



# **Manufactured Payments on Overseas Securities**

## **Guidance Notes**

**April 2001**

**Revenue Policy, Business Tax**

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## 1. Introduction

1.1 These Notes are to help

- approved UK intermediaries,
- those acting as custodians of overseas securities and agents of overseas securities lenders
- others who pay or receive manufactured overseas dividends

to comply with their obligations under the Regulations in SI 1993 No. 2004 about tax on manufactured overseas dividends. Further copies are available from the Inland Revenue website at [www.inrev.gov.uk](http://www.inrev.gov.uk), or contact David Edney at

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1.2 There have been substantial changes to the manufactured overseas dividend regime since the first issue of Guidance Notes in April 1995. The main text in these notes explains legislation that applies currently. Footnotes set out where legislation was different in the past.

1.3 You can get further advice from the City B Large Business Office helpdesk. The address for this is City B LBO, City Gate House, Finsbury Square, London EC2A 1BT. Tel: 020 7330 9834/9383.

**\* 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. Scope of Legislation

- 2.1 The manufactured overseas dividend legislation imposes obligations to account for relevant withholding tax on payments or receipts representing dividends on overseas equities<sup>1</sup>.
- 2.2 It also has rules about how receipts and payments of manufactured payments are taxed and relieved These cover both payments representing dividends on overseas equities and payments representing interest on overseas debt securities<sup>2</sup>.
- 2.3 These notes explain the rules. They also (see chapter 5) describe briefly other related legislation about stocklending and repurchase (repo) transactions.

<sup>1</sup> Prior to 6 November 1996 there was also a requirement to withhold tax on manufactured payments representing overseas interest. SI 1996 No. 2643 removed any requirement to withhold tax from payments representing interest on overseas loan relationships. This followed the introduction of the loan relationships legislation in FA 1996

Note that the obligations are unaffected by the introduction of section 349A into ICTA 1988 proposed in FB2001.

<sup>2</sup> Prior to 1 April 2001 collecting agents may also have had to deduct income tax on receipts representing overseas dividends or interest under regulation 12 SI 1993 No. 2004. This applied the collecting agents rules of Chapter XVIIIA of Part 4 of ICTA 1988. Regulation 12 ceased to have effect from 1 April 2001. This was by virtue of the repeal of paragraph 4(8) of Schedule 23A ICTA 88 by Sch 40 (17) FA 2000.

### **3. Terms Used in these Notes**

#### ***The Regulations***

- 3.1 The "Regulations" are the regulations in SI 1993 No. 2004 (as amended) unless otherwise stated.
- 3.2 The "Double Taxation Relief Regulations" are the Double Taxation Relief (Taxes on Income) (General) (Manufactured Overseas Dividends) Regulations 1993 SI 1993 No. 1957.

#### ***Overseas Dividends and Overseas Securities***

- 3.3 "Overseas dividend" means any interest, dividend or other annual payment payable in respect of any overseas securities.
- 3.4 "Overseas securities" are shares, stock or other securities issued by a government or public or local authority of a territory outside the United Kingdom or by any other body of persons not resident in the United Kingdom<sup>3</sup>

#### ***Approved UK Intermediaries and Approved UK Collecting Agents***

- 3.5 Concerns may be approved as intermediaries or collecting agents under the Regulations<sup>4</sup>. Approved UK intermediaries are expected to be financial traders, but all applications for approval will be treated on their merits. Approved UK collecting agents must carry on a trade in the UK that involved collecting or securing payment of overseas dividends, or be a custodian of securities<sup>5</sup>.

<sup>3</sup> until 1 April 2001, quoted Eurobonds, within the meaning of S124 ICTA 1988, held in a recognised clearing system were also overseas securities. There were five Recognised Clearing Systems - Cedel, Euroclear, European Settlements Office, Depository Trust Co. of New York and First Chicago Clearing Centre. Paragraph 17 of Schedule 40 FA 2000 amended the definition of UK securities from 1 April 2001 so that after this date eurobonds issued by UK companies and bodies are UK securities.

<sup>4</sup> Prior to 28 May 1996 intermediaries or collecting agents were approved under the Stock Lending regulations: SI 1989 No 1299. SI 1996 No 1229 amended SI 1993 No 2004.

- 3.6 AUKIs will be subject to audit by City B Large Business Office and AUKCAs by the Financial Intermediaries and Claims Office (FICO).
- 3.7 Concerns wishing to become approved UK intermediaries or approved UK collecting agents should complete the appropriate undertaking at Appendix G and send it to City B LBO (see paragraph 1.3 above for the address).

### ***Manufactured Overseas Dividends***

#### ***General Definition***

- 3.8 A manufactured overseas dividend is any payment, made under a contract or other arrangements for the transfer of overseas securities, which is representative of a dividend or interest on those overseas securities. For example,
- where a loan of overseas securities is outstanding over a dividend date, and the lender does not receive the real dividend to which he would have been entitled had the securities 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 overseas dividend.
  - Similarly, where a cum dividend short sale of overseas securities 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 overseas 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 overseas dividend (and see paragraph 5.5 below as regards deemed manufactured overseas dividends in certain repo transactions).
- 3.9 But where a recipient is simply passing on a real overseas dividend to which he is not beneficially entitled, for example,

<sup>5</sup> SI 2001 No.403 inserted the definition of collecting agent into regulation 1 of SI 1993 No.2004, from 1 April 2001. Previously an AUCKA had to be a collecting agent within the definition of chapter XVIIIA of part IV of ICTA 1988.

- 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 (and see paragraph 3.14 below regarding the status of the payer).

### ***Scrip Dividends and Bonus Issues***

3.10 Where, instead of paying a dividend, an overseas company issues new share capital in respect of existing shares then, subject to the domestic law of the country of the issuer, that would not normally constitute the payment of a dividend. Thus, where during the term of a repo there is a scrip or bonus issue of shares and the repo buyer acquires and delivers the equivalent number of shares to the repo seller, there is no liability to account for relevant withholding tax on the delivery. Where, however, the domestic law of the country of the issuer treats the issue of new shares as a dividend (and a good indication of this is that withholding tax is levied on the value of the share entitlement), then relevant withholding tax will similarly be due.

3.11 Where a company declares a cash dividend and satisfies that dividend by the issue of shares (ie where the shareholder effectively uses or is obliged to use the cash dividend to subscribe for additional shares), the manufacturer should account for the appropriate amount of tax on the amount of the cash dividend. This would apply for instance to dividend reinvestment plans (DRIPS).

### ***Depository Receipts***

3.12 Where securities are held in a depository and a depository receipt is issued it is necessary to look through the receipt to the underlying securities. 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 overseas securities, that payment will be a manufactured overseas dividend. Similarly, in the case of stapled stock or a depository receipt representing more than one type of security, it is necessary to determine which underlying security has paid a dividend and treat the representative payment accordingly (apportioning the payment if need be).

***“Equivalent” manufactured overseas dividends***

3.13 In this note "equivalent" overseas dividends and manufactured overseas dividends means dividends and manufactured dividends paid in respect of overseas securities of a particular kind, in respect of a particular dividend date.

***Payer and Recipient of Manufactured Overseas Dividends – Principal and Agent***

3.14 A person who manufactures a dividend under a contract or other arrangements for the transfer of overseas securities may be liable to account for tax under the manufactured overseas dividends rules. To manufacture a dividend that person must be acting as a principal. This is because an agent is, in the main, transparent for tax purposes so that the actions of the agent are those of his client. The result is that:

- (a) liability may arise whenever an intermediary, acting as principal, pays a manufactured overseas dividend even though that intermediary is "flat" in respect of the particular transaction giving rise to the manufactured dividend, (but see chapters 13 and 14 below as regards the off-setting of tax suffered against that liability);
- (b) concerns acting as agent will need to be able to show that they are not acting as principal in the transaction.

3.15 On occasion, however, there is liability on an agent acting as such. For the purposes of this note the relevant occasions are

- (a) Paragraph 4(3) Schedule 23A ICTA 1988 - see paragraph 4.4;
- (b) Regulation 4(3) SI 1993 No. 2004 - see chapter 8.

## **4. Statutory Background - Schedule 23A ICTA 1988**

- 4.1 Schedule 23A ICTA 1988 imposes a liability to identify, and account for tax on, manufactured overseas dividends. The legislation came into effect for manufactured overseas dividends on 22 April 1993. Schedule 23A, however, provides only a basic framework for accounting for tax. The Regulations supplement this primary legislation from 1 October 1993 and set out detailed rules.
- 4.2 Schedule 23A and the Regulations apply to all persons who manufacture dividends on overseas securities, and whether or not the manufactured dividends arise from stock lending transactions.
- 4.3 Under Paragraph 4(2) of Schedule 23A ICTA 1988 the payer of a manufactured overseas dividend is treated as making an annual payment from which income tax is to be deducted and accounted for to the Revenue. The Regulations, however, modify this basic approach in certain instances. They also provide the detailed rules governing the rate at which tax should be deducted and the method of accounting for tax.
- 4.4 Paragraph 4(3) of Schedule 23A imposes a charge (the so called reverse charge) on the UK recipient of a manufactured overseas dividend where the manufacturer is not resident in the UK (and does not make the payment in the course of a trade carried on through a branch or agency in the UK) and therefore cannot be taxed directly under Paragraph 4(2) Schedule 23A. The amount of the charge on the recipient is the amount which would have been accountable under Paragraph 4(2) had the manufacturer been resident in the UK. "UK recipient"<sup>6</sup> includes not only any UK resident person but also a non resident who receives the manufactured overseas dividend for the purposes of a trade carried on through a branch or agency in the UK.
- 4.5 Paragraph 4(4) Schedule 23A applies to the UK recipient of a manufactured overseas dividend. It provides that the recipient be treated for tax purposes as receiving a real overseas dividend, of an amount equal to the "gross amount" of the manufactured overseas dividend, but paid after deduction of overseas tax of the amount accounted for by the payer under Paragraph 4(2) Schedule 23A or by the recipient under Paragraph 4(3) Schedule 23A. Again, the Regulations set out the detailed rules. For the meaning of "gross amount" see paragraph 7.5 below.

<sup>6</sup> Words in Paragraph 4(3) substituted and sub-paragraphs (3A) and (3B) inserted by Section 159(4),(5) and (9) FA 1996 with effect from accounting periods ending after 31 March 1996 for Corporation Tax purposes, and with effect from 1996/7 for Income Tax purposes.

- 4.6 For an overseas recipient a manufactured overseas dividend may represent "other income" for the purposes of UK double taxation agreements.
- 4.7 <sup>7</sup>Paragraph 7 Schedule 23A contains an anti-avoidance provision which applies where the amount paid by way of a manufactured overseas dividend plus the tax to be accounted for on that payment, exceeds the gross amount of the equivalent real overseas dividend. The excess is for all purposes regarded not as a manufactured overseas dividend, or part of a manufactured overseas dividend, but as a separate fee for entering into the arrangements. The normal tax rules for both payer and recipient will apply to the fee.
- 4.8 Conversely, where the amount of a manufactured overseas dividend paid, plus the tax accountable in respect of that payment (if any), is less than the gross amount of the real overseas dividend, relief for the payer is limited to the amount of the payment plus the amount of the tax (if any).
- 4.9 Paragraph 7 does not, however, apply<sup>8</sup> for Corporation Tax purposes to a manufactured overseas dividend in respect of interest on an overseas security which represents a loan relationship (see paragraph 21.1 below).

