These notes refer to the Income Tax (Trading and Other Income) Act 2005 (c.5) which received Royal Assent on 24 March 2005

INCOME TAX (TRADING AND OTHER INCOME) ACT 2005

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 4: Savings and investment income

Chapter 4: Dividends from non-UK resident companies

Overview

1627. This Chapter introduces a separate charge to income tax on dividends from companies not resident in the United Kingdom.

1628. Under section 18(3) of ICTA, there are no individual charges according to types of income within the Schedule D Case IV or V charge. But the system of identifying and classifying income by Schedule and Case has been replaced in this Act by individual charges on types of income.

1629. Income which, under the source legislation, is charged to tax under Schedule D Cases IV or V, has, where appropriate, been fully integrated with the equivalent income arising from a UK source. In the case of dividends from non-UK resident companies there is no exact equivalent in terms of UK source income. The closest equivalent is the charge to tax on dividends and other distributions from UK resident companies (section 20 of ICTA, Schedule F in the source legislation). But there is no precise overlap. The UK charge, by the adoption of the definition of "distribution" from Part 6 of ICTA (see the commentary on Chapter 3 of Part 4 of this Act) can include dividends or distributions of a capital nature and can also operate to convert payments that would otherwise be treated as interest into distributions. Any charge on distributions from non-UK resident companies must be confined to income only. For this reason (and also because the basis of assessment is different – see the commentary on section 403 elow), it is not thought appropriate to integrate the charges. So a separate charge is needed to cover dividends from non-UK resident companies.

Section 402: Charge to tax on dividends from non-UK resident companies

1630. This section charges to tax dividends of companies not resident in the United Kingdom. It is based on section 18(1) and (3) of ICTA.

1631. For the reasons explained in the overview, the expression "distribution" has not been adopted. It is possible that a non-UK resident company may make a distribution of income which would not fall within Chapter 4 of Part 4 of this Act because it is not a "dividend". But if the distribution comprises income it will fall to be dealt with either under alternative specific charges (eg interest) or within "income not otherwise charged", the charge on which appears in Chapter 8 of Part 5 of this Act.

1632. The term "dividend" is not defined in this Act. "Dividend" is a widely used and understood term and is defined only in very specific circumstances not applicable in this context (see, for example, section 49 of ICTA – dividends held in the name of Treasury). It is not thought appropriate to attempt to define "dividend" here. It will usually be a matter of referring to the relevant company law to determine whether or not a payment made by a company is a dividend.

1633. *Subsection (2)* highlights an exemption from income tax for dividends paid under approved share incentive plans ("SIPs") and *subsection (3)* signposts section 498 of ITEPA. See further the commentary on the SIPs legislation in Chapter 3 of Part 4 of this Act and Chapter 9 of Part 6 of this Act (particularly the commentary on section 770 of this Act).

1634. *Subsection (4)* ensures that dividends of a capital nature do not fall within the charge to tax under this Chapter. In determining whether a payment is income in nature, it is necessary (as it is under the source legislation) to analyse the payment under local law (see CIR v Trustees of Joseph Reid (dec'd) (1949), 30 TC 431 HL and Rae v Lazard Investment Co Ltd (1963), 41 TC 1 HL). Whiteman on Income Tax, Third Edition, on page 1107, comments in this context "the proper test in such circumstances is, applying the local law, whether or not the corpus of the asset is left intact after the distribution. If it is not, the receipt will be a capital receipt; if it is, the payment will be chargeable".

Section 403: Income charged

1635. This section sets out the amount charged to tax and is based on section 65(1) of ICTA.

1636. *Subsection (1)* charges tax on the full amount of the dividends arising in the tax year. The term "arising" has been retained (see the commentary on income charged in Chapter 2 of Part 4 of this Act). The arising basis is different from the paid basis which applies to the charge to tax on dividends and other distributions from UK resident companies (for a discussion of the paid basis see the commentary on Chapter 3 of Part 4 of this Act) and, given they do not mean exactly the same, "paid" has not been used in this context.

1637. *Subsection (2)* makes the basis of assessment in subsection (1) subject to the SIPs rules and Part 8 of this Act. Part 8 contains the special rules which apply to foreign income (see further the commentary on Part 8 of this Act).

Section 404: Person liable

1638. This section states who is liable for any tax and is based on section 59(1) of ICTA.

Section 405: SIP shares: introduction

1639. This section and the following three sections are based on sections 68A to 68B of ICTA which were inserted into ICTA by ITEPA. They are part of the SIPs code. See also the commentary on the SIPs legislation in Chapter 3 of Part 4 of this Act.

1640. This section introduces the special rules about charges to tax on SIP dividends.

1641. *Subsection (2)* provides that sections 406 to 408 apply only if the participant has benefited from the tax advantages of an approved SIP. Those tax advantages will only apply to an individual who is chargeable to tax under Part 2 of ITEPA in respect of eligible employment, or, in the case of shares awarded before ITEPA came into force, under Schedule E.

Section 406: Later charge where cash dividends retained in SIPs are paid over

1642. This section is based on section 68B of ICTA.

1643. SIP trustees may only retain a cash dividend and carry it forward for three years from the date the dividend is paid by the company. Any amount not reinvested must be paid to the participant if the participant ceases to be in "relevant employment" or if a termination notice is issued in respect of the plan (see paragraph 68(4) of Schedule 2 to ITEPA).

1644. This section makes provision about amounts so paid over.

1645. The definition of "foreign cash dividend" in section 68C of ICTA suggests that it is the date that the company originally paid the dividend that determines whether the tax charge falls under Schedule F or Schedule D Case V in the source legislation. This is rewritten in *subsection (5)*.

Section 407: Dividend payment when dividend shares cease to be subject to SIP

1646. This section is based on section 68B(2) of ICTA and applies if the dividend shares acquired with the cash dividend cease to be subject to the approved SIP within three years of acquisition.

Section 408: Reduction in tax due in cases within 407

1647. This section is based on section 68B(3) of ICTA. *Subsection (1)* provides that the section applies if the participant has paid tax in respect of any capital receipts received in connection with the holding of the dividend shares which cease to be subject to the approved SIP.

1648. *Subsection (2)* operates to reduce the amount of tax otherwise due under Chapter 4 of Part 4 of this Act by an amount equal to the tax paid on the capital receipts.