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

INCOME TAX ACT 2007

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Part 11: Manufactured payments and repos

Overview

1693. This Part contains provisions about sale and repurchase arrangements, stock lending and other transactions in the financial markets giving rise to manufactured payments. It is based on sections 231AA, 231AB, 730A, 730B and 736B to 737E of, and Schedule 23A to, ICTA.

Chapter 1: Introduction

Section 565: Overview of Part

1694. This section gives an overview of the Part. It is new.

1695. The remaining sections of this Chapter explain some important terms which are used in the same sense throughout this Part.

Section 566: Meaning of "UK shares" and "UK securities"

1696. This section defines "UK shares" and "UK securities". It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

1697. This Part uses the label "UK shares" for income tax purposes instead of the label "United Kingdom equities" given in paragraph 1 of Schedule 23A to ICTA, as the definition includes preference shares. The label "United Kingdom equities" is retained in Schedule 23A for corporation tax purposes.

Section 567: Meaning of "overseas securities" and "overseas dividend"

1698. This section defines "overseas securities" and "overseas dividend". It is based on sections 737B and 737C of, and paragraph 1 of Schedule 23A to, ICTA.

Section 568: Meaning of "stock lending arrangement"

1699. This section defines "stock lending arrangement". It is based on sections 231AA and 736B of ICTA and sections 263B and 263C of TCGA.

Section 569: Meaning of "repo"

1700. This section defines "repo". It is based on sections 231AA, 231AB, 730A, 730B, 737B and 737E of, and paragraph 1 of Schedule 23A to, ICTA.

Section 570: Meaning of "buying back" securities etc.

1701. This section provides the meaning of the expression "buying back" securities. It is based on sections 730B, 737B and 737E of ICTA.

Section 571: Meaning of "related" agreements

1702. This section explains when agreements are "related". It is based on sections 730B, 737B and 737E of ICTA.

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.

Chapter 3: Tax credits: stock lending arrangements and repos

Overview

1750. This Chapter denies the recipient of a manufactured dividend the benefit of a tax credit on it. It is based on sections 231AA and 231AB of ICTA.

1751. Sections 231AA and 231AB of ICTA are potentially relevant to the shadow ACT regime, and this Act therefore includes consequential amendments which will confine them to corporation tax.

Section 592: No tax credits for borrower under stock lending arrangement

1752. 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 593: No tax credits for interim holder under repo

1753. This section prevents the interim holder under a repo 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 counterparty, by way of a manufactured dividend or other means. It is based on section 231AA of ICTA.

Section 594: No tax credits for original owner under repo

1754. This section counters unusual repo arrangements where the original owner does not pass entitlement to the dividends to the interim holder under the repo but the interim holder nonetheless pays the lender a manufactured dividend. It prevents shareholders using these arrangements to generate multiple tax credits in respect of the same dividend. It is based on section 231AB of ICTA.

Section 595: Meaning of "manufactured dividend"

1755. This section gives "manufactured dividend" the same meaning in this Chapter as in Chapter 2. It is based on sections 231AA(4) and 231AB(3) of ICTA.

Chapter 4: Deemed manufactured payments

Overview

1756. This Chapter extends the scope of Chapter 2 (manufactured payments) to certain arrangements under which there is no actual manufactured payment.

Section 596: Deemed manufactured payments: stock lending arrangements

1757. This section, which is the first of a group of sections (sections 596 to 600) concerned with stock lending arrangements, deems the borrower in a stock lending arrangement to make a manufactured payment in certain circumstances. It is based on sections 736B, 736D and 231AA of ICTA.

1758. Usually, a stock lending arrangement will require the borrower to make a manufactured payment to the lender, in which case Chapter 2 (or, as the case may be, Schedule 23A to ICTA) will apply.

1759. 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, Chapter 2 applies and, in particular, if the securities are UK securities or overseas securities, then potentially either the borrower is subject to the main charge or the lender is subject to the reverse charge. But the borrower is denied any tax relief for the deemed manufactured payment.