<sup>7</sup> Prior to its repeal from 1 April 2001 Para 4(8) provided authority for rules requiring collecting agents to deduct income tax from manufactured overseas dividend receipts in the same way as they would from a real overseas dividend

Paragraph 5 Schedule 23A dealt with interest and dividends passing through the market. It ceased to apply in relation to overseas securities on 6 November 1996. It has now been repealed.

Paragraph 6 Schedule 23A denied tax relief to the payer of an unapproved manufactured overseas dividend for any tax that it had to deduct. It ceased to apply to manufactured overseas dividends on 28 May 1996 (SI 1996 No 1229) and was repealed entirely from 1 July 1997.

<sup>8</sup> Paragraph 7(1A) Schedule 23A ICTA 1988 - with effect for Corporation Tax purposes from accounting periods ending after 31 March 1996.

## 5. Other relevant legislation

### *Bondwashing*

- 5.1 **Section 731 ICTA 1988** (bondwashing) does not apply<sup>9</sup> 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. 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.
- 5.2 **Section 732 ICTA 1988** (bondwashing - dealers in securities) does not apply where the distribution is brought into account in computing the trading profits of the first buyer under Case I Schedule D provided, where credit for foreign tax falls to be allowed, the first buyer elects that credit should not be so allowed. Where the tax is not subject to the offsetting and matching rules (chapters 13 to 15 below) and an election has been made, S811 ICTA will apply.

### *Stock Lending*

- 5.3 **Section 263B TCGA 1992** ensures that acquisitions and disposals under stock loans are disregarded for Capital Gains Tax purposes<sup>10</sup>. 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.
- 5.4 **Section 736B ICTA 1988** applies where, as a result of a stock lending arrangement, a dividend or interest on any securities<sup>11</sup> is paid to a person other than the lender but no provision is made for a manufactured payment to be paid to the lender by way of compensation. A stock lending arrangement includes arrangements for the transfer of securities other than by way of sale where a requirement is imposed on the borrower to transfer those (or equivalent) securities back to the lender otherwise than by way of sale<sup>12</sup>.

<sup>9</sup> Section 731(2A) ICTA 1988 - with effect from 1 May 1995.

<sup>10</sup> Section 263B TCGA 1992 replaced section 129 ICTA 1988 and s271(9) TCGA 1992, and a regime involving Inland Revenue approval of stocklending arrangements and the parties to them, from 1 July 1997.

<sup>11</sup> "Securities" for this purpose includes all overseas securities, both bonds and equities.

In these circumstances Section 736B 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>13</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.
- 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 to the sum and paragraph 7 of Schedule 23A may be applicable.
- 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.

### ***Sale and Repurchase Arrangements***

5.5 **Section 737A ICTA 1988**<sup>14</sup> has the effect of deeming a manufactured overseas dividend to be paid where, in a sale and repurchase arrangement which crosses a dividend 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.

5.6 Where the section applies, Schedule 23A and the dividend manufacturing regulations apply as if

<sup>12</sup> Section 263B TCGA 1992. N.B. where the transfers are by way of sale, section 737A may apply.

<sup>13</sup> Section 736B ICTA 1988 applies in relation to arrangements entered into on or after 1 July 1997. Legislation, taking effect from 3 October 2000, included in Finance Bill 2001, ensures that the deemed payment does not create a tax deduction for the borrower

<sup>14</sup> S737A came into effect in relation to overseas securities with effect from 6 November 1996 - SI 1996 No. 2645 (C.74).

- 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.

5.7 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<sup>15</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.

5.8 In these Notes “manufactured overseas dividend” includes a deemed dividend under Sections 737A<sup>16</sup> or 736B .

<sup>15</sup> Section 729 ICTA 1988 was not regarded as applying to approved stock lending arrangements, or where a manufactured overseas dividend was within Schedule 23A ICTA 1988, and was repealed with effect from 6 November 1996 - SI 1996 No. 2646 (C.75).

<sup>16</sup> Note that regulation 12, prior to it ceasing to have effect on 1 April 2001, did not apply to deemed manufactured overseas dividends under section 736B or section 737A.

## **6. Manufactured Overseas Dividends paid in connection with Loan Relationships (Regulation 2B)**

- 6.1 There is no liability on a manufacturer to account for tax on a manufactured overseas dividend which is representative of a dividend on an overseas security that in turn represents a loan relationship<sup>17</sup>. Therefore, the references to overseas securities in chapters 7 to 18 below do not include securities representative of loan relationships, and **those paragraphs are concerned only with manufactured overseas dividends in respect of dividends on overseas equities.**
- 6.2 An overseas security represents a loan relationship if a company holding that security would have a loan relationship within the meaning of Section 81 FA 1996. A company has a loan relationship whenever it stands in the position of creditor or debtor as respects any money debt and that debt is one arising from a transaction for the lending of money<sup>18</sup>. Debt securities accordingly represent loan relationships and this will include, for example, convertible debt securities (which, along with other special cases, are given particular treatment in the loan relationship legislation)<sup>19</sup>.

<sup>17</sup> SI 1996 No. 2643 - with effect from 6 November 1996.

<sup>18</sup> Where an instrument is issued for the purpose of representing security for, or the rights of a creditor in respect of, any money debt, that debt is taken to be a debt arising from the lending of money (Section 81(3) FA 1996).

<sup>19</sup> Section 92 FA 1996.

## **7. The rate of withholding tax (Regulation 3)**

### ***General Rule***

- 7.1 Loan relationships apart, the working rule is that an amount on account of income tax should be deducted from the gross amount of a manufactured overseas dividend at the highest rate at which tax would have been payable (and not repayable) to the relevant overseas fisc on a real dividend paid to a recipient in the UK who is subject to UK tax on such a dividend received. That notional recipient is assumed not to be trading outside the UK through a branch or agency, and to have no special relationship with the payer or any other person. Where a double taxation agreement differentiates between a "portfolio" investor and an investor with a substantial holding, the normal effect is that it is the rate applicable to the portfolio investor which is relevant.
- 7.2 Where any particular UK recipient of a manufactured overseas dividend would, exceptionally, have received the real dividend without suffering withholding tax because of some special provision of either the domestic legislation of the country of the issuer of the securities or of the double tax treaty with the UK, tax nevertheless falls to be accounted for on the manufactured payment at the prescribed rate. The rate is determined according to the rate applicable to the particular relevant dividend.
- 7.3 The rate of relevant withholding tax is determined on the basis that all possible reclaims have been made under any relevant UK double taxation agreement.
- 7.4 A list of rates of relevant withholding tax is included at Appendix B. This list will be updated from time to time, but it is not guaranteed to be accurate at any particular time and so dividend manufacturers should take their own steps to ensure that they apply the rates current at the date of payment.
- 7.5 The "gross amount" of a manufactured overseas dividend is defined at Paragraph 4(5)(b) and (c) Schedule 23A ICTA 1988 as equal to the gross amount of the real overseas dividend, including both overseas tax withheld and the amount of any overseas tax credit attaching to that real dividend.

### ***'Domestic to Domestic' Rule***

7.6 There is a different rule, however, where a manufactured overseas dividend is paid to, or for the benefit of,

- ◆ an individual who is beneficially entitled to that dividend and who is resident in a territory outside the UK, or
- ◆ a company not resident in the UK which is beneficially entitled to that dividend and whose central management and control is in a territory outside the UK,

provided the relevant securities were issued by the government or public or local authority of that territory or by a resident of that territory (the "domestic to domestic" situation). In such a case, tax should be deducted at the rate which would have applied to a real dividend paid to that recipient in respect of those securities.

7.7 The "domestic to domestic" rate does **not** apply if there is a double taxation agreement between the UK and the relevant territory and that agreement contains an "other income article". The domestic to domestic rule is intended to provide an alternative rate only where it is not possible to enter into arrangements, based on the existence of an "other income article", under which payments to non-UK residents may be made without accounting for tax (see chapter 9).

### ***Payments which can be made without accounting for tax***

7.8 The requirement to deduct and account for tax on payment of a manufactured overseas dividend under Paragraph 4(2) Schedule 23A is lifted in three circumstances. The first is set out in regulation 4 of SI 1993 No 2004 and the other two in regulation 5.

## **8. Payments to Approved UK Intermediaries or Approved UK Collecting Agents (Regulation 4)**

### ***Non-AUKI pays to AUKI/AUKCA***

8.1 The first of the circumstances in which there is no liability to deduct and account for tax is where a manufactured overseas dividend is paid either to an approved UK intermediary or to an approved UK collecting agent by an overseas dividend manufacturer who:

- (a) is resident in the UK (or if not resident in the UK, makes the payment in the course of a trade carried on in the UK), and
- (b) is not an approved UK intermediary,

#### **Unless**

the payer receives the real overseas dividend of which the manufactured overseas dividend is representative<sup>20</sup> (see paragraph 8.5 below).

### ***Charge on AUKI/AUKCA where payer does not deduct tax***

8.2 Where the non-AUKI payer does not deduct tax from the MOD, the approved UK intermediary or collecting agent who receives the MOD has to account for the relevant withholding tax. This is under Regulation 4(3).

8.3 There is, however, no requirement for the approved UK intermediary or collecting agent to account for tax on the receipt under Regulation 4(3) where that intermediary or agent in turn pays on an equivalent manufactured overseas dividend and

- (a) the intermediary is entitled to pay without accounting for tax under Regulation 5 (see chapter 9 below), or
- (b) the intermediary will account on payment for tax at the “domestic to domestic” rate (paragraph 7.6 above);

<sup>20</sup> Regulation 4 SI 1997 No. 988 with effect from 1 July 1997.

- (c) the collecting agent is entitled to pay without accounting for tax because it has entered into arrangements with the Board under the Double Taxation Relief Regulations enabling it to pay without accounting for tax, or
- (d) the collecting agent is entitled to pay without accounting for tax because he is paying on to an approved UK intermediary who has issued a Notice under Regulation 4(4)(c) to the collecting agent. An approved UK intermediary may issue a Notice under Regulation 4(4)(c) if that intermediary is entitled to pay gross under Regulation 5. See Chapter 9

8.4 A specimen Notice under Regulation 4(4)(c) is provided in Appendix C. This form also covers Notices under Regulation 5(2)(b)(iii) (see paragraph 9.4) and Regulation 7(2)(d) (see chapter 12).

<b><i>Non-AUKI receives real dividend</i></b>
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8.5 The exception to the gross payment rule in paragraph 8.1 above caters for the situation where the overseas dividend manufacturer receives the real overseas dividend. The manufacturer has to account for tax on the manufactured overseas dividend but, under Regulation 9A (chapter 14 below), is able to set the overseas tax deducted from the real overseas dividend against his liability. The manufacturer is not then in the position of having to pay gross out of a net receipt.

## **9. Manufactured Overseas Dividends Paid To Residents Outside the UK (Regulation 5)**

### ***AUKI pays to Treaty Country Resident***

- 9.1 The second, and in practice possibly the most important, circumstance in which payment may be made without accounting for tax is where a manufactured overseas dividend is paid by an approved UK intermediary and that intermediary has entered into arrangements with the Board under the Double Taxation Relief Regulations enabling him to pay gross.
- 9.2 The procedure for entering into arrangements with the Board under the Double Taxation Relief Regulations is set out in Appendix D attached. This covers the MOD 1 and MOD 2 forms.

