



Manufactured Payments on Overseas Securities

Guidance Notes

December 2003

Revenue Policy, Business Tax

CONTENTS

<u>1. Introduction</u>	<u>4</u>
<u>2. Scope of Legislation</u>	<u>5</u>
<u>3. Terms Used in these Notes</u>	<u>6</u>

STATUTORY BACKGROUND

<u>4. Schedule 23A ICTA 1988</u>	<u>10</u>
<u>5. Other relevant legislation</u>	<u>12</u>

DETAILED RULES - SI 1993 No 2004

<u>6. Manufactured Overseas Dividends paid in connection with Loan Relationships (Regulation 2B)</u>	<u>15</u>
<u>7. The rate of withholding tax (Regulation 3)</u>	<u>16</u>
<u>8. Payments to Approved UK Intermediaries or Approved UK Collecting Agents (Regulation 4)</u>	<u>17</u>
<u>9. Manufactured Overseas Dividends Paid To Residents Outside the UK (Regulation 5)</u>	<u>19</u>
<u>10. Retention and Record of Notices Given under Regulations 4 and 5 (Regulation 6)</u>	<u>21</u>
<u>11. Reduction of tax payable under Paragraph 4(3) Schedule 23A (Regulation 6A)</u>	<u>22</u>
<u>12. Disapplication of Paragraph 4(3) Schedule 23A ICTA 1988 (Regulation 7)</u>	<u>23</u>
<u>13. Offsetting of Tax by Approved UK Intermediaries (Regulation 9)</u>	<u>26</u>
<u>14. Offsetting of Tax by dividend manufacturers who are not Approved UK Intermediaries (Regulation 9A)</u>	<u>28</u>
<u>15. Matching of dividends and manufactured overseas dividends (Regulation 10)</u>	<u>29</u>
<u>16. Accounting for tax (Regulation 11)</u>	<u>32</u>
<u>17. Payments made without accounting for tax in accordance with arrangements with the Board under the Double Taxation Relief Regulations (Regulation 14)</u>	<u>33</u>

<u>18. Vouchers (Regulation 15)</u>	<u>34</u>
<u>19. Powers of inspection</u>	<u>36</u>
<u>20. Corporation Tax Treatment</u>	<u>37</u>
Recipients of manufactured overseas dividends	37
Payers of manufactured overseas dividends	37
<u>21. Manufactured overseas dividends in respect of interest on securities representing loan relationships</u>	<u>39</u>
<u>22. Income Tax treatment of manufactured overseas dividends in respect of dividends on overseas equities</u>	<u>40</u>
Recipients of manufactured overseas dividends	40
Payers of manufactured overseas dividends	40
<u>23. Income Tax treatment of manufactured overseas dividends in respect of interest on securities representing loan relationships</u>	<u>41</u>
Recipients of manufactured overseas dividends	41
Payers of manufactured overseas dividends	41
<u>24. Transactions denominated in foreign currency</u>	<u>42</u>
<u>25. Permanent establishments</u>	<u>42</u>
Overseas permanent establishments of UK companies	42
UK permanent establishments of overseas companies	43
<u>26. French Indemnity Payments</u>	<u>43</u>

APPENDIX A - EXAMPLES	45
------------------------------	-----------

A1. Rate of relevant withholding tax (RWT) on a manufactured overseas dividend (MOD) paid (paragraph 7)	45
A2. Reverse charge - non residents (paragraph 3.4)	46
A3. Offsetting by an AUKI (paragraph 13)	48
A4. Interaction of reverse charge and offsetting	49
A5. Offsetting by non-AUKI (paragraphs 8.1, 8.5 and 14)	50
A6. Matching by an AUKI (paragraph 15)	51
A7. Income and Corporation tax treatment (paragraphs 21 to 24)	54

APPENDIX C	57
APPENDIX D Evidence for paying gross	58
APPENDIX E - Regulation 10(3) Certificate	61
APPENDIX F Regulation 15 Certificate	63
APPENDIX G Undertakings for AUKI/AUKCA status	63

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, or contact Richard Rogers at

Inland Revenue
Revenue Policy, Business Tax
Room 4E1, 4th Floor
22 Kingsway
London
WC2B 6NR

Telephone 020-7438-6563

e-mail: Richard.Rogers@ir.gsi.gov.uk

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 following the amendment to SI1993/2004 by SI2003/2582. Earlier versions of the notes can be accessed on the Inland Revenue website:

<http://www.inlandrevenue.gov.uk/mpgn/> .

