

*Bill 6: Corporation Tax
Manufactured payments and repos
May 2008: CC/SC (08) 20*

Manufactured payments and repos

Overview

1. This Part contains provisions about stock lending and other transactions in the financial markets giving rise to manufactured payments. It is based on sections 231AA, 231AB and 736B to 736D of, and Schedule 23A to, ICTA, sections 263B and 263C of TCGA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006. The provisions of this Part largely correspond to provisions of Part 11 of ITA.

2. The corporation tax equivalents of many of the provisions in Part 11 of ITA were superseded by Schedule 13 to FA 2007 (sale and repurchase of securities) and repealed. Schedule 13 to FA 2007 is being rewritten in Chapter 9 of Part 7 of Bill 5 (see the draft Bill 5 published for consultation in February 2008).

3. The draft clauses replicate Part 11 of ITA as far as possible. They differ from Part 11 of ITA in two respects.

4. First, where the draft clauses rewrite provisions of ICTA which are corporation tax specific there are no corresponding provisions in ITA. For example, there is no equivalent in ITA of the unallowable purpose test imposed for corporation tax purposes by paragraph 7A of Schedule 23A to ICTA and rewritten in clauses 17 to 19. In addition there are some provisions in ITA which are not reflected in the draft clauses. For example, paragraph 2 of Schedule 23A to ICTA, as amended, does not include any provision corresponding to section 573(4) of ITA (manufactured dividends on UK shares: payer UK resident and not a company), because that subsection is income tax specific; accordingly, no such provision appear in the draft clauses.

5. Second, where necessary the draft clauses use terminology specific to corporation tax where Part 11 of ITA uses terminology specific to income tax. For example, since persons other than companies are not liable to corporation tax, the draft clauses use the word “company” to refer to the taxpayer where Part 11 of ITA uses the word “person”.

6. In December 2007, HM Treasury and HMRC published a consultation document, *Principles-based approach to anti-avoidance*, proposing (among other things) the repeal of some of the provisions rewritten in these draft clauses. The HMRC 2008 Budget document *Simplifying anti-avoidance: a progress report on the anti-avoidance simplification review* announced that the Government had deferred introduction of the principles-based legislation to the 2009 Finance Bill in order to allow for further consultation. It remains to be seen what implications the anti-avoidance simplification review will have for the provisions rewritten in these draft clauses. The project has been liaising with colleagues working on the anti-avoidance simplification review and will continue to do so. If the provisions rewritten in these draft clauses are amended or repealed by FA 2009, the draft clauses will be adjusted accordingly and, if appropriate, the structure of the draft legislation will be revisited. Meanwhile, in view of the complexity of this legislation, the draft clauses and draft

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commentary are being published for consultation to give interested parties as much time as possible to consider them.

Chapter 1: Introduction

Clause 1: Overview of Part

7. This clause gives an overview of the Part. It is new.

Clause 2: Meaning of “UK shares” and “UK securities”

8. This clause defines “UK shares” and “UK securities”. It is based on sections 231AA, 736B and 736C of, and paragraph 1 of Schedule 23A to, ICTA and section 263B of TCGA. It corresponds to section 566 of ITA.

Clause 3: Meaning of “overseas securities” and “overseas dividend”

9. This clause defines “overseas securities” and “overseas dividend”. It is based on sections 736B and 736C of, and paragraph 1 of Schedule 23A to, ICTA and section 263B of TCGA. It corresponds to section 567 of ITA.

Clause 4: Meaning of “manufactured dividend”

10. This clause defines “manufactured dividend” by reference to clause 8 of this Bill. It is based on sections 231AA and 231AB of, and paragraph 2 of Schedule 23A to, ICTA.

Clause 5: Meaning of “stock lending arrangement”

11. This clause defines “stock lending arrangement”. It is based on sections 231AA, 736B and 736C of ICTA and sections 263B and 263C of TCGA. It corresponds to section 568 of ITA.

Chapter 2: Manufactured payments

Overview

12. This Chapter is concerned with the treatment of manufactured payments, in particular:

- the taxability of manufactured payments in the hands of the recipient (or, if different, the owner);
- tax relief for the payer of manufactured payments; and
- taxes management.

13. The detailed structure of the Chapter is as follows:

- Clauses 6 and 7 – introduction;
- Clauses 8 to 10 – manufactured dividends on UK shares;

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- Clauses 11 to 13 – manufactured overseas dividends;
- Clauses 14 to 16 – special cases;
- Clauses 17 to 19 – manufactured payments under arrangements with unallowable purpose;
- Clauses 20 and 21 – general regulation-making powers.

