



Inland  
**Revenue**

# **Manufactured Dividends on UK Equities**

## **Guidance Notes**

**April 2001**

**Revenue Policy, Business Tax**

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## **1. About These Notes.**

1.1 These notes are to help securities dealers and others who have transactions in UK equities to understand the tax rules for “manufactured” dividends.

1.2 Further copies of the notes can be downloaded from the Inland Revenue website at [www.inrev.gov.uk](http://www.inrev.gov.uk), or by contacting David Edney at

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1.3 These notes reflect legislation from 6 April 1999. Legislation applying to earlier periods is detailed in the January 1998 version of these notes, which can also be obtained from the website or the above address.

**These notes are for guidance only and reflect the tax position at the time of writing. They do not affect any right of appeal.**

**INLAND REVENUE – April 2001**

## **2. Statute - introduction**

### ***Manufactured Dividends Legislation***

2.1 The manufactured dividends legislation is found in Schedule 23A ICTA 1988.

2.2 Schedule 23A ICTA 1988 governs how manufactured dividends are to be treated in the hands of both the payer and the recipient. The broad effect of the legislation is that a manufactured dividend is treated as if it were a real dividend.

### ***Meaning of “Manufactured Dividend” and “UK Equities”***

2.3 A manufactured dividend is any payment, made under a contract or other arrangements for the transfer of UK equities, which is representative of a dividend on those UK equities. For example,

- where a loan of UK equities is outstanding over a dividend date, and the lender does not receive the real dividend to which he would have been entitled had the equities not been lent, any payment made by the borrower to the lender to compensate the lender for loss of the dividend will be a manufactured dividend.
- Similarly, where a cum dividend short sale of UK equities is settled with ex dividend stock, any payment made by the vendor to the purchaser to compensate the purchaser for not receiving the real dividend will be a manufactured dividend.
- And under a sale and repurchase transaction (repo), any payment made by the buyer of the stock under the first leg of the transaction, to the seller, which is representative of the dividend not received by the seller will be a manufactured dividend (and see paragraph 3.4 below as regards deemed manufactured dividends in certain repo transactions).

But where a recipient is simply passing on a real dividend to which he is not beneficially entitled, for example,

- he has made a cum dividend sale out of a long position and receives the dividend merely because the company register has not been updated to reflect the change in membership, or
- he has bought special ex dividend and receives the dividend merely because he is registered as a member, or
- he is a nominee passing the dividend to the beneficial owner,

this does not amount to dividend manufacture.

2.4 Where shares are held in a depository and a depository receipt is issued it is necessary to look through the receipt to the underlying shares. If, therefore, under a contract or other arrangements for the transfer of a depository receipt a payment is made which is representative of a dividend on the underlying shares, that payment will be a manufactured dividend. Similarly, in the case of stapled stock or a depository receipt representing more than one type of share or security, it is necessary to determine which underlying share or security has paid a dividend and apply the provisions of Schedule 23A ICTA 1988 to the representative payment accordingly (apportioning the payment if need be).

2.5 “UK equities” means shares of any company resident in the UK for tax purposes.

### **3. Manufactured Dividends Legislation - Details**

#### ***Manufactured Dividends paid by UK resident companies***

3.1 Under Paragraph 2(2) of Schedule 23A ICTA 1988 a UK resident company paying a manufactured dividend is treated for the purposes of that company as paying a real dividend of its own<sup>1</sup>. Up to 6 April 1999 the paying company accordingly was obliged to account for ACT on payment of the manufactured dividend. ACT has been abolished for dividends paid on or after 6 April 1999. Consequently there is no liability to account for ACT on manufactured dividends paid on or after this date.

3.2 The recipient is treated as receiving a real dividend in respect of the equities transferred<sup>2</sup>. Any tax credit entitlement to UK residents will be the same as would arise on receipt of a real dividend on the equities, paid on the same date<sup>3</sup>.

#### ***Manufactured Dividends paid by others resident or trading in the UK***

3.3 Paragraph 2(3) to (5) of Schedule 23A ICTA 1988, governs the position where the manufacturer is not a UK resident company. Before 6 April 1999 dividend manufacturers who were UK resident, or who paid the manufactured dividend in the course of a trade carried on in the UK through a branch or agency, were liable to account for tax on payment. The amount of tax was equal to the ACT that a UK resident company would have had to account for if it had paid the manufactured dividend.