1.3 You can get further advice from the City B Large Business Office helpdesk. The address for this is HMRC LBS Financial Sector, 4th Floor, 22 Kingsway, London WC2B 6NR.

Tel: 020 7438 7346.

*** 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 – December 2003

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 equities¹.
- 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 securities².
- 2.3 These notes explain the rules. They also (see chapter 5) describe briefly other related legislation about stocklending and repurchase (repo) transactions.

¹ 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.

² 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.

Overseas Dividends and Overseas Securities

3.2 "Overseas dividend" means any interest, dividend or other annual payment payable in respect of any overseas securities.

3.3 "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 Kingdom³

Approved UK Intermediaries and Approved UK Collecting Agents

3.4 Concerns may be approved as intermediaries or collecting agents under the Regulations. 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 involves collecting or securing payment of overseas dividends, or be a custodian of securities⁴.

3.5 AUKIs and AUKCAs will be subject to audit by City B Large Business Office and.

3.6 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).

³Paragraph 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.

⁴SI 2001 No.403 inserted the definition of collecting agent into regulation 2 of SI 1993 No.2004, from 1 April 2001. Previously an AUKCA had to be a collecting agent within the definition of Chapter XVIIIA of Part IV of ICTA 1988.

Manufactured Overseas Dividends

General Definition

3.7 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 5.4 below as regards deemed manufactured overseas dividends in certain repo transactions).

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

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

this does not amount to dividend manufacture (and see paragraph 3.13 below regarding the status of the payer).

Scrip Dividends and Bonus Issues

- 3.9 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.
- 3.10 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

- 3.11 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

- 3.12 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

- 3.13 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.

3.14 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 many 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" 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.
- 4.6 For an overseas recipient a manufactured overseas dividend may represent "other income" for the purposes of UK double taxation agreements.

- 4.7 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 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).

5. Other relevant legislation

Bondwashing

5.1 **Section 731 ICTA 1988** (bondwashing) does not apply⁵ 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.

Stock Lending

5.2 **Section 263B TCGA 1992** ensures that acquisitions and disposals under stock loans are disregarded for Capital Gains Tax purposes⁶. 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.

5.3 **Section 736B ICTA 1988** applies where, as a result of a stock lending arrangement, a dividend or interest on any securities⁷ 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 sale⁸.

⁵ Section 731(2A) ICTA 1988 - with effect from 1 May 1995.

⁶ 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.

⁷ "Securities" for this purpose includes all overseas securities, both bonds and equities.

⁸ Section 263B TCGA 1992. N.B. where the transfers are by way of sale, section 737A may apply.

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. The deemed payment is not deductible in computing the taxable profits of the borrower⁹.

- 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

- 5.4 **Section 737A ICTA 1988¹⁰** has the effect of deeming a manufactured overseas dividend to be paid where, in a sale and repurchase arrangement which crosses a dividend date, no manufactured payment is made to the seller and the repurchase price is accordingly reduced so as to reflect the amount of income foregone.
- 5.5 Where the section applies, Schedule 23A and the dividend manufacturing regulations apply as if
- the relevant person (the first buyer in a simple repo) were required under the arrangements to pay an amount representative of the dividend;
 - a payment were made by that person in discharge of that requirement; and

⁹ Section 736B ICTA 1988 applies in relation to arrangements entered into on or after 1 July 1997. S736B(2A) ensures that the deemed payment does not create a tax deduction for the borrower if made on or after 3 October 2000.

¹⁰ S737A came into effect in relation to overseas securities with effect from 6 November 1996 - SI 1996 No. 2645 (C.74).

- the payment were made on the date the repurchase price of the securities becomes due.

5.6 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 (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.

5.7 In these Notes “manufactured overseas dividend” includes a deemed dividend under Sections 737A or 736B .

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 relationship¹¹. 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 money¹². 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)¹³.

¹¹ SI 1996 No. 2643 - with effect from 6 November 1996.

¹² 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).

¹³ 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 permanent establishment, 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 withholding tax is included in the Double Tax Relief Manual which can be accessed at <http://www.inlandrevenue.gov.uk/manuals/DTRmanual/>
- 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.