### ***AUKI pays to AUKI or AUKCA who pays on in a chain ending with gross payment under a MOD 2 or payment under the 'domestic to domestic' rule***

- 9.3 The third circumstance in which a payment may be made without accounting for tax is where an approved UK intermediary or approved UK collecting agent is the last payer in a chain of payments in the UK and it
- (a) has entered into arrangements with the Board under the Double Taxation Relief Regulations covering a payment which it is to make (paragraph 9.1 above), or
  - (b) will account for tax at the “domestic to domestic”<sup>21</sup> rate (paragraph 7.6 above)
- 9.4 In either case, it may issue a Notice (a Notice under Regulation 5(2)(b)(iii)) to another approved UK intermediary or to an approved UK collecting agent, in turn authorising payment without accounting for tax.
- 9.5 Each intermediary or collecting agent in a chain may similarly issue Regulation 5(2)(b)(iii) Notices, provided each payment along that chain is made by an approved UK intermediary or collecting agent and is an equivalent payment. The recipient of a Regulation 5(2)(b)(iii) Notice may act on the basis of that Notice without knowledge of the chain as a whole.

<sup>21</sup> SI 1996 No. 2643 - with effect from 6 November 1996.

9.6 A specimen Notice under Regulation 5(2)(b)(iii) is provided at Appendix C (This form is provided to cover Notices issued under Regulation 4(4)(c), Regulation 5(2)(b)(iii) and (see chapter 12) Regulation 7(2)(d).)

## **10. Retention and Record of Notices Given under Regulations 4 and 5 (Regulation 6)**

10.1 Regulation 6 details the records to be kept in respect of Notices issued by approved UK intermediaries under Regulation 4(4)(c) or under Regulation 5(2)(b)(iii) and Notices issued by approved UK collecting agents under Regulation 5(2)(b)(iii).

10.2 Recipients of such Notices should retain them for six years. The Notices should be kept available for inspection. If more than one Notice is received in any chargeable period a record must be maintained showing:

- (a) the date of each Notice;
- (b) a description and the amount of the manufactured overseas dividend referred to in each Notice.

This record must be retained for a period of six years from the end of the chargeable period to which the record relates.

10.3 In the same way, the issuer of a Notice must keep a copy of each Notice and, where more than one Notice is issued, a similar record as in paragraph 10.2 above. Again, copy Notices and the necessary record should be retained, available for inspection, for six years.

10.4 If the issuer fails to retain copies of Notices or fails to keep the necessary records an audit may be carried out at that person's expense, of manufactured overseas dividends received, to ascertain whether there has been any loss of tax accountable under Paragraph 4(2) Schedule 23A ICTA 1988. If there has been a loss of tax the issuer is liable to make good that loss plus interest from the due date.

10.5 The scope and method of any necessary audit will normally be agreed with the issuer. A full audit is expected to be needed very rarely. Rather, minor differences in the records will be addressed in a pragmatic way with due regard to the full circumstances, in particular the likely loss of tax compared with the costs of investigation. In serious cases, however, the Board of Inland Revenue has the power, in default of agreement, to determine what auditing should be carried out.

## **11. Reduction of tax payable under Paragraph 4(3) Schedule 23A (Regulation 6A)**

- 11.1 Regulation 6A caters for the situation where overseas tax (under the rules of an overseas fisc) has been deducted from a manufactured overseas dividend and a reverse charge (paragraph 4.4 above) arises on the UK recipient. To impose a full reverse charge where overseas tax has been deducted would leave the UK recipient worse off than if he had received the real dividend (after overseas tax) of which the manufactured payment is representative. The charge is therefore reduced accordingly<sup>22</sup>.
- 11.2 Where the amount (that is, the actual cash rather than the rate) of the manufactured overseas dividend received by the UK recipient exceeds the amount he would have received had he received the real overseas dividend the reverse charge is reduced to the amount of the excess, so leaving him the same in cash terms as if he had received the real dividend.
- 11.3 Where the amount of the manufactured overseas dividend received by the UK recipient is equal to or less than the amount he would have received had he received the real overseas dividend the reverse charge is reduced to nil.
- 11.4 Double taxation relief (other than relief under Section 811 ICTA 1988) is limited to the reduced amount of the reverse charge plus the overseas tax suffered on the manufactured overseas dividend (but see paragraph 13.5 below as regards the consequences of offsetting under Regulation 9).

<sup>22</sup> SI 1996 No. 2643 - with effect from 6 November 1996.

## **12. Disapplication of Paragraph 4(3) Schedule 23A ICTA 1988 (Regulation 7)**

- 12.1 Regulation 7 completely disapplies the reverse charge under Paragraph 4(3) Schedule 23A on payments received from abroad in five situations.

### ***AUKI recipient pays on gross***

- 12.2 The first is where the recipient in the UK is an approved UK intermediary who is paying on an equivalent manufactured overseas dividend, and is entitled to make that payment without accounting for tax. The intermediary will be entitled to pay gross in this way if the intermediary has entered into arrangements with the Board under the Double Taxation Relief Regulations covering that payment or is in receipt of a Notice under Regulation 5(2)(b)(iii), (chapter 9 above).

### ***AUKI recipient pays at domestic to domestic rate***

- 12.3 The second is where the UK recipient is an approved UK intermediary who is paying on an equivalent manufactured overseas dividend and Regulation 3(4) applies (see paragraph 7.4 above). Paragraph 4(3) is disapplied whether the “domestic to domestic” rate is zero or not.

### ***AUKCA receiving on behalf of non-resident***

- 12.4 The third is where the UK recipient is an approved UK collecting agent who receives the manufactured overseas dividend on behalf of a beneficial owner who is not resident in the UK. The collecting agent will require appropriate evidence that the beneficial owner is not UK resident; this will be equivalent to the declarations (forms CA1 and CA2) used prior to 1 April 2001 for the purposes of the foreign dividend collecting agent rules in Chapter VIIA, Part IV, ICTA 1988.

### ***AUKCA recipient entitled to pay on gross to AUKI***

- 12.5 The fourth is where the UK recipient is an approved UK collecting agent required to pay on an equivalent manufactured overseas dividend to an approved UK intermediary. Provided the approved UK intermediary is in turn entitled to pay on without accounting for tax (as in paragraph 12.2 above) he may issue a Notice (a Regulation 7(2)(d) Notice) to the approved UK collecting agent authorising the collecting agent to make payment to the intermediary without deduction of tax. There is then no charge on the approved UK collecting agent under Paragraph 4(3).
- 12.6 A specimen Notice under Regulation 7(2)(d) is provided at Appendix C. (A single form is provided to cover Notices issued under Regulation 4(4)(c), Regulation 5(2)(b)(iii) or Regulation 7(2)(d).)

### ***Overseas Manufacturer receives real dividend***

- 12.7 The fifth<sup>23</sup> is where the UK recipient is an approved UK collecting agent or an approved UK intermediary who can show that the overseas dividend manufacturer was entitled:
- (a) to payment of the overseas dividend as holder of the overseas securities, or
  - (b) to payment of the overseas dividend directly or indirectly from a person from whom he acquired the overseas securities, or to whom he transferred them, and who was entitled to the payment as holder of the securities
- 12.8 A UK recipient who is beneficially entitled to the manufactured overseas dividend in this circumstance is treated for the purposes of Paragraph 4(4) Schedule 23A (see paragraph 3.5 above) as receiving a manufactured overseas dividend on which the reverse charge has been accounted for and paid. But the amount of the overseas tax which is deemed to have been deducted is limited to the excess of the gross amount of the real overseas dividend over the amount actually received by the overseas dividend manufacturer<sup>24</sup>.
- 12.9 Where no overseas tax at all is deducted from the real overseas dividend, for example because it is paid to a resident of the country of issue of the overseas securities, then no double taxation relief or relief under the offsetting provisions for approved UK intermediaries (chapter 13 below) is given to the UK recipient.
- 12.10 An approved intermediary or collecting agent will normally need to secure an original voucher to demonstrate the condition in paragraph 12.7 above is satisfied or to substantiate any claim that overseas tax has been paid in respect of a dividend received, although where an overseas fiscal authority accepts other documentation as sufficient evidence to substantiate a repayment claim against it, the Inland Revenue will consider whether it too should accept that documentation.
- 12.11 Also, where original vouchers are retained by overseas agents to process treaty reclaims on behalf of UK clients, individual cases will be considered on their merits. For example, copies of the claims to the overseas fiscal authority and the payment advices issued by it may provide acceptable evidence of overseas tax paid.

<sup>23</sup> SI 1996 No. 2643 - with effect from 6 November 1996. Prior to that date Paragraph 5 Schedule 23A ICTA 1988 provided relief in respect of registered securities only. The new relief covers both registered and bearer securities but does not extend (unlike Paragraph 5 Schedule 23A) to the case where the overseas dividend manufacturer repos or on-lends the securities so that he is not entitled to payment of the real overseas dividend .

<sup>24</sup> Regulation 5 SI 1997 No. 988 - with effect from 1 July 1997.

- 12.12 Advice notes of money payments issued electronically, or any other form of notice, will not be acceptable except where it can be demonstrated that:
- (a) the advice note relates to a physical holding with an overseas custodian or a physical holding in a depot account, at the record date, and
  - (b) the claimant remained entitled to the dividend on that holding as beneficial owner.
- 12.13 Advice notes in respect of dividends receivable or received from a selling counterparty, even if issued by a clearance or settlement system, will not be acceptable except where the counterparty is an approved UK intermediary.

***Record Keeping where paragraph 4(3) is disapplied***

- 12.14 Both approved UK intermediaries and collecting agents must keep a record of all manufactured overseas dividends in respect of which Paragraph 4(3) Schedule 23A has been disapplied by Regulation 7. The record should include a description and the amount of each dividend, the date it was received and the total amount of such dividends received in the period.
- 12.15 Where paragraph 12.3 or paragraph 12.4 above applies the approved UK intermediary or collecting agent as the case may be must in addition keep a record of the equivalent dividends paid on. That record must include a description and the amount of each payment, the date of the payment, the name and address of the person beneficially entitled to the payment and the total amount of such payments.
- 12.16 An approved UK collecting agent must keep any Notices received under Regulation 7(2)(d) and where more than one such Notice is received in a chargeable period must also maintain a record showing
- (a) the date of each Notice;
  - (b) a description and the amount of the manufactured overseas dividend referred to in each Notice.
- 12.17 Records required by Regulation 7 should be retained for a period of six years from the end of the relevant period to which they relate and should be available for inspection during that time. Similarly, Notices received under Regulation 7(2)(d) should be kept, available for inspection, for six years. Once again, where the necessary records or Notices are not kept there are provisions for an audit to be carried out. The same

considerations apply to the intermediary or collecting agent as to the issuer in paragraphs 10.4 and 10.5 above.

## 13. Offsetting of Tax by Approved UK Intermediaries (Regulation 9)

- 13.1 Regulation 9 entitles an approved UK intermediary to set-off tax suffered on certain real and manufactured overseas dividends received, against the tax that intermediary is liable to pay under Paragraph 4(2) Schedule 23A in respect of manufactured overseas dividends paid.
- 13.2 Subject to paragraph 13.4 below, the tax suffered on receipts which is eligible for set-off is
- (a) overseas tax in respect of real overseas dividends;
  - (b) overseas tax in respect of manufactured overseas dividends<sup>25</sup>;
  - (c) tax deducted under Paragraph 4(2) from manufactured overseas dividends;
  - (d) tax accountable under Paragraph 4(3) Schedule 23A;
  - (e) tax accountable under Regulation 4(3).
- 13.3 The amount of overseas tax available for set-off under Regulation 9 in respect of any particular overseas dividend or manufactured overseas dividend is the overseas tax payable after all possible reclaims have been made under any relevant UK double taxation agreement.
- 13.4 No offsetting is allowed, however, where real or manufactured overseas dividends received have been matched with manufactured overseas dividends paid under the provisions of Regulation 10 (see chapter 15 below) except where such dividends are received net of eligible tax (paragraph 13.2 above) and have been matched with payments made under deduction of tax (net against net). In these circumstances, Regulation 9(3) and (4) effectively create separate “sub-pools” for offsetting tax on net receipts matched with net payments. Where Regulation 9(3) applies, tax on the real and manufactured overseas dividends received can be set-off only against tax on the matched overseas dividends paid; any excess may not flow over against the tax due on other payments (either in the main Regulation 9 offsetting pool or other

<sup>25</sup> Overseas tax on manufactured overseas dividends is catered for in Regulations 9 and 10 with effect from 6 November 1996 - SI 1996 No. 2643.

