

EXPLANATORY NOTE**CLAUSE 31 SCHEDULE 12: TAX CREDITS FOR CERTAIN FOREIGN DISTRIBUTIONS: AMENDMENTS 123 TO 125****SUMMARY**

1. Clause 31 and Schedule 12 provide for changes to the system of taxation for individuals who own foreign shares. Individuals in receipt of dividends from UK-resident companies are entitled under current law to a non-payable dividend tax credit. The clause and Schedule provide that individuals with a less than 10 per cent shareholding in a non-UK resident company will be also entitled to a non-payable dividend tax credit.
2. The amendments provide that the tax credit will not be available where the non-UK resident company is an offshore fund. The amendments have the same commencement as the other provisions of Schedule 12; they will have effect for the tax year 2008-09 and subsequent tax years.

DETAILS OF THE AMENDMENTS

3. Amendment 123 amends new section 397A (1) (a) which applies the new section to a UK resident or eligible non-UK resident who receives a relevant distribution made by a foreign company. The

amendment provides that the new section applies only where the company is not an offshore fund as defined by section 756A of the Income and Corporation Taxes Act 1988.

4. Amendment 124 amends new section 397 (1) (b) to make a drafting amendment consequent on the amendment to new section 397 (1) (a).
5. Amendment 125 amends new section 397B (2) which provides that, for the purposes of the new tax credit in new section 397A, a person is treated as having received a relevant distribution made by a non-UK resident company if, and only if, the manufactured overseas dividend is representative of such a distribution. The amendment provides that this applies only where the non-UK resident company is not an offshore fund.

BACKGROUND NOTE

6. An offshore fund is a collective investment scheme that is not based in the UK. Collective investment schemes enable a number of investors to pool their money, which is then managed by the fund manager who invests it in one or more asset classes. The main benefits for investors are access to the fund manager's professional expertise, risk spreading, reduced dealing costs as well as exposure to certain assets they would not be able to invest in otherwise.

7. Since the Finance Bill was published, it has become clear that some collective investment schemes are seeking to exploit the extension of the non-payable dividend tax credit to distributions from foreign companies by locating their cash or bond fund ranges offshore, with the intention of securing tax advantages for their UK investors. The amendments mean that the position for UK investors in offshore collective investment schemes remains exactly as it was before 6 April 2008.

8. The Government will consider this issue further in the context of the reform of personal dividend taxation and the modernisation of the offshore funds tax regime. The Government intends to introduce further legislation on the non-payable dividend tax credit in Finance Bill 2009 in respect of shareholdings of 10 per cent or more, together with anti-avoidance measures to ensure that the rules for the receipt of all personal dividends from overseas are not subject to abuse.