Payments which can be made without accounting for tax

- 7.6 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 representative¹⁴ (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 or agent is required to pay without accounting for tax under Regulation 5 (see chapter 9 below), or

¹⁴ Regulation 4 SI 1997 No. 988 with effect from 1 July 1997.

- (b) the collecting agent is required to pay without accounting for tax because he is paying on to an approved UK intermediary who has issued a Notice under Regulation 4(6)(b) to the collecting agent. An approved UK intermediary may issue a Notice under Regulation 4(6)(b) if that intermediary pays gross under Regulation 5. See Chapter 9. From 1 January 2004 notices under Regulation 4(6)(b) may be issued electronically.

8.4 A specimen Notice under Regulation 4(6)(b) is provided in Appendix C. This form also covers Notices under Regulation 5(2)(b)(iii) (see paragraph 9.3) and Regulation 7(2)(d) (see chapter 12). Again, from 1 January 2004 these Notices may be issued electronically.

Non-AUKI receives real dividend

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, 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. Offsetting does not apply where the non-AUKI itself pays gross under Regulation 5, instead the foreign tax can be given as expense relief under ICTA88/s811 (see chapter 14 below).

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

MOD is paid to non-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 a UK resident (or by a non-resident in the course of a trade carried on in the UK through a permanent establishment)
- to or for the benefit of a person beneficially entitled to the MOD who is not a UK recipient. A UK recipient is defined in ICTA88/Sch23A paragraph 4(3A) as a person who is either UK resident or who receives the MOD for the purposes of a trade carried on in the UK through a permanent establishment.

AUKI pays to AUKI or AUKCA who pays on in a chain ending with gross payment to a non-UK recipient

9.2 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 makes the payment to or for the benefit of a person beneficially entitled to it who is not a UK recipient.

9.3 In that case, the last payer 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.

9.4 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.

9.5 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(6)(b), 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(6)(b) 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.
- 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).

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 four situations.

UK recipient pays on gross: Regulation 7(2)(a)

12.2 The first is where the UK recipient (paragraph 9.1 above) is paying on an equivalent manufactured overseas dividend, and is required to pay that amount gross under Regulation 5 (chapter 9 above).

AUKCA receiving on behalf of non-resident: Regulation 7(2)(c)

12.3 The second 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. See Appendix D below.

AUKCA recipient entitled to pay on gross to AUKI: Regulation 7(2)(d)

12.4 The third 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 in turn pays gross under Regulation 5, and has issued a notice to the approved UK collecting agent under Regulation 7(2)(d) then there is then no charge on the approved UK collecting agent under Paragraph 4(3).

12.5 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(6)(b), Regulation 5(2)(b)(iii) or Regulation 7(2)(d).)

Overseas Manufacturer receives real dividend

12.6 The fourth 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

- 12.7 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 4.5 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.
- 12.8 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.
- 12.9 An approved intermediary or collecting agent will normally need to secure an original voucher to demonstrate the condition in paragraph 12.6 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.
- 12.10 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.
- 12.11 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.
- 12.12 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.

<i>Record Keeping where paragraph 4(3) is disapplied</i>
--

- 12.13 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.
- 12.14 Where paragraph 12.3 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.
- 12.15 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.
- 12.16 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 dividends¹⁵;
 - (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

¹⁵ 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 received¹⁶ (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.
- 14.3 The rule at paragraph 14.1 does not apply where a person who is not an approved UK intermediary is required to pay the manufactured overseas dividend gross under Regulation 5. In that case, the manufacturer must expense the overseas tax suffered on the real dividend under ICTA88/S811. This rule is intended to replicate the effect of Regulation 9(4B) for non-AUKIs (see paragraph 15.5).

¹⁶ 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 by virtue of Regulation 5.
 - (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 tax¹⁷ (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 a UK 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 tax (which is deemed under ICTA88/Schedule 23A paragraph 4(4)(a) to be overseas 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 UK recipient. 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. Voucher passing/reshaping now only applies to UK recipients.
- 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 the 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 must be passed on to the UK

¹⁷ Regulation 6 SI 1997 No. 988 which inserted a new Regulation 9(4B) with effect from 1 July 1997.

recipient 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 UK 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 Regulations¹⁸, 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 period¹⁹ 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. 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).

¹⁸ 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.