Regulation 9(3) “sub-pools”). No part of any tax suffered on receipts matched under Regulation 10 and offset under Regulation 9(4) qualifies for double taxation relief.

13.5 The consequences of offsetting are that:

- (a) double taxation relief may be claimed only to the extent that tax within paragraph 13.2 above on receipts (excluding receipts within paragraph 13.4 above) exceeds tax due under Paragraph 4(2) Schedule 23A on payments made;
- (b) tax is payable only to the extent that the amount due under Paragraph 4(2) Schedule 23A exceeds tax within paragraph 13.2 above on receipts.

13.6 Real or manufactured overseas dividends received in respect of overseas securities, a profit on sale on which would not be a trading receipt, are excluded from the offsetting process of Regulation 9. For example, where shares in an overseas subsidiary company are held otherwise than on trading account, overseas dividends received in respect of those shares will not enter the offsetting process of Regulation 9. Similarly, tax suffered on overseas dividends received on behalf of other persons will not go into the offsetting process.

## **14. Offsetting of Tax by dividend manufacturers who are not Approved UK Intermediaries (Regulation 9A)**

- 14.1 Regulation 9A entitles a person who is not an approved UK intermediary to set-off overseas tax suffered on real overseas dividends received, against the tax that person is liable to pay under Paragraph 4(2) Schedule 23A ICTA 1988 in respect of manufactured overseas dividends paid which are representative of those real overseas dividends received<sup>26</sup> (and see paragraph 8.5 above).
- 14.2 Double taxation relief is not available in respect of overseas tax which is set-off under this provision.

<sup>26</sup> Regulation 7 SI 1997 No. 988 which inserted a new Regulation 9A with effect from 1 July 1997.

## **15. Matching of dividends and manufactured overseas dividends (Regulation 10)**

- 15.1 Regulation 10 provides the identification rules under which real and manufactured overseas dividends received are matched with their equivalent manufactured overseas dividends paid for the purpose of identifying overseas dividends and manufactured overseas dividends which are effectively passing through the market. The intention is that tax credits attached to such overseas dividends or manufactured overseas dividends should similarly flow through to the final beneficial recipient.
- 15.2 Overseas dividends and manufactured overseas dividends received, on particular securities in respect of a particular dividend date, are ranked in the following order:
- (a) manufactured overseas dividends received gross and in respect of which tax does not fall to be accounted for by the recipient under Paragraph 4(3) Schedule 23A or Regulation 4(3);
  - (b) real overseas dividends received;
  - (c) manufactured overseas dividends received under deduction of, or subject to, eligible tax as in paragraph 13.2 above (that is, overseas tax, and tax under Paragraph 4(2) or Paragraph 4(3) Schedule 23A or under Regulation 4(3)).
- 15.3 Overseas dividends and manufactured overseas dividends received are then matched with equivalent manufactured overseas dividends paid in two stages.
- (a) First, the dividends received are matched, according to the priority ranking in paragraph 15.2 above, with equivalent manufactured overseas dividends paid gross. To be matched, payments gross must be under authority of a Regulation 5(2)(b)(iii) Notice, or under arrangements with the Board under the Double Taxation Relief Regulations, or because the relevant withholding tax rate under Regulation 3(4) is nil.
  - (b) Second, any dividends received but not matched with equivalent payments under (a) above are matched with manufactured overseas dividends paid under deduction of tax, again according to the priority ranking in paragraph 15.2.
- 15.4 Where, as a result of this process, receipts net of tax are matched with payments under deduction of tax, those matched receipts and payments are included in a “sub-pool” in the Regulation 9 offsetting process for Approved UK Intermediaries. Other

matched receipts and payments are excluded from Regulation 9 (see paragraph 13.4 above).

- 15.5 Double taxation relief is not available either in respect of any overseas tax deducted from overseas dividends, or any tax deducted from manufactured overseas dividends or accounted for in respect of manufactured overseas dividends, if those dividends received have been matched under Regulation 10 with manufactured overseas dividends paid. Where, however, overseas dividends or manufactured overseas dividends received are matched with manufactured overseas dividends paid gross by virtue of Regulation 5 (see chapter 9 above) a deduction under Section 811 ICTA 1988 is available in respect of that tax<sup>27</sup> (and see example 7.3 in Appendix A).
- 15.6 The liability to account for tax under Paragraph 4(2) Schedule 23A remains, subject to the operation of Regulation 9 (chapter 13 above).
- 15.7 Where a real or manufactured overseas dividend received is matched with an equivalent manufactured overseas dividend paid, any overseas tax voucher received must be forwarded to the recipient of the manufactured overseas dividend paid (but see paragraph 15.9 below). In addition, no voucher under Regulation 15 (see chapter 18 below) may be written evidencing deduction of UK withholding tax under Paragraph 4(2) Schedule 23A from the manufactured dividend paid on. This applies to each person in a chain and is to ensure that the overseas tax credit flows along the chain to the final recipient, whether that recipient is inside or outside the UK. A copy of the overseas tax voucher should be retained to substantiate any claim for set off under Regulation 9 of the overseas tax suffered against liability to account for tax under Paragraph 4(2) Schedule 23A in respect of the on payment.
- 15.8 It may be that the overseas tax voucher cannot simply be passed on but needs to be "reshaped". In these circumstances it is often possible to obtain fresh vouchers from the overseas payer or his agent which can be passed on. If this is not possible, the recipient of the overseas dividend or manufactured dividend should retain the overseas voucher and issue special vouchers under Regulation 10(3) as necessary, evidencing not UK tax accounted for, but overseas tax. The amount of the overseas tax, however, which can be vouched is limited to the overseas tax payable after all possible reclaims have been made under the relevant double taxation agreement, regardless of whether or not the person in the UK retaining the overseas voucher in fact reclaims any overseas tax in excess of the Treaty rate. Once a Regulation 10(3) voucher has been written it must be treated in the same way as a real overseas voucher, that is, it

<sup>27</sup> Regulation 6 SI 1997 No. 988 which inserted a new Regulation 9(4B) with effect from 1 July 1997.

must be passed on with any equivalent manufactured overseas dividend paid (subject to reshaping and to paragraph 15.9 below) and no Regulation 15 voucher evidencing tax under Paragraph 4(2) Schedule 23A may be written.

- 15.9 Where an overseas dividend manufacturer makes a matched payment and has been advised that the recipient does not require a tax voucher, the Revenue will in practice accept that the requirement to pass a voucher is satisfied if the voucher is destroyed, and that there is no need to write a voucher under Regulation 10(3).
- 15.10 A specimen voucher under Regulation 10(3) is provided at Appendix E.

## 16. Accounting for tax (Regulation 11)

- 16.1 The rules governing payment of tax arising under both sub-Paragraphs 4(2) and 4(3) Schedule 23A and under the Regulations<sup>28</sup>, and the making of returns of that liability, are found in Regulation 11.
- 16.2 Tax is due 30 days after the end of the chargeable period. The chargeable period of a company is its accounting period for Corporation Tax purposes. The chargeable period<sup>29</sup> for a non corporate is the period for which accounts are drawn up (but special rules apply where accounts are drawn up for a period of more than 12 months) or the year of assessment if accounts are not drawn up.
- 16.3 The tax carries interest if paid later than 30 days after the end of the chargeable period, whether or not an assessment has been raised and whether or not a return of the liability has been made. Payment should be made on payslips available from City B LBO, City Gate House, Finsbury Square, London EC2A 1BT. Tel: 020 7330 9384/9383
- 16.4 A return of liability should be made within 30 days of the end of the chargeable period<sup>30</sup>. The appropriate return (form SX1) is available from City B LBO. Advice on completion of the return can be obtained from the City B Help Desk at the above address or telephone number.
- 16.5 Liability under the main charge to tax (paragraph 4.3 above) should be shown under Paragraph 4(2) Schedule 23A on the return, and is the amount due after application of the Regulation 9 offsetting and Regulation 10 matching rules for approved UK intermediaries, and of the Regulation 9A offsetting rule for persons who are not approved UK intermediaries (chapter 14 above).

<sup>28</sup> excluding Regulation 12 or regulation 13 while they were still operative. Regulation 13 was repealed with effect from 6 November 1996 - SI 1996 No. 2643. Regulation 12 ceased to have effect on 1 April 2001.

<sup>29</sup> The definition of chargeable period is in Regulation 2A.

<sup>30</sup> The 30 day time limit applies to chargeable periods ending on or after 1 July 1997. For earlier chargeable periods the time limit was 90 days.

16.6 The normal appeals procedures apply to any assessment raised in respect of liability arising from payments of manufactured overseas dividends.

**17. Payments made without accounting for tax in accordance with arrangements with the Board under the Double Taxation Relief Regulations (Regulation 14)**

17.1 Every overseas dividend manufacturer or approved UK collecting agent who has entered into arrangements with the Board under the Double Taxation Relief Regulations authorising payment without accounting for tax, should keep a record showing:

- (a) the date of payment and the amount of the manufactured overseas dividend;
- (b) the name of the person beneficially entitled to the payment, and the territory in which he was resident at the time of payment;
- (c) particulars of the overseas securities and the overseas dividends on those securities to which the manufactured overseas dividend relates.

17.2 This record, and any certificate (form MOD2 - see Appendix D2) received under the Double Taxation Relief Regulations, should be retained for six years and should be available for inspection during that time.

17.3 Once again, where the necessary records or certificates are not kept there are provisions for an audit to be carried out. Any tax lost and interest due will be accounted for under the arrangements entered into with the Board.

## 18. Vouchers (Regulation 15)

18.1 The normal rule is that whenever an overseas dividend manufacturer deducts tax on payment under Paragraph 4(2) Schedule 23A he must provide the recipient with a voucher showing:

- (a) the gross amount of the payment;
- (b) the amount deducted or, where more than one amount has been deducted, each such amount separately; and
- (c) the actual amount paid.

18.2 But no voucher evidencing tax under Paragraph 4(2) Schedule 23A may be written where Regulation 10(2) or (3) or (4) applies (see paragraphs 15.7 and 15.8 above).

18.3 Moreover, an approved UK intermediary does not have to provide a voucher unless asked to do so by the recipient of the payment.

18.4 At the request of the beneficial owner of a manufactured overseas dividend, an approved UK collecting agent must provide a voucher evidencing the amount of tax accounted for by that collecting agent under either Paragraph 4(3) Schedule 23A or Regulation 4(3) as appropriate. The voucher must show

- (a) the gross amount of the manufactured overseas dividend received by the agent;
- (b) the amount of tax paid or due to be paid by the agent in respect of that dividend; and
- (c) the actual amount paid<sup>31</sup>.

18.5 Where a manufactured overseas dividend is paid in a foreign currency the Regulation 15 voucher may be completed in that currency, but the voucher should also show the sterling equivalents so that the figures can be reconciled with the returns of tax accounted for to the Revenue.