14. Manufactured payments will normally arise under stock loan and repo agreements, but they may also occur if there has been a short sale of securities. A short sale is a sale of securities by someone who does not own the securities at the time of selling them, so is required to acquire them at a time between the date of the bargain and the date when the seller has to deliver them to the purchaser. Dealers may sell short for a variety of reasons. For example, dealers may expect the market price of the securities to fall between the time of the sale bargain and the time at which they expect to buy and so may choose to delay acquiring securities.

15. A consequence of short selling can be that the dealer sells the securities cum-div (with dividend) but buys them ex-div (without dividend – leaving the right to the next dividend with the seller). The dealer pays the buyer a sum as compensation for the dividend that the buyer expected to receive, but did not. This sum is a manufactured payment.

16. Many of the detailed rules, especially as regards manufactured overseas dividends (MODs), are laid down in regulations. This Bill does not rewrite any of these regulations.

Clause 6: Overview of Chapter

17. This clause provides an overview of the Chapter. It is new.

Clause 7: Meaning of “manufactured interest” and “manufactured overseas dividend”

18. This clause defines “manufactured interest” and “manufactured overseas dividend”. It is based on paragraph 4 of Schedule 23A to ICTA (which defines “manufactured overseas dividend”). It adopts the corporation tax definition of “manufactured interest” used in the “loan relationships” Part of Bill 5; this is a minor change in the law. See *Change 609*. This definition is used in clause 19(1) of this Bill.

Q1. We welcome comments on the proposal to use the same definition of “manufactured interest” in the “manufactured payments and repos” Part of Bill 6 as is being used in the “loan relationships” Part of Bill 5 (Change 609).

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19. The clause refers to clause j061097i of Bill 5, which is based on section 97 of FA 1996. See clause 523 of the draft Bill 5 published for consultation in February 2008.

Clause 8: Manufactured dividends on UK shares

20. This clause defines “manufactured dividend” and states how the Corporation Tax Acts apply in the circumstances set out in the clause. It is based on paragraph 2 of Schedule 23A to ICTA, and corresponds to section 573(1) to (3) and (5) of ITA.

Clause 9: Manufactured dividends on UK shares: Real Estate Investment Trusts

21. This clause deals with manufactured dividends (manufactured property income dividends or MPIDs) which are representative of dividends (property income dividends or PIDs) paid by Real Estate Investment Trust companies or by principal companies of Real Estate Investment Trust groups. It is based on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

22. *Subsections (1) to (3) and (8)* correspond to section 574 of ITA.

23. This Bill will rewrite the FA 2006 provisions on Real Estate Investment Trusts. In so doing, this Bill will consequentially amend section 576(1)(b) of ITA. Subsection (1)(b) of this clause will replicate section 576(1)(b) of ITA as consequentially amended, and no particular comments are sought on it at this stage.

Clause 10: Statements about manufactured dividends

24. This clause imposes an obligation on the payer of a manufactured dividend to give the recipient a statement setting out information which may be relevant for tax purposes. It is based on paragraph 2 of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006. It corresponds to section 577 of ITA.

25. This Bill will rewrite the FA 2006 provisions on Real Estate Investment Trusts. In so doing, this Bill will consequentially amend section 577(2) of ITA. *Subsection (2)* of this clause will replicate section 577(2) of ITA as consequentially amended, and no particular comments are sought on it at this stage.

26. *Subsection (8)* refers to sections 12F and 12H of TMA. Consequential amendments inserting these new sections will be included in the draft Bill 6 to be published for consultation in Spring 2009.

Clause 11: Manufactured overseas dividends: treatment of payer

27. This clause deals with the corporation tax treatment of a payer of MODs. It is based on paragraph 4 of Schedule 23A to ICTA.

28. *Subsection (1)* corresponds to section 581(1)(a) and (b) of ITA.

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Clause 12: Manufactured overseas dividends: treatment of recipient

29. This clause deals with the income tax treatment of MODs in the hands of the recipient (or, if different, the owner). It is based on paragraph 4 of Schedule 23A to ICTA.

30. *Subsections (1) to (5)* correspond to section 581(1) to (5) of ITA.

31. *Subsections (6) and (7)* correspond to section 589(3) and (4) of ITA.

Clause 13: Powers about manufactured overseas dividends

32. This clause is concerned with double taxation relief. It is based on paragraph 8 of Schedule 23A, and corresponds to section 582 of ITA.

Clause 14: Manufactured dividends exceeding underlying payments

33. This clause deals with special cases, as do clauses 15 and 16. It is based on paragraph 7 of Schedule 23A to ICTA.

34. If this clause applies, the excess is taken out of the scope of the rules about manufactured payments and is treated as a fee. This may affect relief for the payer or taxability for the recipient (or, if different, the owner) or both, if the person concerned is a corporation tax payer.