1760. *Subsection (5)* provides that for the purposes of this section a quasi-stock lending arrangement is treated as if it were a stock lending arrangement.

Section 597: Deemed interest: cash collateral under stock lending arrangements

1761. This section is a targeted anti-avoidance rule, deeming interest to arise to the borrower on collateral provided under certain stock lending arrangements. It is based on section 736C(1) to (7) and (11) of ICTA.

Section 598: Cash collateral under stock lending arrangements: supplementary

1762. This section supplements section 597. It is based on section 736C(8), (10) and (12) to (14) of ICTA.

1763. Section 736C(11) of ICTA provides that money includes money expressed in a currency other than sterling. This section omits it.

Section 599: Sections 597 and 598: quasi-stock lending arrangements and quasi-cash collateral

1764. This section extends the ambit of sections 597 and 598 to cover arrangements which, although achieving the same economic effect as a stock lending arrangement with cash collateral, fall outside either or both of the detailed definitions of "stock lending arrangement" and "cash collateral". It is based on section 736D(4), (5), (7), (8) and (10) of ICTA.

Section 600: Meaning of "quasi-stock lending arrangements" and "quasi-cash collateral"

1765. This section defines the expressions "quasi-stock lending arrangements" and "quasi-cash collateral". It is based on section 736D(1) to (3), (6) and (10) of ICTA.

Section 601: Repo cases in which deeming rules apply

1766. This section defines circumstances under which sale and repurchase arrangements (repos) are deemed, under section 602, to give rise to manufactured payments to which Chapter 2 applies. It is based on sections 231AA, 231AB, 737A, and 737B, of ICTA.

1767. If, as a matter of legal analysis, a transaction includes an amount which is a manufactured payment within Chapter 2 or, as the case may be, Schedule 23A to ICTA, then Chapter 2 (or, as the case may be, Schedule 23A) will apply to that amount. But if there is no separately identifiable amount then, as a matter of legal analysis, there may be no manufactured payment within Chapter 2 or Schedule 23A.

1768. Sale and repurchase arrangements could therefore be made under which no manufactured payment was payable and, instead, the pricing of the transaction reflected the fact that a payment of interest or dividend on the securities was receivable otherwise than by the seller. Such arrangements would be outside Chapter 2 and Schedule 23A. Chapter 4 plugs this gap by deeming the arrangement to include the making of a manufactured payment.

Section 602: Deemed manufactured payments: repos

1769. This section activates the rules about manufactured payments in a case in which section 601 is satisfied. It is based on sections 231AA, 231AB, 737A and 737C of ICTA.

1770. *Subsection (2)(b)* ensures that, in a repo of Real Estate Investment Trust shares, the deemed manufactured payment will in appropriate circumstances be an MPID.

1771. *Subsections (3)* and *(4)* prevent the holder of securities acquired under a repo from obtaining a tax deduction for a deemed payment representing interest or dividends unless that person is also the person to whom the securities were first transferred.

Section 603: Deemed deductions of tax

1772. This section treats deductions of tax as having been made in the circumstances specified in the section. It covers payments representative of PIDs, periodical payments of interest on UK securities and overseas dividends on overseas securities. It is based on section 737C of ICTA.

1773. This section is the first of a group of sections (sections 603 to 605) all of which are based on section 737C of ICTA (deemed manufactured payments: further provisions). Section 737A of ICTA (sale and repurchase of securities: deemed manufactured payments) interacts not only with Schedule 23A to ICTA (manufactured dividends and interest) but also with section 730A of ICTA (treatment of price differential on sale and repurchase of securities). Section 737C of ICTA ensures that the interaction does not give rise to anomalies.

Section 604: Deemed increase in repurchase price: price differences under repos

1774. This section ensures that, if this Chapter deems a manufactured payment to be made, this is factored into the calculation of the price difference under Chapter 5. It is based on section 737C of ICTA.