<sup>31</sup> If (prior to 1 April 2001) an approved UK collecting agent issues a voucher covering these items under, and in accordance with, the Paying and Collecting Agent provisions this will be regarded as fulfilling the agents obligations under Regulation 15.

- 18.6 A specimen voucher for use by approved UK intermediaries and approved UK collecting agents is provided at Appendix F. For other persons, a simple signed statement (from which the signatory can be identified) showing the amounts set out at paragraph 18.1 above will suffice.
- 18.7 For comment on the evidence needed to substantiate a claim, in connection with the manufactured overseas dividend rules, that a receipt has suffered overseas tax see paragraphs 12.8 to 12.11 above.

## **19. Powers of inspection**

19.1 In order to supervise the tax treatment of manufactured overseas dividends the books and records of any person who carries on a business consisting in or involving any dealings in overseas securities are subject to inspection by officers of the Inland Revenue under the powers granted by Section 21 TMA 1970<sup>32</sup>. The power is limited to those books and records which in the opinion of the Board contain or may contain information relating directly or indirectly to:

- any transaction in securities,
- 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.

<sup>32</sup> S21 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.

## 20. Corporation Tax Treatment

### *Recipients of manufactured overseas dividends*

- 20.1 The normal rule is that the beneficial recipient of a manufactured overseas dividend representative of an equity dividend is treated as receiving a real overseas dividend equal to the gross amount of the manufactured dividend. Accordingly;
- (a) where a manufactured overseas dividend is received in the course of a trade carried on by the recipient the gross amount will be included in the computation of profits under Schedule D Case I in the normal way;
  - (b) where a manufactured overseas dividend is received otherwise than in the course of a trade the gross dividend is assessable under Case V Schedule D<sup>33</sup>.
- 20.2 Tax deducted by virtue of Paragraph 4(2) or Paragraph 4(3) Schedule 23A, or accounted for under Regulation 4(3) is treated as overseas tax and double taxation relief may be claimed according to the normal rules (**except** where that tax has been taken into account in the matching and offsetting process of Regulations 9 and 10 for approved UK intermediaries, and of Regulation 9A for persons who are not approved UK intermediaries). None of the tax so accounted for is repayable to a UK taxpayer by the Inland Revenue.
- 20.3 The normal rule in paragraph 20.1 above does not run where the payer has not accounted for tax, either because Regulation 4 (chapter 8 above) or Regulation 5 (chapter 9 above) applies to the payment. In such cases Paragraph 4(4) Schedule 23A ICTA 1988 (paragraph 4.5 above) does not operate. The manufactured overseas dividend received (that is, the actual amount of the receipt without grossing) will accordingly be taxable in the hands of the recipient under Case I or Case VI of Schedule D as appropriate.

### *Payers of manufactured overseas dividends*

- 20.4 The normal rule is that in the hands of the overseas dividend manufacturer, the gross amount of the manufactured overseas dividend is treated as an annual payment. Relief

<sup>33</sup> Prior to it ceasing to have effect on 1 April 2001, Regulation 12 required deduction of income tax by collecting agents. A receipt with UK tax suffered is not proper to a Case I computation but is assessable to corporation tax on the receipts basis as taxed income. The Income Tax suffered may be relieved by set-off against the corporation tax liability or by repayment, as appropriate.

for corporation tax purposes is therefore available, on payment, as a charge on income. There are, however, two important exceptions to this, both of which relate to circumstances in which payments may be made without accounting for tax.

***Non-AUKI pays to AUKI or AUKCA without deduction***

20.5 The first exception to the treatment is where Regulation 4 (chapter 8 above) applies to a manufactured overseas dividend so that it is paid without deducting tax. In these circumstances the payment is not treated as a charge, but:

- (a) where the payment is made in the normal course of a trade it will, subject to the normal rules, be allowable as a deduction in computing profits for Case I purposes;
- (b) where the payment is not made in the normal course of a trade but the company is an investment company within the meaning of S130 ICTA 1988, the payment is treated as a management expense.

***AUKI pays without deduction***

20.6 The second exception is where an approved UK intermediary is able, under Regulation 5 (chapter 9 above) to make payment without accounting for tax under Paragraph 4(2) Schedule 23A. Subject to the normal rules the payment will be allowable as a deduction in computing profits for Case I purposes.

## **21. Manufactured overseas dividends in respect of interest on securities representing loan relationships**

- 21.1 A manufactured overseas dividend in respect of interest on an overseas security which represents a loan relationship is treated<sup>34</sup> for Corporation Tax purposes
- (a) as if it were interest under a loan relationship to which the company is a party; and
  - (b) where that company is the company to which the manufactured overseas dividend is payable, as if that relationship were the one under which the real interest is payable.
- 21.2 Such manufactured overseas dividends are accordingly treated as interest debits or credits under a loan relationship to which the company is a party, and are brought into account in accordance with the rules in Chapter II, Part IV FA 1996, as if the company had received the real interest.
- 21.3 Where the manufactured overseas dividend is paid by a company for the purposes of its trade it is treated as a trading debit. Any other payments are treated as non trading debits.
- 21.4 Manufactured overseas dividends received are treated as trading credits if they are received in the course of activities forming an integral part of its trade. Any other payments received are treated as non trading credits.

<sup>34</sup> Section 97 FA 1996 - with effect from accounting periods ending on or after 1 April 1996.

## **22. Income Tax treatment of manufactured overseas dividends in respect of dividends on overseas equities**

### ***Recipients of manufactured overseas dividends***

22.1 The Income Tax treatment is the same as for Corporation Tax (see paragraphs 20.1 to 20.3 above).

### ***Payers of manufactured overseas dividends***

22.2 Again, as for Corporation Tax (see paragraphs 20.4 to 20.6 above), the normal rule is that in the hands of the overseas dividend manufacturer the gross amount of the manufactured overseas dividend is treated as an annual payment. Relief as a charge on income is, however, available to an individual<sup>35</sup> only if the payment is made for bona fide commercial reasons in connection with the individual's trade, profession or vocation<sup>36</sup>.

22.3 Where, under Regulations 4 or 5, a payment to an approved UK intermediary or to an approved UK collecting agent is not treated as an annual payment there is no relief for the payment if it is not deductible on ordinary Case I principles in computing the profits of a trade.

<sup>35</sup> "Individual" includes a Scottish partnership in which at least one partner is an individual - Section 347A(6) ICTA 1988.

<sup>36</sup> Section 347A(2) ICTA 1988

## **23. Income Tax treatment of manufactured overseas dividends in respect of interest on securities representing loan relationships**

### ***Recipients of manufactured overseas dividends***

- 23.1 Manufactured overseas dividends received in the ordinary course of a trade will be taken into account in computing the profits of that trade on normal Case I principles.
- 23.2 Where the receipt is not in the normal course of a trade the recipient is treated as receiving an overseas dividend of an amount equal to the cash payment actually received, but the recipient is not entitled to claim any double taxation relief in respect of any tax attributable to the receipt.

### ***Payers of manufactured overseas dividends***

- 23.3 Manufactured overseas dividends paid in the normal course of a trade will be taken into account in computing the profits of that trade on normal Case I principles.
- 23.4 Where the payment is not made in the normal course of a trade the payer is treated as making an annual payment of an amount equal to the cash payment actually made. But there is no liability to deduct, or account for, Income Tax on payment. Relief may be available as a charge against income of that amount (except where the payer is an individual - see paragraph 22.2 above).

## MISCELLANEOUS MATTERS

### 24. Transactions denominated in foreign currency

- 24.1 Where a dividend is receivable in foreign currency, both the net dividend and any overseas tax credit should be translated into sterling at the exchange rate applying at the date the dividend is recognised for UK tax purposes. The use of average rates will, however, be acceptable if applied on a consistent basis not expected to make a material difference taking one year with another.
- 24.2 The principles underlying paragraph 24.1 apply equally to payments in foreign currency.

### 25. Branches

- 25.1 Although most double taxation agreements have the effect of taxing a local branch as if it were a concern distinct from the company of which it is a part, in fact branches are simply one part of the same legal entity. It follows that there cannot be a loan or repo of securities between a branch and its head office; nor can a manufactured payment flow between a branch and its head office. This has a number of ramifications in the manufactured overseas dividend field.

#### *Overseas branches of UK companies*

- 25.2 Where a UK company pays a manufactured overseas dividend through an overseas branch, in the course of a trade carried on by or through that overseas branch, there is a liability on the company to account for tax under Paragraph 4 Schedule 23A ICTA 1988.

#### *UK branches of overseas companies*

- 25.3 Where a manufactured overseas dividend is paid to an overseas company which has provided a form MOD2 (see Appendix D), an AUKI or AUKCA can make the

payment without accounting for tax. This does not apply however where the payment is properly attributable to a trade carried on by the overseas company through a UK branch or agency. Accordingly, where an overseas company has provided a MOD2, that form should not be used to authorise gross payment where the manufactured payment arises from the operations of its UK branch.

- 25.4 The head office (or non UK branch) of an overseas company with a UK branch may borrow, or repo in, securities from a counterparty and pass them to the UK branch. Provided the counterparty supplies a valid form MOD2 to the UK branch, and provided the UK branch is an AUKI which has entered into the arrangements to pay gross (paragraphs 9.1 and 9.2 above), that customer's MOD2 can be used to authorise gross payment by the branch and the issue of an Appendix C notice by the branch (paragraph 9.3 above).

## **26. French Indemnity Payments**

- 26.1 Under the rules of the Society of French Stock Exchanges certain cum dividend sales and other arrangements for the transfer of French equities give rise to a requirement for the seller or transferor to make an indemnity payment to the transferee equal to the amount of a cash dividend arising on those equities. Such an indemnity payment does not suffer any French withholding tax, nor does it entitle the recipient to any tax credit, including Avoir Fiscal. The effect of French tax law on sales of French equities made cum dividend, where an indemnity payment is required, is to treat the sale as made ex dividend. The seller remains entitled to and taxable on the real dividend and can claim a tax credit (including where appropriate Avoir Fiscal). The indemnity payment is not treated as a transfer of the dividend to the buyer but as an adjustment to the sale price of the seller and to the purchase price of the buyer.
- 26.2 SI 1996 No. 1826<sup>37</sup> makes provision for the UK tax treatment to follow the French treatment in certain circumstances. Accordingly, where a person makes or receives a French indemnity payment as a result of a sale of French equities, other than a payment which arises from a sale and repurchase arrangement (see paragraph 26.3 below), then :

<sup>37</sup> SI 1996 No. 1826 applies only to indemnity payments made on or after 1 August 1996, but the Revenue will allow indemnity payments made earlier than this to be treated in accordance with these regulations provided the tax liabilities concerned had not been finalised by that date, and providing that any person choosing to adopt this treatment applies the treatment to all the transactions involving indemnity payments to which he has been party.

- (a) the payment is not treated as a manufactured overseas dividend, and no double taxation relief in respect of any tax attributable to the payment is due;
- (b) the seller is taxable on the real dividend he receives and is entitled to double taxation relief in respect of overseas tax attributable to the real dividend under the normal rules;
- (c) the sale price for the seller and the purchase price for the purchaser are both reduced by the amount of the indemnity payment.

26.3 Where a person makes or receives a French indemnity payment as a result of a sale and repurchase arrangement then:

- (a) the payment is not treated as a manufactured overseas dividend;
- (b) the first buyer is taxable on the real dividend he receives and is entitled to double taxation relief in respect of overseas tax attributable to the real dividend under the normal rules;
- (c) in relation to the payer the indemnity payment is treated as an annual payment, but there is no obligation to deduct, or to account for, Income Tax on payment;
- (d) in relation to the recipient the indemnity payment is treated as an overseas dividend of an amount equal to the cash actually received, but no double taxation relief in respect of any tax attributable to the payment is due.