35. *Subsections (1) to (4)* correspond to section 583 of ITA.

36. *Subsection (5)* refers to clause j061097 of Bill 5, which is based on section 97 of FA 1996. See clause 524 of the draft Bill 5 published for consultation in February 2008.

Clause 15: Manufactured overseas dividend less than underlying payments

37. This clause overrides clause 12(6) of this Bill (the general rule quantifying the gross amount of a MOD). It is based on paragraph 7 of Schedule 23A to ICTA, and corresponds to section 584 of ITA.

Clause 16: Power to deal with other special cases

38. This clause is a general power to modify the rules about manufactured payments contained in clauses 8 to 12 of this Bill. It is based on paragraph 8 of Schedule 23A to ICTA, and corresponds to section 585 of ITA.

Clause 17: Manufactured payments under arrangements with unallowable purpose

39. This clause denies tax relief for manufactured payments made under arrangements having an unallowable purpose. It is based on paragraph 7 of Schedule 23A to ICTA.

40. *Subsection (1)* states when the clause applies.

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41. *Subsection (2)* sets out the consequences of the clause applying.
42. *Subsection (3)* defines “relevant tax relief”.
43. *Subsections (4)* and *(5)* state when a company is subject to another relevant tax relief restriction for the purposes of this section. See the priority rule in subsection (1)(d).
44. Subsection (5)(b) and (c) refer to clauses [j0696913] and [j2000](2)(b) of Bill 5, which are based on paragraph 13 of Schedule 9 to FA 1996 and section 75(4)(b) of ICTA respectively. See clauses 429[j0696913] and 1143[j2000] of the draft Bill 5 published for consultation in February 2008.
45. *Subsection (6)* requires the manufactured payment to be justly and reasonably apportioned in order to determine the part which is attributable to the unallowable purpose.
46. *Subsection (7)* is a signpost to the definition of “arrangements” in clause 19 of this Bill.

Clause 18: Arrangements with an unallowable purpose

47. This clause states when arrangements have an unallowable purpose for the purposes of clause 17 of this Bill. It is based on paragraph 7A of Schedule 23A to ICTA.
48. *Subsections (2)* and *(3)* define arrangements having an unallowable purpose.
49. *Subsection (4)* restricts the business and other commercial purposes of a company to the purposes of activities in respect of which it is within the charge to corporation tax.
50. *Subsections (5)* and *(6)* limit the extent to which a tax avoidance purpose can be a business or other commercial purpose of the company.

Clause 19: Sections 17 and 18: supplementary provisions

51. This supplementary clause is based on paragraph 7A of Schedule 23A to ICTA.
52. *Subsection (1)* includes a minor change in the law. See *Change 609* and the draft commentary on clause 7 of this Bill.

Clause 20: Powers about administrative provisions

53. This clause is a general regulation-making power. It is based on paragraph 8 of Schedule 23A to ICTA, and corresponds to section 586(1) of ITA.

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Clause 21: Regulation-making powers: general

54. This clause is based on paragraph 8 of Schedule 23A to ICTA. It corresponds to section 588 of ITA.

Chapter 3: Tax credits: stock lending arrangements and repos

Overview

55. This Chapter denies the recipient of a manufactured dividend the benefit of a tax credit on it. It is based on sections 231AA and 231AB of ICTA.

56. Bill 6 will rewrite the corporation tax legislation on distributions, and draft clauses have been published in paper CC/SC (08) 11. The appropriate location in Bill 6 of the draft clauses in this Chapter will be kept under review as work on the Bill advances.

Clause 22: No tax credits for borrower under stock lending arrangement

57. This section prevents the borrower under a stock lending arrangement from claiming a tax credit when that person in economic terms does not retain a dividend on the securities, but passes it on to the lender, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA and section 263B of TCGA, and corresponds to section 592(1) and (2) of ITA.

58. *Subsection (2)* refers to clause [j5231] of this Bill, which is based on section 231 of ICTA. See clause 101[j5231] in CC/SC (08) 11 (distributions).

Clause 23: No tax credits for lender under creditor repo or creditor quasi-repo

59. This clause prevents the lender under a creditor repo or creditor quasi-repo from claiming a tax credit when that person in economic terms does not retain a dividend on the shares, but passes it on to the counterparty, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA, and corresponds to section 593 of ITA.

60. *Subsection (2)* refers to clause [j5231] of this Bill, which is based on section 231 of ICTA. See clause 101[j5231] in CC/SC (08) 11 (distributions).

