

CORPORATION TAX ACT 2010

EXPLANATORY NOTES

INTRODUCTION

Part 17: Manufactured payments and repos

Overview

2360. 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, 254 and 736B of, and Schedule 23A to, ICTA, sections 263B and 263C of TCGA, section 139 of FA 2006 and paragraph 30 of Schedule 17 to that Act.
2361. Manufactured payments 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.
2362. 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.
2363. Many of the detailed rules, especially as regards manufactured overseas dividends (MODs), are laid down in regulations. This Act does not rewrite any of these regulations.

Chapter 1: Introduction

Section 780: Overview of Part

2364. This section gives an overview of the Part. It is new.

Section 781: Key definitions

2365. This interpretative section is based on sections 231AA and 231AB of ICTA, paragraphs 2 and 4 of Schedule 23A to that Act and section 139 of FA 2006.
2366. The key expressions “manufactured dividend” and “manufactured overseas dividend” are defined at the beginning of, respectively, Chapters 2 (manufactured dividends) and 3 (manufactured overseas dividends). This section applies those definitions throughout the Part.
2367. As noted in section 780(4), Part-wide definitions are located in Chapter 6.

Chapter 2: Manufactured dividends

Overview

2368. This Chapter is concerned with:

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

Section 782: Meaning of “manufactured dividend”

2369. This interpretative section is based on paragraph 2 of Schedule 23A to ICTA and section 139 of FA 2006.

2370. The expression “UK shares” is used in this section for the first time in this Part. It is defined in section 814.

Section 783: Treatment of payer of manufactured dividend

2371. This section gives corporation tax relief for the payer of a manufactured dividend. It is based on paragraphs 2(1A) to (1F) of Schedule 23A to ICTA.

2372. Paragraph 2(1C) of Schedule 23A to ICTA envisages that a particular manufactured dividend may relate both to a trade carried on by the dividend manufacturer and to life assurance business carried on by the dividend manufacturer. *Subsection (4)* makes it clear that the words about paragraph 2(1E) in paragraph 2(1C) are intended to exclude relief under paragraph 2(1C) only so far as relief is given under paragraph 2(1E). This drafting clarification does not change the law.

Section 784: Treatment of recipient of manufactured dividends

2373. This section deals with the corporation tax treatment, in the hands of the recipient (or, if different, the owner), of a manufactured dividend. It is based on paragraph 2 of Schedule 23A to ICTA.

Section 785: Treatment of payer: Real Estate Investment Trusts

2374. This section gives corporation tax relief for the payer of a manufactured dividend, to the extent that it is representative of a dividend (a property income dividend or PID) paid by a company UK REIT or by the principal company of a group UK REIT. It is based on section 139 of FA 2006 and paragraph 30 of Schedule 17 to that Act.

Section 786: Treatment of recipient: Real Estate Investment Trusts

2375. This section deals with the corporation tax treatment of a manufactured dividend, in the hands of the recipient (or, if different, the owner), to the extent that the manufactured dividend is representative of a PID. It is based on section 139 of FA 2006 and paragraph 30 of Schedule 17 to that Act.

Section 787: Exemption of manufactured dividends

2376. This section provides that a manufactured dividend is exempt from corporation tax to the extent that the dividend of which it is representative is (or would be) so exempt. It is based on paragraph 2(3A) and (3B) of Schedule 23A to ICTA.

Section 788: Statements about manufactured dividends

2377. This section 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.

Section 789: Powers about administrative provisions

2378. This section is a general regulation-making power about manufactured dividends. It is based on paragraph 8 of Schedule 23A to ICTA.

Chapter 3: Manufactured overseas dividends

2379. This Chapter is concerned with:

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

Section 790: Meaning of “manufactured overseas dividend”

2380. This interpretative section is based on paragraph 4 of Schedule 23A to ICTA.

2381. The expressions “overseas dividend” and “overseas securities” are used in *paragraph (a)* for the first time in this Part. They are defined in section 814.

Section 791: Treatment of payer of manufactured overseas dividend

2382. This section deals with the corporation tax treatment of a payer of MODs. It is based on paragraph 4 of Schedule 23A to ICTA.

Section 792: Company receiving manufactured overseas dividend from UK resident etc

2383. This section deals with the corporation tax treatment of MODs in the hands of the recipient (or, if different, the owner) when tax has been deducted under section 922(1) of ITA. It is based on paragraph 4 of Schedule 23A to ICTA.

2384. The expression “gross amount of the manufactured overseas dividend” is used in *subsection (3)(a)* for the first time in this Part. It is defined in section 813.

2385. The expression “overseas tax” is used in *subsection (3)(b)* for the first time in this Part. It is defined in section 814.

Section 793: Section 792: amount treated as withheld

2386. This section quantifies the amount treated as withheld under section 792(3)(b). It is based on paragraph 4A of Schedule 23A to ICTA.

2387. *Subsection (2)* refers to section 925A of ITA, which is based on paragraph 13 of Schedule 13 to FA 2007 and is inserted by Schedule 7 to TIOPA.

Section 794: Company receiving manufactured overseas dividend from foreign payer

2388. This section deals with the corporation tax treatment of MODs in the hands of the recipient (or, if different, the owner) when tax has been accounted for and paid under section 923(1) of ITA. It is based on paragraph 4 of Schedule 23A to ICTA.

Section 795: Exemption of manufactured overseas dividends

2389. This section provides that a MOD is exempt from corporation tax to the extent that the overseas dividend of which it is representative is (or would be) so exempt. It is based on paragraph 4 of Schedule 23A to ICTA.