26.4 “French indemnity payment” means a payment, representative of a dividend on French equities, that a party to a transaction for the sale of those equities is required, under the rules of the Society of French Stock Exchanges, to make to the other party to that transaction.

26.5 “Sale and repurchase” arrangement takes its meaning from S730A ICTA 1988.

## APPENDIX A - EXAMPLES

### ***A1. Rate of relevant withholding tax (RWT) on a manufactured overseas dividend (MOD) paid (paragraph 7)***

These examples assume a gross cash dividend of 100 before any withholding tax, and that the manufactured overseas dividend does not fall to be paid without accounting for Relevant Withholding Tax. References to paragraphs are to paragraph numbers in the main body of the text.

#### *A1.1 No treaty claim possible*

If a UK shareholder would receive 85 with no entitlement to claim anything from the overseas tax authority, then the rate of RWT is 15%.

#### *A1.2 Treaty claim possible*

If a UK shareholder would receive 75, but could claim 10 back from the overseas tax authority under the relevant double tax agreement with the UK, then the rate of RWT is again 15% (that is, the final rate of tax suffered on an equivalent real dividend after all treaty claims).

#### *A1.3 Entitlement to a tax credit*

Assume a UK shareholder would receive 85 but is also entitled under the relevant double tax treaty to a tax credit of say 50, of which it could obtain payment of 42.5 (85% of 50). The gross income is 150, and tax suffered after all treaty claims is 22.5. The RWT rate is therefore 15%. Because the gross amount of the MOD is deemed to be equal to the gross amount of the real dividend (150), the tax accountable is 22.5 regardless of whether the manufacturer agrees to pay his counterparty 100 or 150. However, there are special rules for French Indemnity Payments (chapter 26).

#### *A1.4 Withholding less than treaty rate*

The UK has a treaty with country A under which the maximum withholding on dividends is set at 15%. However, country A only imposes a withholding rate (under domestic law) of 5% which means that a UK shareholder would receive a dividend of 95 from a company in country A. The rate of RWT on MODs on equities of country A is accordingly 5%.

A1.5        *“Domestic to domestic” rate (paragraph 7.6)*

A UK person pays a MOD on an equity of a company resident in country B to a person who is resident in country B. The UK has no Double Tax Treaty with country B (or has a treaty which has no other income article). The equivalent real dividend paid to a UK shareholder would suffer 15% withholding, but if paid to a domestic shareholder would suffer only 5% withholding. The rate of RWT is 5% for MODs paid to persons resident in country B but 15% where paid to anyone else

## **A2. Reverse charge - non residents (paragraph 4.4)**

### *A2.1 Simple case: no real dividend received by manufacturer and no tax on the MOD*

If a UK person would have received 85 in respect of an equivalent real dividend, then a UK recipient will be required to account for RWT of 15 on a MOD received from a non-resident manufacturer. The UK recipient will presumably require cash of 100 in order to be able account for the tax without being out of pocket ie so that he still has cash of 85 left.

### *A2.2 Overseas manufacturer receives the real dividend (paragraph 12.7): AUKI/AUKCA recipient*

UK recipient is either an AUKI or AUKCA, and receives a MOD from a non resident manufacturer who in turn receives the real dividend at the following rates:

(a)	100 (ie gross)
(b)	90
(c)	85
(d)	75

There is no reverse charge on the UK recipient.

If a UK person would have received a real dividend of 85, then the UK beneficial owner of the MOD is taxed on the gross amount of the MOD (100) and is entitled (subject to the normal rules and evidence of tax suffered) to double tax relief of an amount by which the gross amount of the real dividend exceeds the cash amount received by the overseas manufacturer (but limited to 15) as follows:

(a)	NIL
(b)	10
(c)	15
(d)	15

### *A2.3 Overseas tax withheld from MOD (paragraph 11.1)*

Assume an overseas manufacturer withholds tax on a MOD paid to a UK recipient and pays actual net cash (after withholding tax) as follows:

	<u>cash paid</u>	<u>tax withheld</u>	
(a)	95	5	
(b)	90	5	(total 95 not 100)
(c)	85	5	(total 90 not 100)
(d)	85	15	
(e)	75	25	

Assuming a UK person would have received 85 by way of equivalent real dividend, the reverse charge is reduced from the normal 15 to the amount by which the cash received in the UK exceeds the cash that would have been received in respect of the real dividend as follows:

(a)	10	(95 - 85)
(b)	5	(90 - 85)
(c)	NIL	(85 - 85)
(d)	NIL	(85 - 85)
(e)	NIL	(75 less than 85)

The UK person beneficially entitled to the MOD is taxed on the gross amount of 100 and is entitled to double tax relief (other than under Section 811 ICTA 1988, and subject to the normal rules and evidence of tax suffered) on the aggregate of the overseas tax withheld on the MOD plus the tax accounted for under the reverse charge (but again limited to 15), as follows:

(a)	15
(b)	10
(c)	5
(d)	15
(e)	15 (max.)

### **A3. Offsetting by an AUKI (paragraph 13.1)**

#### **A3.1 No matching under Regulation 10 - excess receipts**

AUKI receives and manufactures the following overseas dividends:

	<u>Receipts</u>	<u>tax</u>		<u>Payments</u>	<u>tax</u>
ABC	85	15	JKL	80	20
DEF	75	25*	MNO	90	10
GHI	90	10			
Tax suffered		50	Tax accountable		30

\* None of the 25 tax suffered is reclaimable from the overseas tax authority.

All the receipts and payments go into the offsetting pool created by Regulation 9, with the effect that the tax accountable on MODs paid of 30 is covered by the overseas tax suffered of 50 leaving the AUKI with nothing to pay. Double tax relief is available only on the balance of tax suffered of 20.

#### **A3.2 No matching under Regulation 10 - excess payments**

AUKI receives and manufactures the following overseas dividends:

	<u>Receipts</u>	<u>tax</u>		<u>Payments</u>	<u>tax</u>
ABC	85	15	GHI	90	10
DEF	75	25	JKL	80	20
			MNO	90	10
			PQR	85	15
Tax suffered		40	Tax accountable		55

In this case, the 40 overseas tax suffered is set off against the 55 due on MODs paid, leaving a balance payable under Regulation 9(6) of 15. None of the overseas tax suffered of 40 is available for double tax relief.

#### ***A4. Interaction of reverse charge and offsetting***

AUKI receives and manufactures the following overseas dividends:

	<u>Receipts</u>	<u>tax</u>		<u>Payments</u>	<u>tax</u>
ABC (real)	85	15	GHI	90	10
ABC (MOD)	100	NIL	JKL	95	5
DEF	90	10			
Tax suffered		25	Tax accountable		15

- (a) The AUKI must pay the reverse charge of 15 on the MOD in respect of security ABC.
- (b) The tax accounted for at (a) above is then treated as tax suffered for the purposes of offsetting, giving a total of 40. That leaves nothing to pay under Regulation 9(6), and tax of 25 (40 - 15) is available for double tax relief.
- (c) The AUKI must still pay the reverse charge of 15 to the Revenue.

#### ***A5. Offsetting by non-AUKI (paragraph 14.1)***

Assume a non-AUKI takes securities ABC as collateral from an AUKI, and whilst holding that collateral receives a real dividend of 85. The non-AUKI will be required to pay a MOD to the AUKI: normally the MOD would be paid without accounting for tax (paragraph 8.1), but as the non-AUKI received the equivalent real dividend it is required to account for RWT of 15. However, the non-AUKI can offset that liability against the overseas tax of 15 suffered on the real dividend received leaving nothing to pay. No double tax relief is available to the non-AUKI. The AUKI is treated as receiving an overseas dividend after deduction of overseas tax of 15.

**A6. Matching by an AUKI (paragraph 15.1)**

A6.1 AUKI receives and manufactures the following overseas dividends:

	<u>Nominal</u>	<u>Receipts</u>	<u>tax</u>	<u>Nominal</u>	<u>Payments</u>	<u>tax</u>
ABC	100	850	150	50	425	75
ABC				20	200	NIL
DEF		900	100			
GHI					1700	300

Step 1: matching of ABC payments and receipts

- (a) match dividend received on 20 nominal with the MOD paid gross on 20 nominal
- (b) match dividend received on 50 nominal with MOD paid net on 50 nominal
- (c) balance of dividend received on 30 nominal is not matched and can go into the main offsetting pool.

Result:

- (a) Tax credit relief for tax suffered of 30 on dividend of 200 in respect of nominal 20 of ABC which is matched with gross MOD is lost (but not S811 relief - see example 7.3 below).
- (b) The tax suffered of 75 on the dividend of 500 on nominal 50 of ABC which is matched with the 500 MOD paid net is offset against the tax accountable of 75 in a 'sub-pool' created under Regulation 9(3), leaving nothing to pay and no double tax relief on the tax suffered of 75.
- (c) The tax suffered of 45 on the balance of dividend 300 on nominal 30 of ABC which is not matched goes into the main offsetting pool.

Main offsetting pool:

This now looks like:

	<u>Receipts</u>	<u>tax</u>		<u>Payments</u>	<u>tax</u>
ABC (nominal 30)	255	45	GHI	1700	300
DEF	900	100			
Tax suffered		145	Tax accountable		300

The tax suffered of 145 is set off against the tax accountable of 300, leaving a balance payable under Regulation 9(6) of 155. No double tax relief is due for any tax suffered on dividend receipts.

**A6.2 Application of matching to open bargains**

An AUKI has the following position in stock ABC, on which a dividend of 10 less overseas tax of 1.5 is to be paid:

Depot position	12,000	
Open bargains - cum-div sales	20,000	
Open bargains - cum-div purchases	15,000	
Borrow under stock loan	<u>17,000</u>	(lender has provided form MOD2)
Overall net bear position	10,000	

After all these transactions have settled, the AUKI will have a revised depot position of 7,000 and an outstanding loan of 17,000.

For the purposes of applying the matching and offsetting rules in the Regulations, and subject to the vouching requirement set out below, the dividends paid to counterparties on the open sales of 20,000 can be regarded as merely the passing on of the dividends receivable on the depot position of 12,000 plus 8,000 of the open bargain purchases (see paragraph 3.9). The result is

- (a) the AUKI is not regarded as paying a MOD on any of the open sales of 20,000, and
- (b) the AUKI is treated as receiving dividends on 7,000 (12,000 + 15,000 - 20,000) stock.

The AUKI is therefore regarded as paying MODs of 170,000 gross under the stock loan, and receiving taxed real dividends of 70,000 with overseas tax deducted of 10,500. There is no tax to account for under Paragraph 4(2) Schedule 23A.

The 70,000 taxed dividends received are matched under Regulation 10 with 70,000 of the MODs paid gross. No tax credit relief is thus available for the overseas tax suffered of 10,500, but relief under Section 811 is available (subject to the normal rules) as all the dividends received are matched with MODs paid gross (paragraph 15.5). For Corporation Tax

purposes, the AUKI gets relief for the MODs of 170,000 paid gross as a trading expense and is taxed on dividends received (after Section 811 relief) of 59,500 (70,000 - 10,500).

Dividends claimed on an open purchase can be regarded as satisfying dividends paid on an open sale only where it can be demonstrated that those dividends claimed are either

- (a) real dividends which have suffered overseas tax, or
- (b) MODs on which tax has been accounted for under Paragraph 4(2) Schedule 23A ICTA 1988 by the payer, or
- (c) MODs in respect of which the AUKI has accounted for tax under Paragraph 4(3) Schedule 23A ICTA 1988 or Regulation 4(3).

