

*These notes refer to the Income Tax Act 2007 (c.3)  
which received Royal Assent on 20 March 2007*

# INCOME TAX ACT 2007

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### **Part 11: Manufactured payments and repos**

##### **Overview**

#### *Chapter 2: Manufactured payments*

##### **Overview**

1703. 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.

1704. The detailed structure of the Chapter is as follows:

- Section 572 - overview of the Chapter;
- Sections 573 to 577 - manufactured dividends on UK shares;
- Sections 578 to 580 - manufactured interest on UK securities;
- Sections 581 and 582 - manufactured overseas dividends (MODs);
- Sections 583 to 585 - special cases;
- Sections 586 to 588 - general regulation-making powers;
- Sections 589 to 591 - minor definitions which apply to this Chapter.

1705. 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.

1706. 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.

1707. Many of the detailed rules, especially as regards MODs, are laid down in regulations. The Act does not rewrite any of these regulations.

### ***Section 572: Overview of Chapter***

1708. This section provides an overview of the Chapter. It is new.

### ***Section 573: Manufactured dividends on UK shares***

1709. This section defines “manufactured dividend” and states how the Income Tax Acts apply in the circumstances set out in the section. It is based on paragraphs 2(1) to (3) and 2A(1) of Schedule 23A to ICTA.
1710. For income tax purposes, *subsection (2)* treats the manufactured dividend in the hands of the recipient (or, if different, the owner of the manufactured dividend) as if it was a real dividend on the UK shares.
1711. *Subsections (1)* and *(2)* together ensure that if an income tax payer claims title to the manufactured dividend through or under a recipient (such as a nominee), the manufactured dividend is still treated for income tax purposes as if it was a real dividend even if the recipient is not an income tax payer.
1712. *Subsections (3)* and *(4)* deal with the position of the payer. Subsection *(4)* is subject to sections 574 and 575 (allowable deductions).

### ***Section 574: Allowable deductions: matching***

1713. This section details the special rules on deductibility of manufactured dividends for the payer which are referred to in section 573(4). It is based on paragraphs 2A(1) to (1A) and (4) of Schedule 23A to ICTA.
1714. The effect of the full-out words at the end of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured dividend is deductible as a trading expense, for example, it is not deductible under sections 574 and 575.
1715. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under subsection *(2)*. The amount mentioned in subsection *(2)* is allowable to the extent that it is matched with a dividend-type receipt or with deemed interest on a repo under *subsection (4)* or *(7)* respectively.

### ***Section 575: Allowable deductions: restriction on double-counting***

1716. This section prevents double relief. It is based on paragraph 2A(1B) of Schedule 23A to ICTA.

### ***Section 576: Manufactured dividends on UK shares: Real Estate Investment Trusts***

1717. This section 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.
1718. This section treats the MPID in the hands of the recipient (or, if different, the owner of the MPID) as if it was a real property income dividend. And it ensures that if an income tax payer claims title to the MPID through or under a recipient (such as a nominee), the MPID is still treated for income tax purposes as if it was a real PID even if the recipient is not an income tax payer.
1719. A dividend may be partly but not wholly a PID. *Subsection (2)* therefore provides that the section applies only so far as the manufactured dividend is representative of a PID.

**Section 577: Statements about manufactured dividends**

1720. 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(6) to (8) of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.
1721. The application of section 577 will depend on the tax status of the payer of a manufactured dividend, rather than that of the recipient. Under *subsection (1)*, section 577 will apply only if the payer is within the charge to income tax. If the payer is within the charge to corporation tax, corresponding obligations will be imposed by paragraph 2(6) to (8) of Schedule 23A to ICTA or (by virtue of paragraph 2(2) of that Schedule) section 234A of that Act. These provisions are signposted in *subsection (8)*.
1722. *Subsection (2)* disapplies the provisions of this section so far as the manufactured dividend is an MPID. *Subsection (9)* gives a signpost to the power to make regulations concerning statements about MPIDs.

**Section 578: Manufactured interest on UK securities**

1723. This section deals with the income tax treatment of persons receiving or paying manufactured interest on UK securities. It is based on paragraph 3(1), (2) and (3) of Schedule 23A to ICTA.
1724. *Subsection (1)* defines “manufactured interest” and states when the section applies.
1725. For income tax purposes, *subsection (2)* treats the manufactured interest in the hands of the recipient (or, if different, the owner of the manufactured interest) as if it was a real payment of interest on the UK securities.
1726. Subsections (1) and (2) together ensure that if an income tax payer claims title to the manufactured interest through or under a recipient (such as a nominee), the manufactured interest is still treated for income tax purposes as if it was a real payment of interest even if the recipient is not an income tax payer.
1727. *Subsection (3)* deals with the position of the payer. It is subject to sections 579 and 580 (allowable deductions).

