action to counter avoidance using manufactured overseas dividends (MODs). This document provides draft legislation and explanatory notes.

Comments, which should be made by 31 December 2009, should be addressed to -

Giles Horridge  
Business International  
3rd Floor  
100 Parliament Street  
London SW1A 2BQ

Telephone: 020 7147 2654  
Email: [giles.horridge@hmrc.gsi.gov.uk](mailto:giles.horridge@hmrc.gsi.gov.uk)

## Chapter 1 – Background

1. The Financial Secretary to the Treasury announced in a Written Ministerial Statement dated 21 October 2009 that legislation will be introduced in the forthcoming Finance Bill to block certain avoidance schemes that have been notified to HM Revenue & Customs (HMRC). Under these schemes, companies have used manufactured overseas dividends (MODs) instead of real overseas dividends in order to disapply the anti-avoidance rules in the DTR legislation. The legislation will have effect from 21 October 2009.
2. A [Technical Note \(PDF 34K\)](#), which is available on HMRC's web site, was published on the same day. The Technical Note announced that legislation will be introduced amending the relevant DTR anti-avoidance provision so that it applies to deemed overseas tax deducted from MODs in the same way that it applies to overseas tax deducted from real overseas dividends. The amendment will ensure that the provision can also apply in other circumstances where the UK Tax Acts treat an amount that is not overseas tax as if it were overseas tax. These changes will prevent credits for notional overseas tax from being treated more favourably than tax credits on real dividends.

## **Chapter 2 – Draft Legislation**

This section contains the current draft of the legislation.

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## 1 Double taxation relief: targeted anti-avoidance [-]

- (1) In paragraph 3 of Schedule 28AB to ICTA (schemes about effect of paying foreign tax) –
  - (a) in paragraph (a) of sub-paragraph (2), after “paid” insert “or payable”,
  - (b) in paragraph (b) of that sub-paragraph, for “of the payment of that amount of foreign tax on the foreign tax total” substitute “on the foreign tax total of that amount being so paid or payable”, and
  - (c) in sub-paragraph (3)(b), for “the payment by the claimant of that amount of foreign tax” substitute “that amount of foreign tax being paid or payable by the claimant”.

- (2) After that paragraph insert –

*“Deemed foreign tax*

- 3A (1) This paragraph applies to a scheme or arrangement if in relation to a claimant –
  - (a) an amount (“amount X”) is treated by virtue of a provision of the Tax Acts as if it were an amount of foreign tax paid or payable by the claimant in respect of a source of income, and
  - (b) condition A or condition B is met.
- (2) Condition A is met if, when the claimant entered into the scheme or arrangement, it could reasonably be expected that, under the scheme or arrangement, no real foreign tax would be paid or payable by any person party to, or concerned in, the scheme or arrangement.
- (3) Condition B is met if, when the claimant entered into the scheme or arrangement, it could reasonably be expected that, under the scheme or arrangement –
  - (a) an amount of real foreign tax would be paid or payable by a person party to, or concerned in, the scheme or arrangement, but
  - (b) the effect on the foreign tax total of that amount being so paid or payable would be to increase the foreign tax total by less than the amount allowable to the claimant as a credit in respect of amount X.
- (4) In this paragraph –

“claimant” means a person who has claimed, or is in a position to claim, for a chargeable period an allowance under any arrangements by way of credit for foreign tax;

“the foreign tax total” has the meaning given by paragraph 3(3), except that the reference to “that amount of foreign tax being paid or payable by the claimant” must be read as a reference to “the amount of real foreign tax being paid or payable by any of them”;

“income” includes a chargeable gain;

“real foreign tax” means –

  - (a) in a case involving section 807 (accrued income profits), the foreign tax chargeable in respect of the interest on the securities, as mentioned in subsection (1)(c) of that section,

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- (b) in a case involving paragraph 4(4) of Schedule 23A (manufactured overseas dividends), the foreign tax chargeable in respect of the overseas dividend of which the manufactured overseas dividend is representative, as mentioned in paragraph 4(1) of that Schedule, and
    - (c) in any other case, the foreign tax chargeable in respect of the source of income of which the source mentioned in sub-paragraph (1)(a) is representative.”
  - (3) The amendments made by subsection (1) have effect in relation to amounts of foreign tax payable on or after 21 October 2009.
  - (4) The amendment made by subsection (2) has effect in relation to amounts treated as if they were amounts of foreign tax paid or payable on or after 21 October 2009.

