

DRAFT GUIDANCE ON CHANGES TO “THE INCOME TAX (MANUFACTURED OVERSEAS DIVIDENDS) REGULATIONS 1993” (SI 1993/2004) INTRODUCED BY “THE INCOME TAX (MANUFACTURED OVERSEAS DIVIDENDS) (AMENDMENT No. 2) REGULATIONS 2011” (SI 2011/2503)

The main change to SI 1993/2004 introduced by SI 2011/2503 is regulation 5B, which from 10 November 2011 enables Manufactured Overseas Dividends (MODs) in stock loans that are paid via a central counterparty to be treated as though they had been made directly by the end borrower (known as the “first CCP payer”) to the original lender (known as the “final CCP recipient”). Paragraphs 106-112 below provide draft guidance on this new rule. This guidance will be incorporated into updated Guidance Notes on manufactured payments that will be published shortly.

An associated change is the requirement from 10 November 2011 for all notices issued under regulation 5A (Chains of payments where last payment made to, or for benefit of registered pension scheme or is linked solely to pensions business) to be in a form provided or authorised by HMRC. Paragraphs 101-105 below provide draft guidance on this new rule and on regulations 3(6) and 5A generally, and will also be incorporated into the updated Guidance Notes.

Any enquiries on this draft guidance should be sent to Geoff Heaton (email geoff.heaton@hmrc.gsi.gov.uk; telephone 020 7147 2577) or Robin Blades (email robin.blades@hmrc.gsi.gov.uk; telephone 020 7438 6453).

**HMRC
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UK Pension Schemes (Regulations 3(6) and 5A SI 1993/2004)

101. Since 1 October 2007 special rules have applied where MODs are paid to UK pension schemes. When a real dividend is paid to a pension scheme, overseas tax may be deducted at a different rate from that which applies to dividends paid to other recipients or, in some cases, tax is not deducted at all. Under regulation 3(6) the rate of relevant withholding tax for a MOD paid to, or for the benefit of, a registered pension scheme within the meaning of Part 4 Finance Act 2004 or linked solely to pension business for the purposes of the exemption from corporation tax in s438 ICTA 1988 is the rate at which withholding tax would have been deducted from the real dividend of which the MOD is representative if paid to such a recipient.
102. Just as regulation 5 allows each payment in a chain where the last payment is to a non-UK recipient to be paid without deduction of tax, regulation 5A allows the special rate for pension schemes to apply where there is a chain of payments where the last payment is to or for the benefit of a registered pension scheme or linked solely to pension business.

103. The other conditions for a chain to exist are as follows:

- Each payment, except the first, must be made by an AUKI or AUKCA.
- Each payment, except the last, must be made to an AUKI or AUKCA.
- Each payment is representative of the same overseas dividend.
- Each recipient in the chain except the last has issued a notice to the payer telling it to make the payment at the special rate.
- None of the payments in the chain is a foreign permanent establishment payment.

104. Where the recipient of the first payment in the chain is liable to a reverse charge, this will also be payable at the special rate.

105. From 10 November 2011 the notice under regulation 5A must be in a form provided by or authorised by HMRC. HMRC has not provided a form for use under regulation 5A but something similar to an “Appendix C Notice” would be suitable. However, rather than saying that no tax need be deducted, it should say that tax should be deducted at the specified rate which may, in some cases, be 0%¹. Applications for authorisation should be submitted to: Large Business Service (Banking Sector), 5th Floor, 22 Kingsway, London, WC2B 6NR. Telephone number 020 7438 6453. E-mail robin.blades@hmrc.gsi.gov.uk.

Transactions through a Central Counterparty (Regulation 5B SI 1993/2004)

106. From 10 November 2011 there are special rules to facilitate stock lending via central counterparties (CCPs). Typically such arrangements involve lenders and borrowers acting through clearing members of an exchange. In legal terms the securities are loaned from the original lender to a clearing member acting on the lender’s behalf, from the clearing member to the CCP, from the CCP to a clearing member acting on behalf of the end borrower and from that clearing member to the end borrower². If a dividend is paid during the period of the loan, payments representative of the dividend passing between these parties will each come within the definition of a MOD.

107. Regulation 5B introduces the concept of “a CCP chain” and treats the maker of the first payment in the chain (the “first CCP payer”) as paying a MOD to the recipient of the last payment in the chain (the “final CCP recipient”). The MOD rules will apply to that deemed payment and the actual payments in the chain are disregarded.

108. The conditions for a CCP chain to exist are:

¹ HMRC has previously given non-statutory endorsement to forms of regulation 5A(5) notice produced by market participants, and we can provide statutory authorisation for these and other forms of notice that are currently in use.

² Clearing members of exchanges may also engage in stock lending and borrowing as original lenders and end borrowers in their own right, in which case they will lend directly to, and borrow directly from, the CCP.

- each payment is a payment of a MOD representative of the same overseas dividend
- each payment in the chain is made by or to a CCP or by or to a clearing member acting in that capacity
- a notice is issued to the first CCP payer and the final CCP recipient by or on behalf of the CCP

109. The notice must confirm that the other two conditions are met and either give the names and registered office addresses of the first CCP payer and the final CCP recipient³ or provide sufficient information to enable the parties to meet their tax obligations in the United Kingdom with respect to the manufactured overseas dividend. In particular, this will be the information which tells the first CCP payer whether it needs to account for a primary charge and the final CCP recipient whether it needs to account for a reverse charge. This allows anonymous trading through a CCP.

110. The notice must be in a form provided by or authorised by HMRC. HMRC has not provided a model notice in this case but will agree and authorise forms of notices with individual CCPs which are appropriate to their trading models. Applications for authorisation should be sent to Large Business Service (Banking Sector) at the address above (Paragraph 105).

111. A central counterparty must be a recognised clearing house or recognised investment exchange which carries on a business of providing a central counterparty clearing service for the transfer of overseas securities. Recognised clearing house and recognised investment exchange, which includes a regulated market and a multilateral trading facility, are defined by reference to FSA and EU rules.

112. A CCP chain may form part of a wider chain under regulation 5 or 5A, in which case notices under those provisions will need to be passed to the first CCP payer. Since the standard form of Regulation 5 Notice identifies the payer and the recipient, it cannot be used for anonymous trading. HMRC will therefore agree and authorise notices under regulations 5 and 5A which are appropriate to the CCP's trading model. It will also authorise notices under regulations 4(6)(b) and 7(2)(d). In authorising such notices, HMRC will have satisfied itself that the procedures and functionality of a CCP (or, for instance, a trading platform) are such that the first CCP payer is entitled to pay the MOD without deduction of tax. Applications for authorisation should be sent to Large Business Service (Banking Sector) at the address above (Paragraph 105).

³ Where the final CCP recipient has used an agent to lend the securities, the registered office address of the agent may be given.