

TAXREP 44/05

MANUFACTURED PAYMENTS AND REPOS

TAX LAW REWRITE: BILL 4

Memorandum submitted in September 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in June 2005 by HMRC Tax Law Rewrite Team

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INTRODUCTION

1. We welcome the opportunity to comment on Paper CC/SC(05)19 published on 30 June 2005 by HMRC Tax Law Rewrite Team at <http://www.hmrc.gov.uk/rewrite/exposure/menu.htm>.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are in the Annex.

GENERAL COMMENTS

3. The manufactured payments and repos anti-avoidance legislation for the purposes of income tax becomes more intelligible to the reader in consequence of rewriting sections 730A, 730B, 736B-737E and Schedule 23A ICTA together within the same Part (1) – Manufactured Payments and Repos.
4. Whilst the original provisions are not the most complex of the anti-avoidance provisions which will fall to be dealt with, and are of relatively recent origin, it is clearly encouraging that these pieces of original legislation have proved susceptible to rewrite treatment with their intelligibility improved in consequence.
5. We note that the current draft does not fully achieve the principle of including only purely income tax provisions in Bill 4, with purely corporation tax provisions being in ICTA, and that work is continuing on how best to achieve this.
6. We also note that the relationship between Chapter 2 and the ‘deduction of tax at source’ Part is still under review, and that work on the consequential amendments is still continuing subject to taking detailed decisions about the approach to the IT:CT split.
7. The original legislation is substantially rewritten in its original terminology, but with an improved layout to improve the reader’s understanding of it. This is understandable in a context of HMRC’s concern not to alter the meaning of anti-avoidance legislation.
8. We note that the draft clauses will be revised once the amendments to paragraph 3 Schedule 23A ICTA being made by Schedule 7 to the Summer 2005 Finance Bill (avoidance involving financial arrangements: manufactured interest and the accrued income scheme) are enacted. We also note that the extent to which the powers about administrative provisions in clauses 28-30 should be in Bill 4 rather than ICTA will depend on decisions taken about rewriting the provisions which they supplement.

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9. Chapter 1 (Introduction) provides a helpful overview of the Part.
10. Following its introduction, Chapter 2 (dealing with actual manufactured payments) is logically divided between the clauses concerning manufactured dividends on UK shares, manufactured interest on UK securities and manufactured overseas dividends, followed by the Special cases provisions in clauses 25-27, the general regulation-making powers in clauses 28-30 and the minor definitions in clause 31.
11. Chapter 3 (dealing with deemed manufactured payments in contrast to the actual payments dealt with in Chapter 2) separates stock lending arrangements (in clause 32) from the provisions regarding repos (in clauses 33-40). As regards repos, it is also helpful to distinguish 'non-option' (clause 33) from 'option' (clause 34) cases (and similarly as regards clauses 41 and 42 in Chapter 4), and to distinguish Chapter 3 (where the arrangement/agreement includes a payment of interest/distribution) from Chapter 4 which is concerned with price differences only.
12. It is logical to locate at the end of the Part the Chapter 5 clauses, relating to powers to modify the repo provisions in more unusual non-standard repo circumstances, as listed in the clause 47(4) table and in the case of certain redemption arrangements.
13. We note that the extent to which Chapter 5 will be needed in Bill 4 will depend on the decisions taken about the scope of Chapters 3 and 4.
14. We note that users of the legislation may have difficulties seeing how the rewritten primary legislation on manufactured payments and the regulations on manufactured payments fit together. Whilst the existing regulations will work as before, we appreciate the unavoidable difficulty of discrepancies between what appears in Bill 4 and what is contained in the regulations. We agree that this is a transitional problem, and note that HMRC will be considering what can sensibly be done to mitigate it.

