EXPLANATORY MEMORANDUM TO

THE INCOME TAX (MANUFACTURED OVERSEAS DIVIDENDS) (AMENDMENT) REGULATIONS 2007

2007 No. 2487

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs and is laid before Parliament by Command of Her Majesty. This memorandum contains information for the Select Committee on Statutory Instruments.

2. Description

These Regulations make a number of amendments to the rules for manufactured overseas dividends in the Income Tax (Manufactured Overseas Dividends) Regulations 1993 (S.I. 1993/3220) ("the principal Regulations"). The changes modify the operation of the principal Regulations to ensure that they work properly following the enactment of the new repo rules in Schedule 13 to the Finance Act 2007.

3. Matters of special interest to the Select Committee on Statutory Instruments

None

4. Legislative Background

These Regulations are being made to allow manufactured overseas dividends ("MODs") to be paid to pension funds without deduction of tax in circumstances where the fund would have received the real overseas dividend gross. The Regulations also restrict the amount of foreign tax which can be claimed as double taxation relief.

5. Extent

This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 MODs are payments which arise under an agreement for the transfer of overseas securities such as shares and which represent dividends payable in respect of the securities. They commonly arise under repo or stocklending arrangements.

7.2 Schedule 23A of Income and Corporation Tax 1988 and the principal Regulations aim to ensure that MODs are taxed in the same way as the payments that they represent, and that the entitlement of the recipient to claim double taxation relief should in most cases be the same as if the recipient had received the real dividend. The principal Regulations lay down rules that prescribe the amount of tax that the payer of the MOD must deduct and the way the deduction is to be treated by the recipient.

7.3 The principal Regulations provide that the amount of tax that the payer of a MOD must deduct is the highest amount of tax that would have been payable in respect of an equivalent real overseas dividend paid to any UK recipient. It has been suggested that this operates harshly if the recipient of the MOD is a pension scheme that would not have suffered the "highest" rate but a reduced or nil withholding. The amendments ensure that where the recipient is a pension fund (or the payment is linked solely to pension business of a long-term insurance fund) then the rate of withholding will be that which would have applied in relation to a real overseas dividend paid to that fund.

7.4 The amendments also ensure that where a MOD is received by a UK recipient from a non-resident dividend manufacturer that received the real dividend, the UK recipient of the MOD will be entitled to double taxation relief in respect of the smaller of:

- The overseas tax suffered by the dividend manufacturer in respect of the real overseas dividend, and

- The excess of the gross amount of the real overseas dividend received by the dividend manufacturer over the amount of the MOD representing that dividend paid by the overseas dividend manufacturer.

7.5 A draft of the Regulations was circulated to members of Standing Committee examining the Finance Bill of 2007. They have been developed in consultation with business with whom drafts of the Statutory Instrument have been shared.

8. Impact

A Regulatory Impact Assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

9. Contact

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