Clause 24: No tax credits for borrower under debtor repo or debtor quasi-repo

61. This clause counters unusual repo arrangements where the borrower does not pass entitlement to the dividends to the counterparty but the borrower nonetheless receives a manufactured dividend. It is based on section 231AB of ICTA, and corresponds to section 594 of ITA.

62. *Subsection (2)* refers to clause [j5231] of this Bill, which is based on section 231 of ICTA. See clause 101[j5231] in CC/SC (08) 11 (distributions).

Clause 25: Meaning of “creditor repo”, “creditor quasi-repo”, “debtor repo” and “debtor quasi-repo”

63. This clause gives various expressions in this Chapter the meanings which they have in the Chapter of Bill 5 which is based on Schedule 13 to FA 2007. It is based on sections 231AA and 231AB to ICTA.

64. This clause refers to clauses j6077, j6078, j6072 and j6073 of Bill 5. See clauses 527[j6077], 528[j6078], 532[j6072] and 533[j6073] of the draft Bill 5 published for consultation in February 2008, which are based on, respectively, paragraphs 7, 8, 2 and 3 of Schedule 13 to FA 2007.

Chapter 4: Deemed manufactured payments resulting from stock lending arrangements

Overview

65. This Chapter extends the scope of the rules about manufactured payments to certain arrangements under which there is no actual manufactured payment.

Clause 26: Deemed manufactured payments: stock lending arrangements

66. This clause deems the borrower in a stock lending arrangement to make a manufactured payment in certain circumstances. It is based on sections 231AA, 231AB and 736B of ICTA, and corresponds to section 596 of ITA.

67. Usually, a stock lending arrangement will require the borrower to make a manufactured payment to the lender, in which case Chapter 2 of this Part will apply for corporation tax purposes.

68. Exceptionally, a stock lending arrangement may be structured in such a way that the lender is not entitled to receive a manufactured payment, even though the lender has forgone interest or dividends on the securities transferred. In such a case, this section deems the borrower to make a manufactured payment. In consequence, Chapter 2 of this Part applies and, in particular, if the securities are overseas securities, the lender is deemed to receive a MOD. But the borrower is denied any tax relief for the deemed manufactured payment.

Clause 27: Deemed interest: cash collateral under stock lending arrangements

69. This clause is a targeted anti-avoidance rule, deeming interest to arise to the borrower on collateral provided under certain stock lending arrangements. It is based on section 736C of ICTA, and corresponds to section 597 of ITA.

70. Section 736C(11) of ICTA provides that money includes money expressed in a currency other than sterling. This clause omits it.

Clause 28: Tax treatment of interest payable in respect of cash collateral under stock lending arrangements

71. This clause supplements clause 27 of this Bill. It is based on section 736C of ICTA.

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72. *Subsection (6)* corresponds to section 598(3) of ITA.

Clause 29: Cash collateral under stock lending arrangements: supplementary

73. This clause supplements clauses 27 and 28 of this Bill. It is based on section 736C of ICTA, and corresponds to section 598(4) to (6) of ITA.

Clause 30: Quasi-stock lending arrangements and quasi-cash collateral

74. This clause extends the ambit of clauses 26 to 29 of this Bill to cover arrangements which, although achieving the same economic effect as a stock lending arrangement with cash collateral, fall outside either or both of the detailed definitions of “stock lending arrangement” and “cash collateral”. It is based on section 736D of ICTA, and corresponds to section 599 of ITA.

Clause 31: Meaning of “quasi-stock lending arrangement” and “quasi-cash collateral”

75. This clause defines the expressions “quasi-stock lending arrangement” and “quasi-cash collateral”. It is based on section 736D of ICTA, and corresponds to section 600 of ITA.

Schedule 3: Repeals

Paragraph 7A(9) of Schedule 23A to ICTA

76. Repeals and consequential amendments arising from the rewrite of these provisions will be included in the draft of Bill 6 to be published for consultation in Spring 2009. Meanwhile, the opportunity has been taken to note that paragraph 7A(9) of Schedule 23A to ICTA will be repealed without replacement. Following paragraph 5 of Schedule 13 to FA 2007 and the repeal of section 737A of ICTA, it is not possible for a deemed manufactured payment to give rise to “relevant tax relief” within the meaning of paragraph 7A(10) of Schedule 23A to ICTA. Paragraph 7A(9) of that Schedule is therefore otiose.