ANSWERS TO QUESTIONS

15. **Q1** The approach taken in draft Chapter 2 (manufactured payments) and related consequential amendments, of splitting the income tax and corporation tax codes and rewriting the income tax provisions in Bill 4 whilst consequentially amending the source legislation in ICTA to apply solely for corporation tax purposes, appears appropriate in the context of rewriting legislation in an income tax rewrite Bill.
16. **Q2** We agree the proposal in Bill 4 to rewrite the primary legislation on the income tax treatment of payments representative of dividends on UK shares and to amend the source legislation consequentially to apply solely for corporation tax purposes.
17. **Q3** We agree the proposal to rewrite the primary legislation on deduction of income tax from MODs and to amend the source legislation consequentially to apply solely for corporation tax purposes.

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18. **Q4** We agree the proposal to rewrite the other primary legislation on the income tax treatment of MODs and to amend the source legislation consequentially to apply solely for corporation tax purposes.
19. **Q5** By reference to Explanatory Notes paragraph 35, we note the theoretical application of clause 5(4) as covering the case where the UK resident company paying the manufactured dividend is acting in a fiduciary capacity and so subject to income tax rather than corporation tax. If it transpires that such a case is not possible, then we agree that clause 5(4) might be omitted.
20. **Q6** Having regard to the commentary in Explanatory Notes paragraphs 45-49, it appears preferable to adopt the current approach to the rewriting of paragraphs 2(6)-(8) Schedule 23A ICTA as set out in Explanatory Notes paragraph 46.
21. **Q7** It does appear to be a reasonable conclusion that UK securities which were the subject of the contract or other arrangements mentioned in paragraph 3(1) Schedule 23A ICTA could include any loan satisfying any of ss 353-365 ICTA; and that paragraph 3(2)(c)(i) might accordingly be regarded as otiose. It would appear to have been otiose since its introduction in FA 1997, and we assume that HMRC have not encountered any instance to date where such a loan did arise. In this context we agree the proposal to not now rewrite paragraph 3(2)(c)(i).
22. **Q8** We agree the proposal to rewrite the rules on deduction of tax from manufactured interest on UK securities. As the income tax rules on deduction of tax at source are being rewritten in Bill 4, we agree that it would be anomalous to leave the rules on deduction of tax from manufactured interest on UK securities in ICTA.
23. **Q9** As Chapter 2 of Part 4 of ITTOIA 2005 rewrote the income tax rules on the taxability of interest on UK securities, we agree that Bill 4 as a further income tax Bill should 'follow suit' with clause 10(1) and (2) rewriting the rules about the income tax treatment of manufactured interest in the hands of the recipient (or, if different, the owner).
24. **Q10** It appears anomalous to rewrite clause 21 (Power to set certain sums off against liabilities) as applicable for both income tax and corporation tax. If Bill 4 is an income tax Bill, then it would appear more appropriate to confine the clause 21 power to income tax and leave paragraphs 4(7) and (7AA) Schedule 23A ICTA in place (consequentially amended as necessary) for corporation tax purposes.
25. **Q11** We support the proposal to rewrite paragraph 8(1A) Schedule 23A ICTA for the purposes of income tax and capital gains tax in Bill 4 (subject to any later provision to put the provision about capital gains tax into TCGA1992) and amend it consequentially to apply for the purposes of corporation tax only.
26. **Q12** We support the proposal to rewrite paragraphs 7 and 8(1) of Schedule 23A ICTA for income tax purposes and to amend these provisions consequentially so that they apply solely for the purposes of corporation tax.

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27. **Q13** We support the proposal to rewrite s 737D ICTA for income tax purposes and to amend it consequentially so that it applies solely for the purposes of corporation tax.
28. **Q14** We support the rewriting of ss 736B and 737A-737C ICTA in Chapter 3 for income tax purposes, with their consequential amendment for corporation tax purposes.
29. **Q15** On the assumption stated, we agree that ‘distribution’ is an acceptable generic label for dividends, periodical payments of interest and overseas dividends. It is unfortunate that this label necessarily includes periodical payments of interest which are not distributions within the familiar meaning of s 209 ICTA; but this will be clear from the clause 35 definition. The clause 4(3) definition of ‘overseas dividend’ similarly includes interest and annual payments in respect of any overseas securities and we note from Explanatory Notes paragraph 123 that the original definition in Schedule 23A ICTA, which clause 4(3) rewrites, has not caused any confusion in practice.
30. **Q16** We support the rewriting of s 730A ICTA, and the provisions which supplement it, for income tax purposes and to amend the source legislation consequentially to apply solely for the purposes of corporation tax.
31. **Q17** We are not aware of any circumstances in which paragraph 3 of Schedule 23A ICTA could have a corporation tax application following the rewriting of it for income tax purposes and accordingly agree to its consequential repeal (together with paragraph 3A Schedule 23A ICTA).

