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 15: Deduction of income tax at source

Overview

Chapter 9: Manufactured payments

Overview

2793. This Chapter deals with deduction of income tax at source from manufactured property income dividends, manufactured interest and manufactured overseas dividends (MODs). It is based on paragraphs 3 to 4 of Schedule 23A to ICTA and section 139 of, and paragraph 30 of Schedule 17 to, FA 2006.

Section 918: Manufactured dividends on UK shares: Real Estate Investment Trusts

2794. This section imposes an obligation to deduct income tax at source on payers of 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.

2795. *Subsection (1)* sets the conditions for the section to apply. First, the person must pay a "manufactured dividend" as mentioned in section 573. Second, the manufactured dividend must be representative of a PID.

2796. A dividend may be partly but not wholly a PID. *Subsection (2)* provides that the section applies only so far as the manufactured dividend is representative of a PID.

2797. *Subsection (3)* ensures that, if the payer of the MPID is either UK resident or paying the MPID through a UK branch or agency, the rules on deducting income tax at source from PIDs apply, with any necessary modifications, to the MPID.

2798. *Subsections (4)* and *(5)* enable regulations to be made subjecting MPIDs, if they fall outside subsection (3) to a reverse charge. This provision is analogous to sections 920 and 923, which impose reverse charges on manufactured interest on UK securities and MODs and are discussed in detail below.

2799. *Subsections (6)* and *(7)* provide that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the payment had been an actual PID.

Section 919: Manufactured interest on UK securities: payments by UK residents etc

2800. This section imposes an obligation on payers of manufactured interest to deduct income tax at source. It is based on section 4(1A) of, and paragraph 3 of Schedule 23A to, ICTA.

2801. It is the first of a group of sections about manufactured interest on UK securities (sections 919 to 921).

2802. *Subsection (1)*sets out three conditions for the section to apply. First, the person must pay "manufactured interest" as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). Third, the payer must be either (a) UK resident or (b) paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2803. *Subsection (2)* is based on paragraph 3(2) of Schedule 23A to ICTA. Paragraph 3(2)(a), so far as relevant, provides that "the manufactured interest shall be treated … as if it (i) were an annual payment to the recipient, but (ii) were neither yearly interest nor an amount payable wholly out of profits or gains brought into charge for income tax." This deeming provision brings the manufactured interest within section 349(1)(a) of ICTA.

2804. Section 349(1)(a) of ICTA is rewritten in Chapter 6 of this Part (deduction from annual payments and patent royalties). But paragraph 3 of Schedule 23A to ICTA applies section 349(1)(a) to manufactured interest with important modifications: see paragraph 3(2)(b), (4) and (5). This Chapter therefore rewrites paragraph 3 of Schedule 23A separately from Chapter 6.

2805. This is done without the use of deeming. Subsection (2) spells out that the payer of the manufactured interest must, on making the payment, deduct from the gross amount of the manufactured interest a sum representing income tax on it.

2806. The rate applicable under subsection (2) is the savings rate in force for the tax year in which the payment is made (and not, as in Chapter 6, the basic rate). This follows from section 4(1A) and (2)(b) of, and paragraph 3(2)(b)(ii) of Schedule 23A to, ICTA.

2807. *Subsection (3)* defines the "gross amount" of manufactured interest.

2808. *Subsection (4)* explains that this section is subject to certain other provisions:

- sections 583 and 585 in Part 11 (Manufactured payments and repos);
- section 921 (cases where interest on underlying securities paid gross) in this Chapter; and
- Chapter 11 of this Part (payments between companies etc: exception from duties to deduct) – see section 930(2)(g), which is based on section 349A(3) of ICTA.

2809. *Subsection (5)* is a signpost to the collection provisions. If the payer has to deduct tax from the manufactured interest under section 349(1)(a) of ICTA, and the payer is a company, the tax is collected under section 350(4) of, and Schedule 16 to, ICTA. Under paragraph 3(7) of Schedule 23A to ICTA, this applies whether or not the company is UK resident. These provisions are rewritten in Chapter 15 of this Part. Chapter 15 includes some minor changes to the law which are potentially relevant to payments within section 919:

- *Change 143* makes it clear that a return need be submitted only where a relevant payment was made in that particular return period. It also clarifies related points.
- *Change 144* brings into line the information required to be included on a return where a payment is made otherwise than in an accounting period with the information which is required where the payment is made in an accounting period.
- *Change 147* removes the charging provision in section 350(1) of ICTA, to bring this legislation into line with the approach taken in other legislation about collection of income tax deducted at source. So a person will not be chargeable in cases falling within Chapters 3 to 7, 10, 12, 13 and 18 of this Part.

2810. If the payer is not a company, the tax is collected under section 350(1) of ICTA, which is rewritten in Chapter 16 of this Part. Chapter 16 also includes *Change 147*.

Section 920: Foreign payers of manufactured interest: the reverse charge

2811. This section imposes an obligation on certain recipients to account for and pay income tax on manufactured interest received. It is based on paragraphs 3 and 3A of Schedule 23A to ICTA.

2812. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this obligation as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

2813. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2814. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay “manufactured interest” as defined in section 578. Second, the manufactured interest must be paid in the circumstances set out in section 578(1). These conditions are identical to those in section 919(1). The third condition contrasts with the third condition in section 919(1): the payer must be non-UK resident and not paying the manufactured interest in the course of a trade carried on in the United Kingdom through a branch or agency.