Annex 1

Change 609: Manufactured payments and repos: definition of “manufactured interest”: clauses 7 and 19

This change:

- adopts the definition of “manufactured interest” used in the loan relationships regime in rewriting the unallowable purpose test for manufactured payments; and
- abolishes the power to apply, with modifications, prescribed provisions of TMA 1970 to manufactured interest.

Section 97(1) of FA 1996 defines “manufactured interest” as:

“any amount [which] is payable by or on behalf of, or to, the company [under review] under any contract or arrangements relating to the transfer of an asset representing a loan relationship, [such that]

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that amount is, or (when paid) will fall to be treated as, representative of interest under that loan relationship”.

“Loan relationship” is defined in section 81 of FA 1996, as supplemented by section 100 of that Act.

Paragraph 1(1) of Schedule 23A to ICTA defines “manufactured interest” as:

“an amount –

- (a) which is representative of a periodical payment of interest on United Kingdom securities [as defined in paragraph 1(1) of that Schedule], and
- (b) which, under a contract or other arrangements for the transfer of the securities, one of the parties is required to pay to the other”.

These two definitions are similar but not the same.

“Manufactured interest” as defined in FA 1996, unlike “manufactured interest” as defined in ICTA, does not necessarily relate to United Kingdom securities. However, paragraph 4(1) of Schedule 23A to ICTA provides:

“This paragraph applies in any case where, under a contract or other arrangements for the transfer of overseas securities, one of the parties (the “overseas dividend manufacturer”) is required to pay to the other (“the recipient”) an amount representative of an overseas dividend on the overseas securities; and in this Schedule the “manufactured overseas dividend” means any payment which the overseas dividend manufacturer makes in discharge of that requirement.”

Paragraph 1(1) of Schedule 23A to ICTA gives “overseas securities” a wide definition, and any manufactured interest as defined in FA 1996 which did not relate to United Kingdom securities would be a MOD. (The converse does not hold; a MOD relating to foreign shares will not be manufactured interest within either definition.)

Broadly speaking, therefore, manufactured interest as defined in FA 1996 will be either manufactured interest as defined in ICTA or else a MOD.

There are two technical differences between the two definitions of “manufactured interest”.

First, “United Kingdom securities” is defined using the expression “securities”, which is non-exhaustively defined in paragraph 1(1) of Schedule 23A to ICTA as including any loan stock or similar security. It is logically possible for an instrument to rank as a “United Kingdom security” as defined in paragraph 1(1) without being a loan relationship as defined in FA 1996. In this respect, the ICTA definition is wider than the FA 1996 definition.

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Second, “manufactured interest” as defined in FA 1996, unlike “manufactured interest” as defined in ICTA, is not necessarily representative of a periodical payment. In this respect, the FA 1996 definition is wider than the ICTA definition.

“Manufactured interest” is defined in these two different ways for historical reasons. Schedule 23A to ICTA (manufactured dividends and interest) was inserted by FA 1991; in that Schedule, “manufactured interest” was chiefly used in provisions relating to income tax which have since been rewritten in ITA. By contrast, FA 1996 uses “manufactured interest” in the corporation tax provisions relating to loan relationships. The income tax provisions of Schedule 23A to ICTA were rewritten in Chapter 2 of Part 11 and Chapter 9 of Part 15 of ITA and repealed.

“Manufactured interest”, as defined in paragraph 1(1) of Schedule 23A to ICTA, is used in:

- the definition of “manufactured payment” in paragraph 7A(10) of that Schedule (manufactured payments under arrangements having an unallowable purpose); and
- the power given by paragraph 8(3)(a) of that Schedule to apply, with modifications, prescribed provisions of TMA 1970 to manufactured interest.

The opportunity has been taken to simplify and harmonise the corporation tax legislation by adopting the FA 1996 definition of “manufactured interest” in rewriting paragraph 7A(10) of Schedule 23A in clause 19 of this Bill.

In principle, adopting the FA 1996 definition of “manufactured interest” in clause 19 of this Bill changes the scope of the unallowable purpose test for manufactured payments, because it narrows the definition of “manufactured interest” in one respect and broadens the definition in another respect. In principle, the former change to the definition is favourable to some taxpayers and the latter change is adverse to some taxpayers.

But, in the context of this provision, it is considered that the technical differences between the two definitions of “manufactured interest” do not amount to any difference in practice.

As paragraph 8(3)(a) of Schedule 23A to ICTA has been superseded by Corporation Tax Self Assessment, this Bill repeals it as unnecessary. The Treasury has not exercised its power to make regulations for corporation tax purposes under paragraph 8(3)(a). Abolishing this power will therefore have no practical effect.

This change is in principle adverse to some taxpayers and favourable to others. But it is expected to have no practical effect as it is in line with current practice.