REGULATORY IMPACT ASSESSMENT (RIA)

MANUFACTURED OVERSEAS DIVIDENDS

Introduction

1. The Government proposes to end the requirement for the payer to account for tax when a Manufactured Overseas Dividend (MOD) is paid to a non-UK recipient. The proposed changes support the Government's aim of modernising the tax system, by ending a paper-based administrative procedure which imposes a compliance burden and cost on businesses.

2. A consultation document, issued 1st May 2003, sets out the detail of the proposed changes and seeks responses from interested parties by 30th June 2003. Subject to those responses, the proposed implementation date is 30th September 2003.

Purpose and intended effect

3. Manufactured Overseas Dividends (MODs) are payments made, during a sale and repurchase agreement or a stock loan, by the current holder of overseas securities to the original holder. The purpose of the payment is to compensate the original holder for non-receipt of the real dividend so that the original holder retains the economic benefits of ownership.

4. At present, income tax must be accounted for by the payer of a MOD. This applies where the MOD represents a dividend on overseas equities (there is already no requirement to account for tax where the MOD represents interest on overseas loan stock). However, provided that certain conditions are satisfied, the vast majority of non-UK recipients can be paid without the need to account for tax. The procedure for certifying this entitlement imposes a cost on the markets, creates uncertainty over whether tax must be accounted for, and can make it unattractive for UK businesses to trade with business partners where certification cannot be obtained. The uncertainty involved can lead to tax being accounted for and then repaid under a double taxation treaty.

5. The proposed change will allow all payments of MODs to non-UK recipients to be made without the need to account for tax. This will remove the burden of the certification procedure.

Risks

6. The current position contains two main risks. Firstly, transactions can be delayed or cancelled altogether whilst the payer determines whether or not tax has to be accounted for - but in the vast majority of cases the payer could normally be satisfied that payment can be made without accounting for tax. Secondly, the conditions for payment to be made without accounting for tax

cannot be met by the residents of all countries because of the particular wording of the Treaty. This is hampering business with trading partners in those countries, which in turn means that UK businesses are not able to choose efficiently between stocks and securities from the widest possible range of sources.

Options

7. "No change" would retain the existing procedure. The current system is well understood by the markets and appears to function with few difficulties. This option would not, however, address the risks, costs and burdens that have been identified.

8. A limited change would involve abolishing the current certification procedure, which the payee must undertake, and replacing it with a self-certification procedure operated by the payer. This would speed up the process but would not address the concerns of business about their ability to trade with a wider range of counter-parties.

9. The consultation document sets out the Government's preferred option, which is to end the need to account for tax on all payments of MODs to parties outside the UK. The document sets out the details of this proposal and invites responses.

Benefits

10. The aim is to bring benefits to UK businesses by:

(a) reducing administration and costs;

(b) improving the ability of UK businesses to source stocks and securities from a wider range of trading partners and across a wider range of security types, thus enabling them to spread risks, source cheaper finance and obtain better returns; and

(c) providing greater certainty about the tax treatment that applies to transactions with overseas counter-parties.

Policy Costs

11. The immediate Exchequer effect of this proposal is expected to be nil or negligible. The proposal is expected to bring economic benefits to the UK by enabling trade with a wider range of business partners and by removing constraints that currently put UK businesses at a disadvantage.

Implementation costs

12. There may be some one-off costs for businesses as they adjust their current systems to reflect the end of the current paper-based procedure. These are expected to be small, and the subsequent cost savings and business benefits are expected to more than outweigh any initial costs.

Competition Impact

13. This proposal is not expected to have any significant impact on competition in the financial markets. The changes are expected to be beneficial in enabling all UK-based firms to trade with a wider range of business partners.

Equality and Diversity

14. These proposals are not expected to have any differential or discriminatory effects on individuals in relation to any issues of equality or diversity.

Securing Compliance

15. The changes will simplify the compliance procedure significantly. At present, the recipient of a MOD must pass a number of tests in order to receive payment without the need to account for tax. The recipient must be resident in a country with which the UK has a double taxation treaty, that treaty must exempt the MOD (in the hands of that recipient) from UK tax under the "other income" article, and the recipient must be subject to tax on the MOD in their home country. Compliance with these conditions must be certified by the tax authority of the recipient's home country.

16. Under the proposed change, the payer and recipient would have to identify that the recipient is not resident in the UK and does not receive the MOD in the course of a trade carried on in the UK through a permanent establishment. This should make the process much simpler and quicker.

Impact on Small Business

17. The impact on small businesses is expected to be negligible. The vast majority of transactions involved are undertaken by large financial concerns, although where there are small businesses involved they should enjoy the benefits from these changes, usually as clients of the larger market participants.

Consultation

18. Informal discussions have been held with representatives of financial businesses, who have identified the burdens, complexity and risks involved

with the current position. The proposal contained in the consultation document has been shaped by those discussions.

19. The consultation will be shorter than the 12 week recommended period so that the changes can be put in place as soon as possible in order to benefit business, but allowing sufficient time for interested parties to comment on the proposals.

20. We would welcome comments on whether or not the assumptions in this Partial RIA are correct. If after consultation our view that the costs and cost savings for businesses are negligible is found to be correct we do not propose to issue a Full RIA.

Summary

21. This proposed change will allow all MODs paid to non-UK recipients to be paid without accounting for tax. This will reduce administration and costs, for businesses and for government, and will allow UK based financial concerns to do business on a level playing field with a wider range of business partners.

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