SPECIFIC COMMENTS ON DRAFT LEGISLATION

- cl 3 Meaning of ‘UK shares’ and ‘UK securities’**
32. With reference to Explanatory Notes paragraph 30, what is the point in retaining the label ‘United Kingdom equities’ in Schedule 23A ICTA, for corporation tax purposes, instead of aligning it with ‘UK shares’ as now adopted for income tax purposes? When corporation tax is rewritten, will this term not be changed to ‘UK shares’?
- cl 6 Allowable deductions: general**
33. With reference to Explanatory Notes paragraph 39, we note the use of “income” as the provisional translation for “profits or gains” (in paragraph 2A(4)(a) Schedule 23A ICTA), and note it will be necessary to ensure that this use does not inadvertently disturb the interpretation of the law in other places in the source legislation for Bill 4.
- cl 8 Allowable deductions: restriction on double-counting**
34. Is the drafting of clause 8(1) clear enough? Is not the intention simply to say that if a ‘relevant amount’ (as defined in clause 8(2) has been deducted already for income tax purposes under clause 7(2) or 7(5), then the same amount cannot be so deducted again? Perhaps insert the words ‘that whole or part of the same’ before ‘relevant amount’ at the end of the sentence? (Similar comments apply to clause 12(2) - Allowable deductions: restriction on double counting.)

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cl 9 Statements about manufactured dividends

35. Paragraph 2(6) Schedule 23A ICTA applies only where the payer of a manufactured dividend is not a company resident in the UK. Sub-clause 9(5) recognises this. As rewritten, in clause 9(1), the bracketed reference to 'a person' in 'section 5(1)' appears to include a reference to a UK resident company (referred to in clause 5(4)). This, of course, depends still upon responses to Q5; but, as currently drafted, clause 9(1) does not appear to correctly rewrite paragraph 2(6) Schedule 23A ICTA as relating to non-UK resident companies only. If clause 5(4) is finally retained, will clause 9(5) still stand to exclude all UK resident companies (then including those acting in a fiduciary capacity) from the duty to give a statement?
36. (4)(b) Paragraph 2(7)(c)(ii) Schedule 23A ICTA would be more accurately rewritten if the phrase 'the person concerned' in clause 9(4)(b) were replaced by 'recipient, or a person claiming title through or under the recipient'. The use of the word 'person' only is confusing in a context where 'the recipient' is distinguished from 'a person' claiming title through or under him/her.
37. Does s 234A ICTA oblige a UK resident company to provide a statement in respect of a manufactured dividend?

cl 10 Manufactured interest on UK securities: the main charge

38. As comments in Explanatory Notes paragraphs 50-55, we note that clause 10(4) and similarly clause 13 are at present place-holders only awaiting a more advanced stage of rewriting s 349 ICTA and that both of these draft clauses are accordingly subject to change.

cl 13 Adaptations for cases where interest on underlying securities paid gross

39. Is its bracketed description after s 14(4) misleading insofar as it might superficially be read as referring also to s 14(3); whereas the latter subsection concerns UK resident recipients only?

cl 14 Foreign payers of manufactured interest: the reverse charge

40. We note that the words 'and pay' are bracketed, and assume that this indicates uncertainty whether or not they should be included in the draft clause. As these words are included in sub-paragraph 3(6) Schedule 23A ICTA, and do remove all doubt as to whether or not 'account for' includes payment, we would be inclined to include them in clause 14(5).
41. We have no objection to the clause 14 side-note including the expression 'reverse charge'; but it might perhaps be clearer to the reader if it were also inserted after '(4)' in the first line.

cl 15 Collection of income tax on certain manufactured interest

42. With reference to Explanatory Notes paragraph 67, we note that clause 15 is at present a place-holder only and is subject to change pending the completion of the rewrite of Schedule 16 ICTA.