3.4 As a result of the abolition of ACT, there is no liability to account for this tax on manufactured dividends paid on or after 6 April 1999.

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<sup>1</sup> But see paragraphs 5.6 and 5.12 below regarding shadow ACT.

<sup>2</sup> In the case of manufactured dividends paid before 6 April 1999 the recipient was treated as receiving a dividend in respect of shares in the company paying the manufactured dividend. This was changed by s102(5) FA 98 with effect for manufactured dividends paid on or after 6 April 1999

<sup>3</sup> Note that schedule 23A para 2B still applies to any payment after 5 April 1999 representative of a FID paid on or before 5 April 1999. See the January 1998 version of these notes for details of payments representative of FIDs.

3.5 The recipient of the manufactured dividend is treated as receiving a real dividend paid on the UK equities in question. Any tax credit entitlement to UK residents will be the same as would arise on receipt of a real dividend on the equities, paid on the same date.

### ***Manufactured dividends received in the UK from abroad***

3.6 Up to 6 April 1999 UK recipients of manufactured dividends paid from abroad may have had to account for tax on receipt equivalent to the ACT to which a UK payer would have been liable on payment. This was known as the 'reverse charge'<sup>4</sup>. Again, as a result of the abolition of ACT, there is no 'reverse charge' on UK recipients of manufactured dividends that are paid from abroad on or after 6 April 1999.

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<sup>4</sup> See paragraph 2.9 et seq. of the January 1998 version of these notes for more details of the reverse charge, and the meaning of UK recipient.

## 4. Other relevant legislation

### *Stock Lending: tax treatment*

4.1 In computing the profits of a trade for the purposes of Schedule D Case I the accounting treatment, which is to reflect the substance of the transaction in accordance with Financial Reporting Standard 5, will be followed.

4.2 **Section 263B TCGA 1992** ensures that acquisitions and disposals under stock loans are disregarded for Capital Gains Tax purposes.

4.3 **Section 736B ICTA 1988** applies where, as a result of a stock lending arrangement, a dividend or interest on any securities<sup>5</sup> is paid to a person other than the lender but no manufactured payment is made to the lender by way of compensation. In these circumstances Section 736B<sup>6</sup> deems there to be a manufactured payment by the borrower to the lender on the same date as payment of the real interest or dividend<sup>7</sup>.

- Section 736B does not apply where distributions or interest (or representative amounts) arising on securities transferred as credit support collateral is added to the amount of the returnable credit support, even where the amounts are not immediately remitted to the credit support provider. Schedule 23A will apply to the amounts.
- Where a manufactured payment due under the arrangement is netted by book entry against a payment due in the opposite direction, then provided the offsetting amounts are each treated as paid for tax purposes, including for Schedule 23A, section 736B will not apply.

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<sup>5</sup> “Securities” for this purpose includes UK equities.

<sup>6</sup> Section 736B ICTA 1988 applies in relation to arrangements entered into on or after 1 July 1997.

<sup>7</sup> Legislation to be introduced by FB 2001, effective from 3 October 2000, will ensure that the deemed manufactured payment does not create a tax deduction for a borrower

- Where a payment is made under the arrangement that is clearly representative of a dividend or interest payment together with a stock lending fee section 736B will not then apply. Schedule 23A will apply, including paragraph 7 where appropriate.
- In any other case where a payment is calculated by taking into account more than one item, including a dividend or interest payment not received by the securities lender, it will be a question of fact whether the payment is representative of that dividend or interest or whether section 736B applies.

### ***Bondwashing***

4.4 **Section 731 ICTA 1988** (bondwashing) does not apply where the first buyer is required under the arrangements for the purchase of the securities (or is treated by Section 737A(5) ICTA 1988 as required) to make to the person from whom he purchased the securities, not later than the date on which he subsequently sells the securities, a payment of an amount representative of the dividends or interest on the securities<sup>8</sup>. Such a payment will be within Schedule 23A ICTA 1988 and there will accordingly have been no effective transfer of the income from seller to buyer for tax purposes.

4.5 **Section 732 ICTA 1988** (bondwashing - dealers in securities) does not apply<sup>9</sup> where the distribution is brought into account in computing the trading profits of the first buyer under Case I Schedule D in accordance with Section 95 ICTA 1988 (paragraphs 5.1 - 5.4 below).