2815. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the manufactured interest.

2816. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 919.

2817. *Subsection (4)* provides that, if the payer would not have been required to deduct any sum under section 919, the recipient is not required to account for and pay any income tax under subsection (3). For the convenience of users, *subsection (5)* highlights important cases in which subsection (4) applies.

2818. The collection rule for all recipients, whether or not they are companies and whether or not they are UK resident, is given by secondary legislation: regulation 3(1) and (2) of SI 1997/992, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586, which refers to this Chapter.

Section 921: Cases where interest on underlying securities paid gross

2819. This section is an exception to the withholding provisions of sections 919 and 920. It is based on paragraphs 1 and 3A of Schedule 23A to ICTA. Broadly speaking, if the interest itself mentioned in *subsection (1)* is payable gross, the manufactured interest representative of it is also payable gross.

Section 922: Manufactured overseas dividends: payments by UK residents etc

2820. This section imposes an obligation on the payer of a MOD to deduct income tax from the gross amount of the MOD. It is based on paragraphs 4(1) and 4(2) of Schedule 23A to ICTA. It is the first of a group of sections concerned with MODs (sections 922 to 925).

2821. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as defined in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). Third, the payer must be either (a) UK resident or (b) paying the MOD in the course of a trade carried on through a branch or agency in the United Kingdom.

2822. Paragraph 4(2) of Schedule 23A to ICTA deems the MOD to be an annual payment within section 349 of ICTA. This section avoids the use of deeming. *Subsection (2)* spells out that the payer of the MOD must, on making the payment, deduct from the gross amount of the manufactured overseas dividend a sum equal to the relevant withholding tax on the gross amount.

2823. *Subsection (3)* explains that this section is subject to certain other provisions. Unlike section 919, this section is not subject to Chapter 11 of this Part (payments between companies etc: exception from duties to deduct), because section 349A(4)(b) of ICTA excludes MODs from the provisions of sections 349A to 349D of that Act.

2824. *Subsection (4)* is a signpost to the powers in sections 586 and 925 to make regulations about collection of tax. The collection rules about MODs, and the rules about tax vouchers for MODs, are given by secondary legislation: regulations 11 and 15 respectively of SI 1993/2004, made under paragraph 8 of Schedule 23A to ICTA. The relevant provisions of paragraph 8 are rewritten in section 586.

Section 923: Foreign payers of manufactured overseas dividends: the reverse charge

2825. This section imposes an obligation on certain recipients to account for and pay income tax on MODs received. It is based on paragraphs 4 and 3A of Schedule 23A to ICTA. By analogy with section 8 of the Value Added Tax Act 1994, specialists refer to this as the reverse charge. This expression does not appear in the legislation itself but is commonly used. So it has been included in the sidenote to this section.

2826. Although this section is not about deduction of income tax at source, it is included in this Chapter because it applies in circumstances in which there would be a requirement to deduct income tax at source if the payer was UK resident.

2827. *Subsection (1)* sets out three conditions for the section to apply. First, the person must pay a MOD as mentioned in section 581. Second, the MOD must be paid in the circumstances set out in section 581(1). These conditions are identical to those in section 922(1). The third condition contrasts with the third condition in section 922(1): the payer must be non-UK resident and not paying the MOD in the course of a trade carried on in the United Kingdom through a branch or agency.

2828. If these conditions are satisfied, *subsection (2)* sets out the circumstances in which the recipient must account for and pay income tax in respect of the MOD.

2829. *Subsection (3)* provides that the amount of income tax to be accounted for and paid is equal to the amount which the payer would have been required to deduct if the case had been within section 922.

Section 924: Power to reduce section 923 liability

2830. This section supplements section 923. It is based on paragraph 4(3B) of Schedule 23A to ICTA.

Section 925: Power to provide set-off entitlement

2831. This section is a power to make regulations dealing with the interaction between Chapter 9 and double taxation relief. It is based on paragraph 4(3), 4(7) and 4(7AA) of Schedule 23A to ICTA.

2832. This section also brings into line with practice the law on the periods by reference to which overseas dividend manufacturers may set amounts of overseas tax off against their UK tax liabilities. See *Change 141* in Annex 1.

2833. This section uses the labels "relevant amounts of tax suffered" and "relevant tax liabilities". These labels are defined in *subsections (3)* and *(4)* respectively.

2834. *Subsection (5)* makes it clear that the credit mentioned in *subsection (1)* which a person can claim includes credit against corporation tax. So paragraph 4(7) and (7AA) of Schedule 23A to ICTA are repealed.

Section 926: Interpretation of Chapter

2835. This section provides that expressions used both in this Chapter and in Chapter 2 of Part 11 (manufactured payments and repos: manufactured payments) have the same meaning in this Chapter as they do in the earlier Chapter, so avoiding the need to duplicate definitions. It is based on paragraphs 1(1), 2(1), 3(1) and (10), 4(1) and (2A) and 7(1) of Schedule 23A to ICTA and section 153(2) of FA 2003.

2836. *Subsection (2)* provides that references in this Chapter to a trade carried on through a branch or agency are to be read, in relation to a company, as references to a trade carried on through a permanent establishment. This may make a difference in some cases as it is possible for a non-UK resident company to be trading in the UK through a branch or agency but not through a permanent establishment.

Section 927: Regulation-making powers: general

2837. This section provides that regulations under this Chapter may make different provision for different cases. It is based on paragraph 8(4) of Schedule 23A to ICTA.