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cl 16 Statements about manufactured interest

43. With reference to Explanatory Notes paragraph 69, we agree that paragraphs 3(8) and (9) Schedule 23A ICTA should be rewritten in Bill 4 (as clause 16).
44. We assume that, in the Explanatory Notes, paragraph 68 should follow paragraph 69 as both relate to clause 16.

cl 18 Manufactured overseas dividends: the main charge

45. We note that clause 18(2), (3) and (4)(b) are place-holders only and subject to change pending the completion of the rewrite of s 350 and Schedule 16 ICTA.

cl 19 Foreign payers of manufactured overseas dividends: the reverse charge

46. With reference to our comments on clause 14(5) (Foreign payers of manufactured interest: the reverse charge), it may also be appropriate to insert the words ‘and pay’ after ‘for’ in the second line. Paragraph 4(3) Schedule 23A ICTA does refer to ‘account for and pay’.

cl 28 Powers about administrative provisions

47. We note from Explanatory Notes paragraph 102 that the extent to which the powers in clauses 28-30 should be found in Bill 4 rather than ICTA will depend on decisions taken about rewriting the provisions which they supplement.

cl 30 Regulation-making powers: general

48. With reference to Explanatory Notes paragraph 111, we agree that the better view is that it is implicit that regulations under s 737D ICTA could make different provision for different cases, and that clause 30 is appropriately drafted on that basis as merely making explicit in relation to regulations under clause 29 something that would in any event be implied so that clause 30 does not change the law.

cl 31 Minor definition

49. Does the commentary in Explanatory Notes paragraph 113 need to make it clear that the first sentence refers to a company carrying on a trade through a branch or agency?

cl 32 Deemed manufactured payments: stock lending arrangements

50. With reference to Explanatory Notes paragraph 116 we note that, should Bill 4 finally rewrite only a few of the provision of Schedule 23A ICTA, then it may be better to leave s 736B in ICTA to apply for the purposes of both income tax and corporation tax and for Bill 4 to make consequential amendments to it as appropriate.

cl 38 Deemed increase in repurchase price: price differences under repos

51. With reference to Explanatory Notes paragraph 129, we note that how exactly s 737C ICTA should be rewritten is still being considered and hence that clause 38 (and clauses 39 and 40) are published in provisional form only.

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DETAILED COMMENTS ON DRAFTING

cl 10 Manufactured interest on UK securities: the main charge

52. In Explanatory Notes paragraph 56, does the first sentence require amendment?
Possibly the deletion of the words 'income tax on' in the second line?

cl 13 Adaptations for cases where interest on underlying securities paid gross

53. In Explanatory Notes paragraph 65, a space is needed between '10' and 'and' in the second line and between 'it' and 'is' in the third line.

cl 28 Powers about administrative provisions

54. In Explanatory Notes paragraph 102, in the first and second lines, should the reference to clause '33' be to clause '30'?

cl 30 Regulation-making powers: general

55. In Explanatory Notes paragraph 111, in the penultimate line, 'by' should read 'be'.

cl 49 Sections 47 and 48: supplementary provisions

56. There appears to be an inconsistency in that in the first line of clause 49(3) the reference is to 'supplementary', whereas in the first line of clause 45(4) (Power to modify sections 41 to 44 and 46) the word 'supplemental' is used.

Sch 3 Repeals and revocations

57. In Schedule 23A, at (i), include also '3(1)' (now omitted from sub-paragraph 7(1) Schedule 23A ICTA).

Annex 3

58. In amending s 737D of ICTA (Power to provide for manufacturing payments to be eligible for relief) is it appropriate to refer in clause 737D(1) to ss 592(2) and 608(2) (a)? These sections do afford income tax relief; but do they also apply for corporation tax purposes? If so, could HMRC indicate the authority for this?

TJH/PCB

29.9.05

WHO WE ARE

The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.

The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.