### ***Repurchase Agreements***

4.6 **Section 737A ICTA 1988**<sup>10</sup> has the effect of deeming a manufactured dividend to be paid where, in a sale and repurchase arrangement which crosses a dividend

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<sup>8</sup> Section 731(2A) ICTA - with effect from 1 May 1995.

<sup>9</sup> Section 732 ICTA was disapplied in these circumstances in relation to distributions paid on or after 2 July 1997.

<sup>10</sup> Section 737A came into effect in relation to UK Equities with effect from 1 May 1995.

date the first buyer does not make a separate manufactured payment to the seller in respect of the dividend, but the repurchase price is reduced to reflect the dividend received by that buyer.

4.7 Where the section applies, Schedule 23A ICTA 1988 applies as if

- the relevant person (the first buyer in a simple repo) were required under the arrangements to pay an amount representative of the dividend;
- a payment were made by that person in discharge of that requirement; and
- the payment were made on the date the repurchase price of the securities becomes due.

4.8 Section 737A applies not only where the sale and repurchase are made under the same agreement, but also where they are made under related agreements. Agreements are “related” if they are entered into in pursuance of the same arrangement regardless of the date on which either agreement is entered into. This wording is much wider than that previously used in Section 729 ICTA 1988<sup>11</sup> (which referred to the same or any collateral agreement), and for instance prevents the parties avoiding the effects of the legislation by entering into the first agreement on day 1 and the second agreement on day 2.

### ***Powers of Inspection***

4.9 **Section 21 Taxes Management Act 1970.** In order to supervise the tax treatment of manufactured dividends the books and records of any person who carries on a business consisting in or involving any dealings in UK equities are subject to inspection by officers of the Inland Revenue under the powers granted by Section 21 TMA 1970<sup>12</sup>. The power is limited to those books and records, which in

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<sup>11</sup> Section 729 ICTA 1988 was not regarded as applying to approved stock lending arrangements, or where a manufactured dividend was within Schedule 23A ICTA 1988, and was repealed with effect from 6 November 1996 - SI 1996 No. 2646 (C.75).

<sup>12</sup> Section 21 TMA 1970 as amended by Paragraph 14 Schedule 10 FA 1997 applies to transactions entered into on or after 1 July 1997, and all manufactured payments made on or after that date.

the opinion of the Board contain or may contain information relating directly or indirectly to

- any transaction in shares,
- any transaction under which a manufactured payment has, will or may be made,

or

- the making or receipt of a manufactured payment.

Inspection visits will be made periodically.

## **5. Tax Treatment of manufactured dividends paid and received**

### ***Corporation Tax Treatment: Dealers***

5.1 Where a manufactured dividend is received or paid by a dealer the amount of the receipt or payment is taken into account in computing the Case I profit or loss<sup>13</sup>.

5.2 A person is a “dealer” for this purpose in relation to a distribution if, had that person sold the shares in respect of which the distribution was made, the proceeds of sale would be taken into account in computing the profits of his trade.

5.3 Companies (whether resident in the UK or not so resident but carrying on a trade through a branch or agency in the UK) should bring into the Case I computation the amount of distributions or manufactured dividends received or paid without addition for tax credits.

5.4 No real or manufactured dividend paid on or after 6 April 1999 can be used by the recipient to ‘frank’ ACT liability on dividends or manufactured dividends paid before this date<sup>14</sup>.

5.5 A recipient of manufactured or real dividends on which it is taxable by virtue of section 95 ICTA 1988 cannot use the receipts to reduce its shadow ACT<sup>15</sup>.

5.6 Payment of a manufactured dividend by a company does not give rise to shadow ACT.

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<sup>13</sup> Section 95 ICTA 1988 - as amended, applies to manufactured dividends representative of distributions made on or after 2 July 1997. Previously, Section 95 applied only to qualifying distributions within Schedule 7 FA 1997 and manufactured payments representative of such distributions

<sup>14</sup> Section 31(3) FA 98, and SI 1997 No. 993 regulation 2(2) - as amended by the manufactured dividends (Tax)(Amendment) regulations SI 1999 No. 621

<sup>15</sup> SI 1999 No.358 regulation 9

## ***Corporation Tax Treatment : non - dealers***

### ***a. Receipts***

5.7 Companies (whether resident in the UK or not so resident but carrying on a trade through a branch or agency in the UK) are not liable<sup>16</sup> to Corporation Tax on real and manufactured dividends received unless Section 95 ICTA 1988 applies (paragraphs 5.1 - 5.4 above).