The AUKI or his settlement agent will normally need to secure evidence of tax as set out in paragraphs 12.10- 12.12.

## ***A7. Income and Corporation tax treatment (chapters 20 to 23)***

### **MODs on equities**

#### **A7.1**      *Deemed amount of MODs paid and received*

The normal rule is that a recipient of an equity MOD is taxed on gross income of 100 (that is, an amount equal to the gross amount of the real overseas dividend) notwithstanding that he may actually receive less cash (after any tax withheld) than the net amount of the real dividend, and tax accounting is always computed by reference to the gross amount of the equivalent real dividend. But the payer only gets relief for the amount of cash MOD paid plus any tax accounted for. For example: an overseas dividend is 100 and withholding tax is 15. If two UK resident parties to a repo agree to a payment before withholding of 90, the manufacturer (repo buyer) must still account for RWT of 15 (presumably paying the balance of cash 75 to the repo seller) and will get relief as a charge for 90 (75 + 15). The repo seller will be taxed on an overseas dividend of gross amount 100 with, subject to the normal rules, double tax relief on 15.

#### **A7.2**      *Payers and recipients of MODs paid without accounting for tax*

The exception to the normal rule referred to in paragraph 7.1 above is where a MOD passes without accounting for tax under Regulation 4 or 5. Here, the recipient is taxed on the amount of cash actually received and the payer gets relief (where available) for the amount actually paid. So for example if a UK AUKI repo buyer (who sells the security outright and so does not receive the equivalent real dividend) in the course of his trade agrees to pay a non resident repo seller a MOD of cash 90 and holds a valid form MOD2, then relief as a trade expense will be on an amount of 90 only. Alternatively, if the UK party in turn repos on the security to another AUKI, agrees to a MOD of 90 and issues an Appendix C notice, then that UK party will be taxable on the 90 cash received and get relief for the 90 cash paid on, thus matching its commercial position.

#### **A7.3**      *Taxed receipts matched with payments made without accounting for tax (paragraph 15.5)*

Assume an AUKI receives an overseas dividend of 850 after withholding of 150 on nominal 1000 of equity ABC, and under a separate transaction has agreed to pay a MOD on nominal 1000 of security ABC of 900 (rather than the true gross amount of 1000) to a non resident counterparty who has provided form MOD2. The real dividend is matched with the MOD paid, so that no tax credit relief is available for the tax suffered of 150.

However, to ensure the tax position does not penalise the AUKI who has received cash of 850 and paid out cash of 900 with no credit relief for the tax suffered, relief under S811 is allowed to the extent that the net dividend received is matched with a MOD paid without accounting for tax. In this case therefore, the AUKI may deduct the tax suffered 150 from his taxable receipt of 1000, leaving him taxable on an amount of 850, with relief for the payment made of 900 - thus reflecting the cash loss he has made of 50.

## **MODs on Loan relationships**

### *A7.4 MODs on loan relationships received or paid by companies*

The rule that the MOD is deemed to be equal to the gross amount of the real overseas dividend does not apply to a company holding a security which represents a loan relationship. The accounts will reflect an amount in respect of interest accruing on the security in respect of which the MOD is received and the tax treatment would normally follow the accounting. Assuming a company accrues the full gross amount of interest, then double tax relief may be available subject to the normal rules and evidence that the underlying real interest suffered overseas tax on payment.

*A7.5* A company gives overseas bonds as collateral for a cash loan and receives a MOD of 85 (equal to the net real interest it would have received). The company would normally continue to accrue the gross interest of 100 and is taxable on that amount. Double tax relief would be available if the company can demonstrate that the real interest on the bonds given as collateral suffered withholding tax. If alternatively the company took in the overseas bonds as collateral for a cash loan it had made, received the net real interest of 85 and paid a MOD of 85, normal commercial accounting would mean that neither the receipt nor the payment would be reflected in its profit and the tax treatment would normally follow that.

### *A7.6 MODs on loan relationships received or paid by persons other than companies*

A non-corporate who receives a MOD on a bond (ie what would be a loan relationship in the hands of a company) but not in the course of a trade, is deemed to receive income by way of an overseas dividend of the amount of the cash received. There is no entitlement to double tax relief. A non trading non corporate payer of a loan relationship MOD is treated as making an annual payment equal to the amount actually paid.

Where a person other than a company is trading in securities, commercial accounting should produce a similar result to that set out in paragraph A7.4 above and the revenue would expect to follow that for tax purposes.

A7.7 If a non-corporate not trading in securities takes collateral of overseas bonds for a cash loan it makes, receives a real dividend of 85 and pays a MOD of 85 to the collateral provider, the non-corporate is taxed under Case V on the gross overseas dividend of 100 with double tax relief of 15 (or can claim relief under S811 and be taxed on 85) and gets relief as a charge on the 85 paid. Alternatively, if the non corporate gives the overseas bonds as collateral for a cash loan received and receives a MOD of 85, then it is taxed under Case V on an overseas dividend of 85 with no double tax relief at all.

## Appendix B Rates of Relevant Withholding Tax

Schedule of Relevant Withholding rates and domestic rates where benefit of other income article unavailable or domestic lender of domestic securities as at 31 December 1996. [Change since 31 March 1995 shown by\*] [Note that the information on this page is in the process of being updated]

<u>Country of origin of securities</u>	<u>Dividends</u>	<u>Domestic Dividends</u>		
Argentina	0	0		
Australia unfr	15 X	0		
Australia fran	0 C	0		
Austria	15		O Inc	
Bangladesh	15	10		
Barbados	0		O Inc	S Tax
Belgium	10		O Inc	
Bolivia	12.5		O Inc*	
Botswana	15	15		
Brazil	0*	0*		
Brunei	0	0		
Bulgaria	10		O Inc	
Cameroon	25	16.5		
Canada	15	0		
Chile	35	0		
China	10	20		
Columbia	7*	0		
Costa Rica	15	0 I		
Croatia	15		O Inc	
Cyprus	0		O Inc	
Czech Republic	15		O Inc	
Denmark	15		O Inc	
Dominican Rep	25	25		
Ecuador	0*	0		
Egypt	0		O Inc	
Estonia	15		O Inc	
Falkland Islands	0		O Inc	
Fiji	15	0/5* I		

Finland	15		O Inc	
France	15		O Inc	
Gabon	20	20		
Germany	15		O Inc	S Tax
Gibraltar	0	0		
Greece	0 X	0		
Guam	30	0		
Guatemala	12.5	0		
Guernsey	0 C	0		
Honduras	15	10		
Hong Kong	0	0		
Hungary	15		O Inc	
Iceland	15		O Inc	
India	15	24.73 I		
Indonesia	15			
Ireland	15 G		O Inc	
Isle of Man	20 N	0		
Israel	15		O Inc	S Tax
Italy	15		O Inc	
Ivory Coast	12		O Inc	
Jamaica	15		O Inc	S Tax
Japan	15		O Inc	
Jersey	0 C	0		
Jordan	10*	0		
Kazakhstan	15		O Inc	
Kenya	10		O Inc	S Tax
Korea	15		O Inc*	
Libya	0	0		
Luxembourg	15		O Inc	
Malaysia	0 C	0		
Mauritius	0		O Inc	S Tax
Mexico	0		O Inc	
Morocco	15		O Inc	S Tax
Mozambique	18	18		
Namibia	15		O Inc	S Tax
Netherlands	15		O Inc	
New Zealand	15	33		
Nigeria	10*	10*		
Nor. Mariana Isl.	30	0		
Norway	15		O Inc	

Pakistan	15 X	10		
Panama	20 X	10		
Papua New Guinea	17 X		O Inc	
Paraguay	5	0		
Peru	0	0		
Philippines	25	0		
Poland	15		O Inc	
Portugal	15		O Inc	S Tax
Puerto Rico	25 X	0		
Romania	15		O Inc	
Russia	0**		O Inc	

\*\* - The rate under the new DTA with Russia is 10% but this is not yet in force. Until ratified the old UK-USSR treaty is regarded as applying, giving a withholding rate of NIL.

Senegal	16	16		
Singapore	0 C	0		
Slovakia	15		O Inc	
Slovenia	15		O Inc	
South Africa	0*		O Inc	S Tax
Spain	15		O Inc	
Sri Lanka	15	15		
Sudan	15		O Inc	
Surinam	25	25		
Swaziland	15		O Inc	
Sweden	5		O Inc	
Switzerland	15		O Inc	
Taiwan	35 X	15		
Tanzania	20	20		
Thailand	10	10		
Trin & Tobago	20	0		
Tunisia	0		O Inc	
Turkey	20		O Inc	
Uganda	15		O Inc	
Uruguay	30	0		
USA	15		O Inc	
Uzbekistan	10		O Inc	
Vietnam	15		O Inc	
Virgin Islands(BR)	0	0		
Virgin Islands(US)	11*	0		
Zambia	15		O Inc	S Tax
Zimbabwe	20		O Inc	

- N - not eligible for credit, withholding refers to net amount receivable.
- C - company tax deducted, withholding refers to net amount receivable.
- X - there is more than one rate so reference must be made to real dividend or interest.
- S Tax - a subject to tax test applies
- O Inc - Other Income Article in Convention.
- I - different rate for corporate and non corporate non resident - check status.
- G - withholding relates to abated dividend grossed up under Irish imputation system.

These rates were correct at the date of preparation. Changes will be notified on Topic3.

Approved UK collecting agents and UK intermediaries should apply the rate prevailing at the time of payment.

**APPENDIX C**

**NOTIFICATION TO PAY A MANUFACTURED OVERSEAS DIVIDEND WITHOUT DEDUCTION OF TAX AS PROVIDED BY REGULATION 4, 5 OR 7 SI 1993 No. 2004**

(To be used only by approved UK intermediaries and approved UK collecting agents)

Notification No.....

We hereby certify that our claim, or where we are an approved UK collecting agent our claim on behalf of,

.....(insert name of client or unique client designation number notified to Inland Revenue)

against.....  
of.....

.....  
for a manufactured overseas dividend in respect of the securities described below can be paid without deduction of tax by virtue of our:

- i) possession of an Inland Revenue authority or a certificate under Regulation 3 SI 1993 No 1957, or
- ii) receipt of a notice issued under Regulation 4(4)(c), or
- iii) receipt of a notice issued under Regulation 5(2)(b)(iii), or
- iv) receipt of a notice issued under Regulation 7(2)d

Amount and description of the securities.....  
.....

Due and payable date.....

Currency.....

Amount payable.....

(as..... % of gross dividend)

Signature.....

Date.....

Firm.....

Address.....  
.....  
.....

This form of certificate has been provided by the Board of the Inland Revenue

## **APPENDIX D ARRANGEMENTS TO PAY MANUFACTURED OVERSEAS DIVIDENDS WITHOUT ACCOUNTING FOR TAX - PROCEDURE**

D.1 Before an approved UK intermediary or approved UK collecting agent may pay a manufactured overseas dividend without accounting for tax under paragraph 4(2) Schedule 23A ICTA 1988 or under the Manufactured Overseas Dividend Regulations SI 1993 No. 2004, that intermediary or agent must first have entered into an arrangement with the Inland Revenue, the terms of which are set out in form MOD1 (which is reproduced in Appendix D1).

D.2 Those approved intermediaries and collecting agents which have made an arrangement with the Board, and the date from which that arrangement is effective, are shown in the lists published on TOPIC 3 screens under the column headed "Reg 3" They can also be found on the Inland Revenue website.