¹⁹ The definition of chargeable period is in Regulation 2A.

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 (Regulation 14)

17.1 Every overseas dividend manufacturer or approved UK collecting agent who pays a manufactured overseas dividend without accounting for tax by virtue of Regulation 5(1B) should keep a record showing:

- (a) the date of payment and the amount of the manufactured overseas dividend;
- (b) the name of the person to whom payment was made; and
- (c) his grounds for believing that the payment should be made without deduction of tax; and
- (d) particulars of the overseas securities and the overseas dividends on those securities to which the manufactured overseas dividend relates.

17.2 This record together with any other evidence on which the belief that payment should be made gross was based, 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.

17.4 Appendix D gives further guidance on the operation of these rules.

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 paid²⁰.

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.

²⁰ 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 12.7 to 12.10 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 1970²¹. 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.

²¹ 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 D²².
- 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 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 V of Schedule D as appropriate.

Payers of manufactured overseas dividends

- 20.4 The normal rule is that the gross amount of a manufactured overseas dividend representative of an equity dividend is treated as an annual payment²³. Relief for

²² 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.

²³ Paragraph 4(2), Schedule 23A, ICTA1988

corporation tax purposes is therefore normally 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 ordinary rules of Case 1, be allowable as a deduction in computing profits of the trade;
- (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, in the circumstances set out in paragraphs 9.1 (manufactured overseas dividends paid to or for the benefit of non-UK recipients) or 9.2 above (chains of AUKIs/AUKCAs involving non-UK end recipients), to make payment without accounting for tax under Paragraph 4(2) Schedule 23A. Subject to the ordinary rules of case 1 the payment will be allowable as a deduction in computing the profits of the AUKI's trade. .

20.7 However, where a payment is made by a non-AUKI without accounting for tax in the circumstances set out in paragraph 9.1 above then the payment is treated as an annual payment but not so as to require the deduction of relevant withholding tax. So again in these circumstances relief for corporation tax is normally available as a charge.

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 treated²⁴ 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.

²⁴ 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 individual²⁵ only if the payment is made for bona fide commercial reasons in connection with the individual's trade, profession or vocation²⁶.

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.

²⁵ "Individual" includes a Scottish partnership in which at least one partner is an individual - Section 347A(6) ICTA 1988.

²⁶ 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. Permanent Establishments

- 25.1 Although most double taxation agreements have the effect of taxing a local permanent establishment 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 permanent establishment and its head office; nor can a manufactured payment flow between a permanent establishment and its head office. This has a number of ramifications in the manufactured overseas dividend field.

Overseas permanent establishments of UK companies

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

UK permanent establishments of overseas companies

- 25.3 Where a manufactured overseas dividend is paid to or for the benefit of an overseas company (see Chapter 9 above) the manufacturer 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 permanent establishment.
- 25.4 The head office (or non-UK permanent establishment) of an overseas company with a UK permanent establishment may borrow, or repo in, securities from a counterparty and pass them to the UK permanent establishment. Provided the counterparty is not a UK resident then gross payment may be made by the permanent establishment to the overseas company. Where the permanent establishment is an authorised UK intermediary then it may issue Appendix C notices (paragraph 9.4 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 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 :
- (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%.

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 12.6): 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	<u>10,000</u>	

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 3.8). 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 12.9- 12.11.

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 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) satisfying the conditions in Regulation 5(1B), or
- ii) receipt of a notice issued under Regulation 4(6)(b), 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 REGULATION 14: EVIDENCE FOR PAYING MANUFACTURED OVERSEAS DIVIDENDS WITHOUT ACCOUNTING FOR TAX

D.1 The right to make payment under Regulation 5(1B) without deduction of tax is an objective one based upon the beneficial owner of the manufactured overseas dividend being a person who is not a “UK recipient”²⁷. The Revenue has the right to recover any tax where payment was incorrectly made without deduction of tax. “UK recipient” is defined in ICTA88/Sch 23A paragraph 4(3A) to be a person who is either resident in the UK or, if not so resident, who receives the manufactured overseas dividend for the purposes of a trade carried on in the UK through a permanent establishment.

D.2 Regulation 14 does not specify what evidence needs to be held or obtained as evidence that payment was properly made under Regulation 5(1B) without deduction of tax, but requires that such evidence that is used to justify paying gross should be recorded and retained for 6 years. Where no evidence of beneficial ownership is held at the time of payment, payment should be made under deduction of tax.