**Section 579: Allowable deductions: matching**

1728. This section details the special rules on deductibility of manufactured interest for the payer which are referred to in section 578. It is based on paragraph 3(2), (2A) and (10) of Schedule 23A to ICTA.
1729. The effect of the closing words of *subsection (2)* and *subsection (3)(a)* is that the general rules on income tax relief take priority. To the extent that the manufactured interest is deductible as a trading expense, for example, it is not deductible under this section.
1730. *Subsection (3)(b)* restricts the extent to which a deduction is allowable under subsection (2). The amount mentioned in subsection (2) is allowable to the extent that it is matched with an interest-type receipt, with a taxable amount under Chapter 2 of Part 12 (accrued income profits), or with deemed interest under a repo under *subsection (4)*, (6) or (7) respectively.
1731. Paragraph 3(2) of Schedule 23A to ICTA, so far as relevant, provides that “the manufactured interest shall be treated, *except in determining whether it is deductible*, as if it were an annual payment”. As explained in the commentary on section 919, this Act does not continue the annual payment pretence and the italicised words have therefore not been rewritten.
1732. *Subsections (6)* and *(10)* include by implication a minor change in the law on accrued income profits; see *Change 101* in Annex 1.

***Section 580: Allowable deductions: restriction on double counting***

1733. This section prevents double relief. It is based on paragraph 3(2B) of Schedule 23A to ICTA.

***Section 581: Manufactured overseas dividends***

1734. This section 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(1), (2), (3) and (4) of Schedule 23A to ICTA.

1735. *Subsections (1) and (3)* together ensure that if an income tax payer claims title to the MOD through or under a recipient (such as a nominee), the MOD is still treated for income tax purposes as if it was a real overseas dividend even if the recipient is not an income tax payer.

1736. *Subsection (6)* identifies the provisions of the Income Tax Acts in relation to which the deeming provisions in *subsections (4) and (5)* have effect: namely, those applicable to UK residents or persons carrying on business through a UK branch or agency.

***Section 582: Powers about manufactured overseas dividends***

1737. This section is concerned with double taxation relief. It is based on paragraph 8(1A) of Schedule 23A to ICTA.

***Section 583: Manufactured payments exceeding underlying payments***

1738. This section deals with special cases, as do sections 584 and 585. It is based on paragraph 7(1) of Schedule 23A to ICTA.

1739. Unlike sections 573 to 577 (manufactured dividends on UK shares), sections 578 to 580 (manufactured interest on UK securities) and sections 581 and 582 (MODs), sections 583 to 585 are not restricted to a single type of manufactured payment.

1740. This section overrides sections 573 to 582 (main rules about manufactured payments) and Chapter 9 of Part 15 (deduction of income tax at source: manufactured payments). If it applies, the excess is taken out of the rules about manufactured payments and is treated as a separate 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 an income tax payer; it may also affect the amount of income tax which has to be deducted or accounted for and paid under Chapter 9 of Part 15.

***Section 584: Manufactured payments less than underlying payments***

1741. This section overrides sections 578 to 582 (main rules about manufactured interest and MODs) and 589(3) (meaning of gross amount of MOD). It is based on paragraph 7 of Schedule 23A to ICTA.

1742. If it applies, the gross amount of the manufactured interest or MOD is adjusted for the purposes of giving income tax relief to the payer.

***Section 585: Power to deal with other special cases***

1743. This section is a general power to modify the rules about manufactured payments contained in sections 572 to 582 and Chapter 9 of Part 15. It is based on paragraph 8(1) of Schedule 23A to ICTA.

***Section 586: Powers about administrative provisions***

1744. This section is the first of a group of sections (sections 586 to 588) which are about general regulation-making powers. It is based on paragraph 8(2) to (3) of Schedule 23A to ICTA.

***Section 587: Power for manufactured payments to be eligible for relief***

1745. This section enables the Treasury to make exceptions to the main rules in this Chapter on the taxability of manufactured payments. More specifically, it enables manufactured payments to be exempt from income tax in the hands of pension funds if the actual dividends or interest which the manufactured payments represent would have been exempt from income tax in their hands. It is based on section 737D of ICTA and not, like the rest of this Chapter, on Schedule 23A to that Act.

***Section 588: Regulation-making powers: general***

1746. This section is based on paragraph 8(4) of Schedule 23A to ICTA.

***Section 589: Meaning of “gross amount”: interest and manufactured overseas dividends***

1747. This section defines “gross amount” for the purposes of the rules in this Chapter about interest and manufactured overseas dividends. It is based on paragraphs 3(13), 4(5) and 7(1) of Schedule 23A to ICTA.

***Section 590: Meaning of “relevant withholding tax”***

1748. This section defines “relevant withholding tax” for the purposes of this Chapter. It is based on paragraph 4(5) and (6) of Schedule 23A to ICTA.

***Section 591: Interpretation of other terms used in Chapter***

1749. This section gathers up minor definitions for the purposes of this Chapter. It is based on paragraphs 1(1), 2(1), 3(1), 4(1) and 7(1) of Schedule 23A to ICTA, section 153(2) of FA 2003. and on section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.