These notes refer to the Finance Act 2010 (c.13) which received Royal Assent on 8 April 2010

FINANCE ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Section 36Schedule 11: Reliefs and Reductions for Foreign Tax

Summary

1. Section 36 and Schedule 11 introduce legislation (i) to prevent the use of manufactured payments instead of real overseas dividends in order to sidestep existing anti-avoidance defences in the double tax relief (DTR) legislation, (ii) to ensure that a person may only deduct foreign tax from any foreign income where he has not already reduced his income by reference to the foreign tax, and (iii) to reaffirm the scope of the targeted DTR anti-avoidance rule.

Details of the Schedule

2. Paragraph 1(2)(a) amends paragraph 3(2)(a) of Schedule 28AB to the Income and Corporation Taxes Act 1988 (ICTA) by expressly including amounts of foreign tax payable by the person claiming credit relief. This is to ensure consistency with the provisions which allow relief for double taxation by way of credit in respect of tax which is payable under the law of any territory outside the UK.

3. Paragraph 1(2)(b) and 1(3) introduce consequential amendments.

4. Paragraph 2(2)(a) amends section 85(2) of the Taxation and (International and Other Provisions) Act 2010 (TIOPA) by expressly including amounts of foreign tax payable by the person claiming credit relief. This is also to ensure consistency with the provisions which allow credit relief.

5. Paragraph 2(2)(b) and 2(3) introduce consequential amendments.

6. Paragraph 3 contains provision about commencement.

7. Paragraph 4(1) inserts into TIOPA new section 85A which prescribes a scheme or arrangement where there is an amount of deemed foreign tax and either condition A or condition B is met.

8. New section 85A(2) provides that condition A is met where it could reasonably be expected that, under the scheme or arrangement, no real foreign tax would be paid or payable by a participant in the scheme or arrangement.

9. New section 85A(3) provides that condition B is met where it could reasonably be expected that, under the scheme or arrangement, real foreign tax would be paid or payable by a participant in the scheme or arrangement but the foreign-tax total would be increased by less than the amount of credit allowable to the claimant in respect of the amount of deemed foreign tax.

10. New section 85A(4) contains a number of definitions. The “real foreign tax” definition sets out that, in relation to section 10 of TIOPA, account is taken of the foreign tax chargeable in respect of the interest payable on the securities referred to in section 10(1)

(c) of TIOPA and, in relation to the manufactured overseas dividend (MOD) rules, account is taken of the foreign tax chargeable on the overseas dividend of which the MOD is representative. The definition also includes a sweep-up for other deeming provisions.

11. Paragraph 4(2) and (3) contain provision about commencement.

12. Paragraph 5(1)(b) replaces the existing section 85(2) of TIOPA with a new subsection which removes the condition that an amount of foreign tax is paid or payable by C. The new subsection looks to the effect of the "the FT amount" (now defined in section 85(1)) being paid or payable.

13. Paragraph 5(3) contains provision about commencement.

14. Paragraph 6(1)(a) deletes the words "under the scheme or arrangement" from section 86(1) of TIOPA, making clear that it is immaterial whether a pre-execution step was under a scheme or arrangement.

15. Paragraph 6(1)(b) inserts new sections 86(3A) and (3B) into TIOPA. New section 86(3A) confirms that a step taken or not taken by a participant in a scheme or arrangement can be a step taken or omitted from being taken before a scheme or arrangement comes into existence.

16. New section 86(3B) provides that the reason for taking or not taking the step does not matter provided the effect is to increase, or give rise to, a credit claim by a participant.

17. Paragraph 6(2) contains provision about commencement.

18. Paragraph 7(1) inserts new sections 112(2A) and 112(2B) into TIOPA. New section 112(2A) reduces the deduction from income for foreign tax by the difference between X and Y where X is less than Y.

19. New section 112(2B) defines X as the amount of the foreign income which the person would actually have to bring into account for the purposes of computing his tax liability (absent section 112), taking into account any deductions. Y is the amount of income arising outside the UK on which an amount of foreign tax has been paid.

Background Note

20. The current MOD rules and regulations aim to give the recipient of a MOD (or any payment deemed to be a MOD) the same relief for foreign tax as the recipient of the real dividend.

21. Sections 81 and 82 of TIOPA reduce or eliminate claims to double tax relief where there is an avoidance scheme or arrangement. The scheme must fall within one of the prescribed schemes in sections 84 to 88 of TIOPA. Section 85 of TIOPA prescribes a scheme where the person claiming credit for foreign tax has not suffered the full economic cost of the foreign tax for which it is claiming relief. The amendment to section 85 removes the condition that the person claiming the credit has paid the foreign tax.

22. Section 85 does not work effectively where the claim is for foreign tax which is treated by tax law (for example the MOD rules) as having been paid. The new measure will insert a new section 85A into TIOPA so that sections 81 and 82 will apply to deemed overseas tax deducted from MODs in the same way that they apply to real overseas dividends. The amendment will ensure that the provision can also apply in other circumstances where the UK Tax Acts deem income to be received under deduction of overseas tax. These changes will prevent credits for notional overseas tax from being treated more favourably than tax credits on real dividends.

23. This will not result in the automatic denial of DTR in relation to deemed overseas tax, since it will still be necessary for that tax to arise as part of a scheme or arrangement one

of the main purposes of which is to cause that tax to be taken into account for double tax relief purposes.

24. Section 86 of TIOPA prescribes a scheme where a person who is a party to a scheme takes a step, or omits a step, and the effect is to increase a double tax relief claim. The amendment ensures that the provision can apply to any steps taken, or not taken, before the scheme is implemented which have the effect of increasing a credit claim.

25. Section 112 of TIOPA provides that, where foreign tax is paid and no credit is claimed, double tax relief may be given as a deduction to reduce the foreign income assessable to UK tax. The amendment ensures that a person may only deduct foreign tax where that person has not already reduced his income by reference to the foreign tax, so ensuring the foreign tax is only deducted once.