Chapter 4: Further provision about manufactured payments

Overview

2390. This Chapter makes further provision about manufactured payments. The detailed structure of the Chapter is as follows:

- Sections 796 to 798 – manufactured payments exceeding, or less than, underlying payments;
- Sections 799 to 801 – manufactured payments under arrangements with unallowable purpose;
- Sections 802 to 804 – miscellaneous.

Sections 796 and 797: Manufactured dividends and manufactured overseas dividends: amounts exceeding underlying payments

2391. These sections deal with cases in which an amount paid by way of manufactured dividend or MOD would otherwise exceed the amount of the payment of which it is representative. They are based on paragraph 7 of Schedule 23A to ICTA.

2392. If either of these sections applies, the excess is taken out of the scope of the rules about manufactured payments and is treated as a fee. This may affect (a) relief for the payer, (b) taxability for the recipient (or, if different, the owner) or (c) both, if the person concerned is a corporation tax payer.

2393. In paragraph 7(1) of Schedule 23A to ICTA, the words “notwithstanding anything in paragraph 2 above or anything in paragraph 4 other than in sub-paragraph (1A)” signal that the treatment of the excess element of manufactured dividend or MOD as a fee does not prevent it from being eligible for relief as (for example) a trading expense (even though it does not qualify for such relief under paragraph 4(1A) of that Schedule). These words are not rewritten, as they add nothing except emphasis.

Section 798: Manufactured overseas dividends less than underlying payments

2394. This section overrides section 813(2) of this Act (the general rule quantifying the gross amount of a MOD). It is based on paragraph 7 of Schedule 23A to ICTA.

Section 799: Manufactured payments under arrangements with unallowable purpose

2395. This section denies tax relief for manufactured payments made under arrangements having an unallowable purpose. It is based on paragraph 7A of Schedule 23A to ICTA.

2396. *Subsection (1)* states when the section applies.

2397. *Subsection (2)* sets out the consequences of the section applying.

2398. *Subsection (3)* defines “relevant tax relief”.

2399. *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).

2400. *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.

2401. *Subsection (7)* is a signpost to the definition of “arrangements” in section 801 of this Act.

Section 800: Arrangements with an unallowable purpose

2402. This section states when arrangements have an unallowable purpose for the purposes of section 799 of this Act. It is based on paragraph 7A of Schedule 23A to ICTA.

2403. *Subsections (2) and (3)* define arrangements having an unallowable purpose.

2404. *Subsection (5)* 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.

2405. *Subsections (6) and (7)* limit the extent to which a tax avoidance purpose can be a business or other commercial purpose of the company.

Section 801: Sections 799 and 800: supplementary

2406. This supplementary section is based on paragraph 7A of Schedule 23A to ICTA.

2407. *Subsection (1)* adopts the corporation tax definition of “manufactured interest” used in Chapter 9 of Part 6 of CTA 2009 (relationships treated as loan relationships etc: manufactured interest). This is a minor change in the law. See *Change 51* in Annex 1.

Section 802: Powers about amounts representative of overseas dividends

2408. This section is concerned with double taxation relief. It is based on paragraph 8 of Schedule 23A to ICTA.

Section 803: Power to deal with special cases

2409. This section is a general power to modify the rules about manufactured payments contained in sections 783 to 788, 791, 792, 794 and 795. It is based on paragraph 8 of Schedule 23A to ICTA.

2410. *Subsection (2)* does not refer to section 793, which is based on paragraph 4A of Schedule 23A to ICTA, because paragraph 8(1) of that Schedule does not refer to that paragraph. Section 793 merely specifies an amount for the purposes of section 792, which is within the scope of this section.

Section 804: Regulation-making powers: general

2411. This section is a general provision about powers to make regulations. It is based on paragraph 8 of Schedule 23A to ICTA.

Chapter 5: Stock lending arrangements and repos

Overview

2412. This Chapter contains rules concerning stock lending arrangements and repos.

2413. The detailed structure of the Chapter is as follows:

- Sections 805 to 807 – interpretation;
- Sections 808 to 811 – tax credits: stock lending arrangements and repos;
- Section 812 – deemed manufactured payments.

Sections 805 to 807: “Stock lending arrangement”; section 805: supplementary; “creditor repo”, “creditor quasi-repo”, “debtor repo” and “debtor quasi-repo”

2414. These interpretative sections are based on sections 231AA and 736B of ICTA, paragraph 1 of Schedule 23A to that Act and sections 263B and 263C of TCGA.

Section 808: No tax credits for borrower under stock lending arrangement

2415. 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.

Section 809: No tax credits for lender under creditor repo or creditor quasi-repo

2416. This section 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.

2417. *Subsection (3)(b)* refers to section 925A of ITA, which is based on paragraph 13 of Schedule 13 to FA 2007 and is inserted by Schedule 7 to TIOPA.

Section 810: No tax credits for borrower under debtor repo or debtor quasi-repo

2418. This section 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.

Section 811: Arrangements between companies to make distributions

2419. This section extends the meaning of distribution to encompass arrangements between two or more companies to make distributions to each other’s members. It is based on section 254(8) of ICTA.

Section 812: Deemed manufactured payments: stock lending arrangements

2420. This section 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.

2421. Usually, a stock lending arrangement requires the borrower to make a manufactured payment to the lender, in which case Chapter 2 of this Part applies for corporation tax purposes.

2422. 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, Chapters 2 to 4 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.

Chapter 6: Interpretation of Part

Sections 813 and 814: The gross amount of a manufactured overseas dividend etc; other interpretation

2423. These interpretative sections are based on sections 736B and 736C of ICTA, paragraphs 1, 4 and 7 of Schedule 23A to that Act and section 263B of TCGA.