D.3 Before making any payments an approved UK intermediary or an approved UK collecting agent must hold as required by the arrangement either a certificate as in (a) below or a specific authorisation as in (b) below. The required documentation must be held at the time of gross payment.

- (a) A certificate in the form provided (form MOD2 - see Appendix D2) which is in two parts:-
  - i. Part 1 is a claim by the person beneficially entitled to the manufactured overseas dividend for exemption under the Other Income Article of a Double Taxation Convention between the UK and the territory in which that person is resident.
  - ii. Part 2 is a certificate by the fiscal authority of that territory that
    - the person beneficially entitled to the manufactured overseas dividend is resident in that territory
    - where the Other Income Article is conditional on a "subject to tax test", the person beneficially entitled to the manufactured overseas dividend is subject to tax in that territory.
- (b) A specific authorisation by the Inland Revenue authorising payment without accounting for tax.

D.4 Where an overseas resident is unable to obtain certification of part two of form MOD2 by its local fiscal authority, the Inland Revenue will, on application, consider if any alternative form of evidence of residence (and if appropriate being “subject to tax”) is acceptable.

D.5 Foreign language versions of form MOD2 are available from the Inland Revenue in the following languages: French, German, Dutch, Norwegian, Swedish, Italian, Spanish and Portuguese. The forms can be obtained at the address shown below.

D.6 Where the approved UK intermediary or approved UK collecting agent relies on a certificate as in D.3(a) above, that intermediary or agent must hold either the original certificate or a photocopy of that original certificate bearing an Inland Revenue acknowledgement and unique number. Where photocopies are necessary:

- (a) the original certificate should be sent to  
Inland Revenue  
City B LBO  
City Gate House  
Finsbury Square  
LONDON EC2A 1BT
- (b) the original certificate may be submitted by the person beneficially entitled to the manufactured overseas dividend, or by his agent, nominee or counterparty;
- (c) the original certificate should be accompanied by a stamped addressed envelope (SAE) for return of a photocopy to the person beneficially entitled to the manufactured overseas dividend, or his agent and a second SAE if a UK counterparty submitted the original,
- (d) the Inland Revenue will retain the original and return a photocopy which can be further photocopied as necessary;
- (e) the person beneficially entitled to the manufactured overseas dividend is responsible for supplying photocopies to approved UK intermediaries or approved UK collecting agents when needed, and the Inland Revenue will not supply photocopies other than the first.

D.7 Specific authorisations within D.3(b) above may be issued by the Inland Revenue to approved UK collecting agents or approved UK intermediaries on a disclosed basis or if requested on the basis of a unique account designation supplied in the clearance application in respect of clients of overseas custodians and agents who wish to remain anonymous. In such cases the authorisation may refer to payments to an agent or custodian in respect of a

uniquely designated account number. The client will need to provide the Inland Revenue with a certificate as in D.3(a) above. The condition at paragraph D.9 below will apply to these authorisations also.

D.8 Specific authorisations<sup>38</sup> within D.3(b) may also be provided

- i. in respect of sovereign immune entities, and
- ii. where a certificate within D.3(a) cannot be given but the requirements for relief under the other income article of the relevant DTA are met

D.9 **Certificates within D.3(a) should be renewed every three years.** A certificate dated more than three years earlier than the time of payment of a manufactured overseas dividend is not valid authority to pay without accounting for tax.

D.10 Where the manufactured overseas dividend is claimed from an approved UK intermediary or approved UK collecting agent by an approved UK intermediary or approved UK collecting agent the claimant should whenever appropriate issue a notice under the regulations authorising payment without accounting for tax. Notices issued in error should be recalled and tax accounted for in the usual way. Notices should be in the form provided (see Appendix C) by the Board or a form authorised under the arrangements entered into with the Board.

D.11 Where UK agents issue notifications to pay a manufactured overseas dividend without deduction of tax they must specify the name of their client or if they wish to protect the anonymity of their clients their client's unique designation number.

D.12 Payments without accounting for tax under these arrangements will not be possible if an agent is unable to specify both the client and the amount of that client's dividend entitlement for example because a pooling system is operative.

<sup>38</sup> A specific authorisation has been given in respect of payments by AUKIs in connection with the Euroclear Securities Lending and Borrowing Program operated by Euroclear Bank, and MODs paid to Euroclear Bank under this programme may therefore be made without accounting for tax.



**ARRANGEMENT UNDER REGULATION 3 SI 1993 NO.1957**

This form is for use by approved UK collecting agents and approved UK intermediaries wishing to enter into arrangements with the Board under the Double Taxation Relief Regulations SI 1993 No.1957 to make payments of manufactured overseas dividends without accounting for tax under paragraph 4(2) Schedule 23A ICTA 1988 or under the Manufactured Overseas Dividends Regulations SI 1993 No. 2004.

**DECLARATION BY APPROVED UK COLLECTING AGENT OR APPROVED UK INTERMEDIARY**

I.....  
(Full name of signatory and capacity in which completed)

acting for .....  
(Full name and address of applicant)  
.....  
.....  
.....

am an officer duly authorised by the approved UK collecting agent or approved UK intermediary (the applicant) named above to make this declaration and undertake on its behalf that it will account for tax on all payments of manufactured overseas dividends except where it:

- a. holds a validly completed certificate in the form provided in respect of the person beneficially entitled to the manufactured overseas dividends,
- or
- b. holds a specific authorisation from the Inland Revenue in respect of the person to whom or for whose benefit the manufactured overseas dividend is paid.

I declare that the applicant will account for tax, and interest on that tax, to the Inland Revenue in respect of any manufactured overseas dividend which may have been paid to a person not entitled to receive that dividend without accounting for tax, as if the arrangement with the Board of Inland Revenue had never applied to that amount.

Signature..... Date.....



**Inland  
Revenue**

Ref No.....  
(for insertion by Inland Revenue when photocopied)

**APPLICATION FOR RELIEF FROM UK INCOME TAX ON MANUFACTURED OVERSEAS DIVIDENDS  
(Double Taxation Relief (Taxes on Income) (General) (Manufactured Overseas Dividends) Regulations SI 1993  
No. 1957)**

**Part 1 Claimant's Declaration**  
I declare, to the best of my knowledge and belief, that

.....  
(insert name of claimant)  
Claimant's address .....

.....  
is beneficially entitled to the manufactured overseas dividends receivable from approved UK intermediaries or  
approved UK collecting agents as defined in SI 1993 Number 2004 and claim exemption under the Other Income  
article of the ...../UK Tax Convention in respect of the manufactured overseas dividends

.....  
(claimant's signature)

**Part 2 Certificate of Tax Authority**

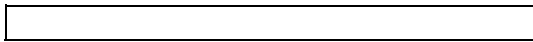
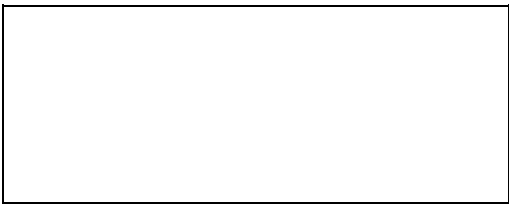
I certify  
(a) that.....is resident in .....within  
(insert name of claimant)  
the meaning of the ...../United Kingdom Tax Convention and

(b)\* is subject to tax on the manufactured dividends to which it is entitled.  
\* delete if not required by Other Income article of convention

.....  
(signature) (date)

Stamp of overseas revenue authority

Overseas revenue reference No.



Copy of Inland Revenue original  
Issued on  
.....  
Signature.....

**APPENDIX E - Regulation 10(3) Certificate**

**OVERSEAS SECURITY**

**TAX CERTIFICATE : Issued under Regulation 10(3), SI 1993 No. 2004**

(For use by approved UK intermediaries)

This form shall be used only for dividends on overseas securities as defined in paragraph 1(1) Schedule 23A ICTA 1988, other than overseas securities which represent loan relationships (Regulations 2(2) and 2B of the Manufactured Overseas Dividend Regulations - SI 1993 No. 2004).

We hereby certify that on paying the dividend shown below

to.....  
of.....

.....  
the securities referred to below formed part of a larger block of the same securities and the original certificate ♦ of deduction of overseas tax is held available for inspection by the Inland Revenue.

♦ if the original certificate has been returned to the relevant fiscal authority suitable alternative evidence must be available for inspection

Amount and description of securities etc.....  
.....

Due and payable date of dividend, or if paid abroad, date realised .....	Country of origin.....
---	---------------------------

Gross amount of dividend*	£
---------------------------	---

\* This is the amount to be included in a return of income for UK tax purposes.

Less overseas tax if any at.....% @	£
-------------------------------------	---

@The rate applicable may not exceed the relevant withholding rate

Net amount of payment	£ _____
-----------------------	---------

Signature.....

Firm.....

Address.....

.....

Date.....

Note  
Relief from United Kingdom tax may be due in respect of overseas tax directly or indirectly relevant to the dividend /interest. Any question regarding relief should be raised with the appropriate Inspector of Taxes.

This form of certificate has been provided by the Board of the Inland Revenue



**APPENDIX F Regulation 15 Certificate**

**OVERSEAS SECURITY**

**TAX CERTIFICATE : Issued under Regulation 15 SI 1993 No 2004**

(For use by approved UK intermediaries and approved UK collecting agents)

This form shall be used only for manufactured dividends on overseas securities as defined in Paragraph 1(1) Schedule 23A Taxes Act 1988, other than overseas securities which represent loan relationships (Regulations 2(2) and 2B of the Manufactured Overseas Dividend Regulations - SI 1993 No. 2004).

We hereby certify that on paying the dividend shown below  
to.....  
of.....  
.....  
we deducted (UK intermediaries) or accounted for (UK collecting agents) tax as shown and that we have paid , or will pay the tax as provided under Reg 11 SI 1993 No. 2004 to the Revenue

Amount and description of securities etc.....

Date of payment ..... Country of origin .....

Gross amount of dividend\* £

\* This is the amount to be included in a return of income for UK tax purposes.

Less relevant withholding tax representing overseas tax  
if any at.....% on £

Net amount of payment £ \_\_\_\_\_

Signature .....

Firm.....

Address.....

Date.....

Note  
Relief from United Kingdom tax may be due in respect of overseas tax directly or indirectly relevant to the dividend.

Any question regarding relief should be raised with the appropriate Inspector of Taxes.

This form of certificate has been provided by the Board of the Inland Revenue

**APPENDIX G - UNDERTAKINGS**

Where a person wishes to be approved as a UK Intermediary or a UK Collecting Agent, the appropriate form of undertaking as set out below should be completed, and sent to the Inland Revenue at

City B Large Business Office  
City Gate House  
Finsbury Square  
LONDON EC2A 1BT

**Approved UK Intermediary**

"On behalf of ..... I seek the approval of the Inland Revenue to act as an approved UK intermediary for manufactured overseas dividends. I confirm that the intermediary is either resident in the UK or trades in the UK through a branch or agency and, if approved, will

- a) accept that its name should be included in a list to be published under the authority of the Inland Revenue, and
- b) notify the Inland Revenue immediately if it ceases to satisfy the conditions for approval, or wishes to withdraw from its approved status.

Authorised signatory ..... Date .....

**Approved UK Collecting Agent**

"On behalf of ..... I seek the approval of the Inland Revenue to act as an approved UK collecting agent for manufactured overseas dividends. I confirm the collecting agent is either resident in the UK or trades in the UK through a branch or agency and, if approved, will

- a) accept that its name should be included in a list to be published under the authority of the Inland Revenue, and
- b) notify the Inland Revenue immediately if it ceases to satisfy the conditions for approval, or wishes to withdraw from its approved status.

Authorised signatory ..... Date .....