Section 605: Deemed increase in repurchase price: other income tax purposes

1775. This section extends the circumstances in which the deemed increase in the repurchase price made by section 604 has effect. It is based on section 737C(11A) of ICTA.

Section 606: Interpretation of Chapter

1776. This section defines various terms. It is based on sections 231AA, 231AB and 737A to 737C of ICTA and section 139 of, and paragraph 4 of Schedule 17 to, FA 2006.

Chapter 5: Price differences under repos

Overview

1777. This Chapter contains provisions about the treatment of the difference between the sale price and the repurchase price in relation to sale and repurchase agreements. It is based on sections 730A and 730B of ICTA, with supplementary provisions based on section 737E of ICTA.

1778. Section 737A of ICTA deals with repos which straddle an ex-dividend date; if it applies, there is a deemed manufactured payment to which Schedule 23A to ICTA applies. Section 737A is rewritten in Chapter 4 of this Part.

1779. For the purposes of section 730A of ICTA, by contrast, it does not make any difference whether the repo straddles an ex-dividend date, and section 730A does not have a direct connection with Schedule 23A. If a sale and repurchase agreement is within section 730A, the difference between the sale price and the repurchase price is deemed to be a payment of interest on a deemed loan. If the other conditions are met, this deemed interest may come within the withholding obligation of section 349(2) of ICTA. Section 349(2) is rewritten in Chapter 3 of Part 15 (deduction of income tax at source: deduction from certain payments of yearly interest).

Section 607: Treatment of price differences under repos

1780. This section deals with the treatment of price differences under repos. It is based on sections 730A(1), (2), (3) and (8A), 730B and 737B of, and paragraph 1(1) of Schedule 23A to, ICTA.

Section 608: Exceptions to section 607

1781. This section disapplies section 607 in certain cases. It is based on section 730A(8) of ICTA.

1782. It disapplies section 607 in cases where:

- the agreement or agreements for sale and repurchase are not what one would expect of persons dealing at arm’s length; or
- the interim holder has all the benefits and risks from fluctuations in the market value of the securities between their sale and repurchase.

Section 609: Additional income tax consequences of price differences

1783. This section deals with some additional consequences of section 607. It is based on section 730A(4), (4A) and.(7) of ICTA.

Section 610: Repurchase price in deemed manufactured payment case

1784. This section deals with the interaction between Chapters 4 and 5 of this Part. It is based on sections 730A of ICTA.

Section 611: Power to modify Chapter in non-arm's length case

1785. This section enables the Treasury to make regulations modifying the provisions of this Chapter in cases where agreements for sale and repurchase are not what one would expect of persons dealing at arm's length. It is based on section 737E of ICTA.

1786. Section 737E(3) of ICTA does not mention section 730B of ICTA. But section 611(1), in rewriting section 737E(3), includes within its scope section 610, which rewrites section 730B. This does not mean that section 611(1) changes the law.

1787. Since section 737E(3) refers to section 730A and section 730B has the sidenote "interpretation of section 730A", the omission of "section 730B" from section 737E(3) is not significant. Section 737E(3) enables the Treasury to modify section 730B indirectly (for example, by making a regulation saying that, despite anything in section 730B, section 730A applies as if it said …).

Chapter 6: Powers to modify repo provisions

Overview

1788. This Chapter contains powers to modify some of the provisions of Chapters 4 and 5 of this Part.

Section 612: Non-standard repo cases

1789. This section is a power to make regulations dealing with certain non-standard repo cases. It is based on section 737E(1), (8) and (9) of ICTA.

Section 613: Redemption arrangements

1790. This section is a power to make regulations dealing with certain cases involving repos and the redemption of securities. It is based on sections 737B(1) and 737E(2), (8) and (9) of ICTA.

Section 614: Sections 612 and 613: supplementary

1791. This section contains provisions which supplement sections 612 and 613. It is based on section 737E(5), (6) and (7) of ICTA.