## Chapter 3 – Draft Explanatory Note

This section contains the draft explanatory note based on the current draft of the legislation.

### SUMMARY

1. The clauses introduce legislation to prevent the use of MODs instead of real overseas dividends in order to disapply the anti-avoidance rules in the DTR legislation.

### DETAILS OF THE CLAUSES

2. Section 1(1)(a) corrects paragraph 3(2)(a) of Schedule 28AB to the Income and Corporation Taxes Act 1988 (ICTA) by including amounts of foreign tax payable by the person claiming credit relief.
3. Sections 1(1)(b) and (c) introduce consequential amendments.
4. Section 1(2) inserts new paragraph 3A into Schedule 28AB (section 804ZA: Prescribed Schemes and Arrangements) to ICTA for a scheme or arrangement involving deemed tax.
5. New paragraph 3A(1) prescribes a scheme or arrangement where there is an amount of deemed foreign tax and either condition A or condition B is met.
6. New paragraph 3A(2) provides that condition A is met where it could reasonably be expected that, under the scheme or arrangement, no real foreign tax is paid by persons involved in the scheme or arrangement. The subparagraph therefore identifies circumstances where a tax credit arises in respect of an amount representative of real foreign tax, in circumstances where the effect of the scheme or arrangement is such that the claimant expected no real foreign tax to be paid.
7. New paragraph 3A(3) provides that condition B is met where it could reasonably be expected that, under the scheme or arrangement, real foreign tax would be paid by persons involved in the scheme or arrangement but another person party to the scheme would by reason of that payment become entitled to tax relief, with the result that the foreign tax total increases by less than the amount of deemed foreign tax.
8. New paragraph 3A(4) defines “claimant”, “the foreign tax total”, “income” and “real foreign tax”. The “real foreign tax” definition sets out that, in relation to section 807 of ICTA, we are taking account of the foreign tax chargeable in respect of the interest payable on the securities referred to in section 807(1)(c) of ICTA and, in relation to the MOD rules, we are taking account of the foreign tax chargeable on the overseas dividend of which the MOD is representative. The definition also includes a sweep-up for other deeming provisions.

9. Section 1(3) applies the amendments made by section 1(1) to amounts of foreign tax payable on or after 21 October 2009.
10. Section 1(4) applies the amendment made by section 1(2) to amounts treated as if they were amounts of foreign tax paid or payable on or after 21 October 2009.

#### **BACKGROUND NOTE**

11. The current MOD rules and regulations aim to give the recipient of a MOD (or any payment deemed to be a MOD) the same relief for foreign tax as the recipient of the real dividend.
12. Section 804ZA of ICTA reduces or eliminates claims to DTR where there is an avoidance scheme or arrangement. The scheme must fall within one of the prescribed schemes in Schedule 28AB to ICTA. Paragraph 3 of Schedule 28AB to ICTA prescribes a scheme where the person claiming credit for foreign tax has not suffered the full economic cost of the foreign tax for which it is claiming relief. However, it does not work effectively where the claim is for foreign tax which tax law treats as having been paid, for example the MOD rules.
13. The new measure will amend Schedule 28AB to ICTA so that it applies to deemed overseas tax deducted from MODs in the same way that it applies to real overseas dividends. The amendment will ensure that the provision can also apply in other circumstances where the UK Tax Acts deem income to be received under deduction of overseas tax. These changes will prevent credits for notional overseas tax from being treated more favourably than tax credits on real dividends.
14. This will not result in section 804ZA of ICTA applying automatically to deny DTR in relation to deemed overseas tax, since it will still be necessary for that tax to arise as part of a scheme or arrangement one of the main purposes of which is to cause that tax to be taken into account for DTR purposes.