D.3 The notes below are intended to illustrate the approach to types of evidence the Revenue will need to satisfy itself that payment was correctly made without deduction of tax. They are not intended as an exhaustive list of examples of evidence which would be acceptable, but rather as a guide to the approach which should be adopted in gathering the necessary evidence. The overriding principle is that the evidence should be obtained in good faith and give reasonable grounds for believing that the beneficial owner is not a UK recipient.

D.4 The first question a payer must ask is whether the recipient is the beneficial owner of the manufactured overseas dividend (i.e. receives the payment in a principal capacity). Where the answer is yes, manufacturers should proceed as in D.5 below. Where the answer is **no**, manufacturers should proceed as in D6 below.

D.5 Where the recipient is beneficially entitled to the manufactured overseas dividend, the manufacturer should either already hold or obtain evidence from the recipient that it is not a UK recipient.

²⁷ A specific authorisation has been given to Euroclear, and all MODs paid to Euroclear may be made without accounting for tax.

D.6 Where the recipient is not the beneficial owner then the manufacturer should either already hold or obtain evidence that the beneficial owner is not a UK recipient. This evidence could be obtained directly from the beneficial owner or from the recipient on behalf of the beneficial owner.

D.7 The evidence that the beneficial owner is not a UK recipient can be either formal or informal, but should be in such a form as can be retained for 6 years for later inspection and audit. The evidence need not be obtained specifically for the purposes of paying a manufactured overseas dividend without deduction of tax, but could have been obtained as a result of normal business dealings with that counterparty.

D.8 For example, but subject to D9 below,

- a) acceptable evidence could take the form of a letter or e mail from the beneficial owner, or where different, the recipient on behalf of the beneficial owner(s), stating that it was not a UK recipient;
- b) such evidence might also take the form of information provided by the recipient for the purposes of opening their account with the manufacturer, or representations made by the beneficial owner (or the recipient on behalf of the beneficial owner) in stock lending, repo or other commercial contracts which clearly and reasonably shows that the beneficial owner is not a UK recipient;
- c) where a MOD2 or other form of evidence acceptable under the regime in force until 31 October 2003 is already held by the overseas dividend manufacturer, this will be acceptable evidence that payment should continue to be made gross.
- d) As may be noted from the definition of “UK recipient” set out at D.1 above, care should be taken to ensure that an overseas entity does not have a UK trading operation, or if it does, that the MOD paid does not relate to that operation.

D.9 No specific time limit will be placed on how long evidence that the beneficial owner is not a UK recipient remains valid. Nor will specific intervals at which evidence should be refreshed be imposed. But in continuing to rely on past evidence, two important caveats should be borne in mind:

- a) Where there has been a break in business dealings with a particular counterparty, an overseas dividend manufacturer must obtain fresh evidence that the beneficial owner is not a UK recipient. For this purpose but subject to point (b) below, a “break” will be considered to be a period of more than 3 years.
- b) Where anything comes to the attention of the overseas dividend manufacturer which might indicate a change in the circumstances of the beneficial owner, and where different the recipient, and which might reasonably suggest that the status as a non UK recipient could have changed, the manufacturer must refresh the evidence before continuing to pay manufactured

overseas dividends without deduction of tax. A simple but obvious example here would be a notification of a change of address (particularly to the UK).

D.10 Where the beneficial owners of manufactured payments are a mixture of UK and non-UK recipients the manufacturer should already hold or obtain evidence as above of the proportion of UK and non-UK recipients and, in the absence of other information, apportion on this basis.

D.11 In applying D.10 above to cases where the recipient or owner of the manufactured overseas dividend is an entity which represents a group of underlying persons (such as a partnership or a collective investment scheme), it will be necessary to determine whether under local law the entity is transparent for tax purposes and whether it is the beneficial owner. In determining at these issues, attention is drawn to Revenue guidance which has already been issued in Tax Bulletins 39 and 50.

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. Under paragraph 4(4)(a) Schedule 23A Taxes Act 1988 the tax is overseas tax.

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

Before a payment can be made gross under Regulation 5(2) the manufacturer must be approved as a UK Intermediary or a UK Collecting Agent. To request approval , 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 permanent establishment 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 permanent establishment 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