5.8 Manufactured dividends paid or after 6 April 1999 can reduce the recipient's shadow ACT amounts in the same way as real dividends on the equities concerned. They **cannot** be used by the recipient to 'frank' ACT liability arising on dividends or manufactured dividends paid before 6 April 1999 (see paragraph 5.4 above).

5.9 However a stock borrower, or repo interim holder, cannot use receipts of real or manufactured dividends in respect of the borrowed or repo'd equities to reduce shadow ACT<sup>17</sup>, because they are not entitled to a tax credit in respect of the dividend or manufactured dividend<sup>18</sup>.

5.10 A repo original owner is also denied entitlement to a tax credit on manufactured dividends received from the interim holder if either

- the real dividends of which the manufactured dividends are representative are received by the original owner, or
- they are received by someone else, but not as a result of the repo.

### ***b. Payments***

5.11 Generally, no deduction is due for Corporation Tax purposes for manufactured dividends except where paragraph 5.1 applies. However, a company

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<sup>16</sup> Section 208 ICTA 1988.

<sup>17</sup> Section 231AA ICTA 1988

<sup>18</sup> Note that section 231AA ICTA 1988 operates from 8 April 1998. If the receipt was on or after 8 April 1998 and before 6 April 1999, the stock borrower/repo interim holder is not entitled to a tax credit (and therefore to use the receipt to 'frank' ACT liability), unless it pays a corresponding manufactured dividend before 6 April 1999, or is deemed to do so by virtue of section 737A or Section 736B ICTA 1988. See section 102(9) FA 98.

which is not resident in the UK may, exceptionally, be due a deduction under normal principles, for example in a Schedule D Case VI computation.

5.12 Payments of manufactured dividends by a company do not give rise to shadow ACT<sup>19</sup>.

### ***Income Tax Treatment: dealers***

5.13 Non-corporate dealers (see paragraph 5.2 above for a definition of 'dealer') should bring into the Case I computation the amount of distributions and manufactured dividends received, without addition for tax credits. See paragraph 5.14 below regarding the use of tax credits. Manufactured dividends paid for the purposes of a trade will be deductible in the case I computation.

### ***Income Tax Treatment : non - dealers***

#### ***a. Receipts***

5.14 Dividends and manufactured dividends received are subject to Income Tax. Any tax credits attaching to those dividends are available to set against the Income Tax liability. In some circumstances any surplus may be payable to a UK resident.

5.15 Income Tax liability arises under Schedule F and the normal Schedule F rules apply.

#### ***b. Payments***

5.16 Where the payer of a manufactured dividend is resident in the UK, but is not a company, and the payment is not otherwise deductible, for example in computing the profits of a trade under Section 95 ICTA 1988, then the amount of the manufactured dividend actually paid is allowable for Income Tax purposes as a deduction against total income<sup>20</sup>.

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<sup>19</sup> SI 1999 No. 358 regulation 11(2)(a)

<sup>20</sup> Paragraph 2A(1) Schedule 23A ICTA 1988.

## **6. Returns**

6.1 No payment or receipt of a manufactured dividend on UK equities paid on or after 6 April 1999 should be included in a CT 61 or SX1 return.

## **7. Vouchers**

7.1 The normal rule<sup>21</sup> is that when any person makes a payment of a manufactured dividend, that person must provide the recipient with a voucher showing the date of the payment, the amount of the manufactured dividend and the tax credit.

### ***Crest Settlement***

7.2 The normal rule that a voucher must be written by a dividend manufacturer is modified where the payment is made by way of a market claim through the CREST settlement system. In order to ease any administrative burden on the UK financial markets the voucher may in certain instances be written by the recipient of the manufactured dividend or his agent/custodian. The details are explained in separate notes on CREST claims.

7.3 The notes on CREST claims were last published as Appendix A in the January 1998 version of these notes. In turn this appendix was the text of a paper on market claims and vouchers issued to CREST participants in 1997. The current notes are a slightly modified version of the original, which reflects the abolition of Foreign Income Dividends with effect from 6 April 1999.

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<sup>21</sup> Section 234A(7) ICTA 1988 for UK resident companies, and Paragraph 2(7) Schedule 23A ICTA 1988 for other dividend manufacturers.