

BOARD OF INLAND REVENUE FINANCE BILL 2004
REPORT
***NEW CLAUSE**

Mr Chancellor of the Exchequer

**NEW CLAUSE: MANUFACTURED PAYMENTS UNDER
ARRANGEMENTS HAVING AN UNALLOWABLE
PURPOSE**

To move the following Clause-

‘(1) In Schedule 23A to the Taxes Act 1988 (manufactured dividends and interest) after paragraph 7 (irregular manufactured payments) insert –

Manufactured payments under arrangements having an unallowable purpose

- 7A (1) This paragraph applies in any case where –
- (a) a manufactured payment falls to be made by a company in an accounting period in pursuance of any arrangements (see sub-paragraphs (9) and (10) for definitions), and
 - (b) the arrangements have an unallowable purpose at any time (see sub-paragraphs (3) to (5)).

But this is subject to sub-paragraph (8) below (cases where tax relief is denied apart from this paragraph).

- (2) The company is not entitled, by virtue of anything in this Schedule or any provision of regulations under it, or otherwise, to any relevant tax relief (see sub-paragraph (10)), to the extent that the relief is in respect of, or referable to, the whole or any part of so much of the manufactured payment as, on a just and reasonable apportionment, is attributable to the unallowable purpose.
- (3) Arrangements have an unallowable purpose at any time if at that time the purposes for which the company is a party to -
 - (a) the arrangements,

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- (b) any related transaction (see sub-paragraphs (6) and (7)), or
 - (c) any transaction in pursuance of the arrangements,
include a purpose (“the unallowable purpose”) which is not among the business or other commercial purposes of the company.
- (4) The business and other commercial purposes of a company do not include the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.
- (5) Where one of the purposes for which a company is at any time a party to -
 - (a) any arrangements,
 - (b) any related transaction in the case of any arrangements, or
 - (c) any transaction in pursuance of any arrangements,is a tax avoidance purpose, that purpose shall be taken to be a business or other commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is party to the arrangements or transaction at that time.
- (6) One or more transactions are to be regarded as related transactions, in the case of any arrangements, if it would be reasonable to assume, from either or both of -
 - (a) the likely effect of the transactions, and
 - (b) the circumstances in which the transactions are entered into or effected,that none of the transactions would have been entered into or effected independently of the arrangements.
- (7) Transactions are not prevented from being related transactions, in the case of any arrangements, just because the transactions -
 - (a) are not between the same parties, or

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- (b) are not between the parties to the arrangements.
- (8) This paragraph does not apply if, as a result of any of the following provisions -
- (a) section 75(4)(b) (expenses of management of companies with investment business: unallowable purposes),
 - (b) section 76(4)(d) (expenses of insurance companies: unallowable purposes),
 - (c) paragraph 13 of Schedule 9 to the Finance Act 1996 (loan relationships with unallowable purposes),
- the company in question is not entitled to a relevant tax relief in respect of, or referable to, the whole or any part of the manufactured payment.

The references to sections 75 and 76 are references to those provisions as they have effect in relation to accounting periods beginning on or after 1st April 2004.

- (9) Any reference in this paragraph to a manufactured payment falling to be made by a company includes a reference to a manufactured payment which is deemed by or under any provision of the Tax Acts to be made by a company (and references to a transaction, or to a company being party to a transaction, are to be construed accordingly).
- (10) In this paragraph -
- “arrangements” includes schemes, arrangements and understandings of any kind, whether or not legally enforceable, and shall be taken to include any related transactions;
 - “manufactured payment” means any of the following -
 - (a) any manufactured dividend;
 - (b) any manufactured interest;
 - (c) any manufactured overseas dividend;

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“related transaction” shall be construed in accordance with sub-paragraphs (6) and (7) above;

“relevant tax relief” means any of the following -

- (a) any deduction in computing profits or gains for the purposes of corporation tax;
- (b) any deduction against total profits;
- (c) the bringing into account of any debit for the purposes of Chapter 2 of Part 4 of the Finance Act 1996 (loan relationships);
- (d) the surrender of an amount by way of group relief;

“tax advantage” has the same meaning as in Chapter 1 of Part 17 (tax avoidance);

“tax avoidance purpose” means any purpose that consists in securing a tax advantage (whether for the company in question or any other person);

and sub-paragraphs (3) to (7) above have effect for the purposes of this paragraph.”.

- (2) In section 95 of the Taxes Act 1988 (taxation of dealers in respect of distributions etc) before subsection (2) insert –

“(1C) The application of subsection (1) above in relation to a payment made by a dealer is subject to paragraph 7A of Schedule 23A (manufactured payments under arrangements having an unallowable purpose).”.

This amendment has effect on and after the commencement date.

- (3) The amendment made by subsection (1) has effect -
- (a) in the case of new arrangements, in relation to manufactured payments made, or deemed by or under any provision of the Tax Acts to be made, on or after the commencement date, and

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- (b) in the case of old arrangements, in relation to manufactured payments made, or deemed by or under any provision of the Tax Acts to be made, on or after the day on which this Act is passed.
- (4) But where -
 - (a) as a result of old arrangements, any income arose or accrued, or any gain accrued, to a company before the commencement date,
 - (b) the income or gain is or was within the charge to corporation tax, and
 - (c) a manufactured payment in pursuance of the arrangements is made, or deemed by or under any provision of the Tax Acts to be made, by the company on or after the day on which this Act is passed,the amendment made by subsection (1) does not have effect in relation to so much of the manufactured payment as (on such just and reasonable apportionments as may be necessary) represents the income or gain.
- (5) For the purposes of subsection (4) -
 - (a) “income” includes any income deemed by or under any provision of the Tax Acts to arise or accrue,
 - (b) “gain” includes any gain deemed by or under any provision of the Tax Acts to accrue.
- (6) In this section -
 - “the commencement date” means 2nd July 2004;
 - “new arrangements” means any arrangements other than old arrangements;
 - “old arrangements” means arrangements which were, or some part of which was, entered into or acted upon before the commencement date.
- (7) For the purposes of subsection (6), the cases where arrangements were, or some part of any arrangements was, acted upon before the commencement date are those cases where a transaction in pursuance of the arrangements, or of any part of the arrangements, has taken place before that date.’

SUMMARY

1. The clause is an anti-avoidance measure that provides for an “unallowable purpose” rule in respect of manufactured payments made by companies.
2. It applies in any case where a company makes a manufactured payment in pursuance of any arrangements that have an unallowable purpose. The rule denies any tax relief for the manufactured payment to the extent the relief is, on a just and reasonable apportionment, attributable to that unallowable purpose.
3. Arrangements have an unallowable purpose where the purposes for which the company is a party to them include a purpose that is not among the business or other commercial purposes of the company. It follows a similar definition to existing ‘unallowable purpose’ rules in other areas of tax legislation.
4. The rule applies to all manufactured payments made by companies on or after 2 July 2004 except where any part of the arrangements was entered into or acted upon before that date. In such cases, the rule applies only to manufactured payments made after Royal Assent, but not to the extent that, on a just and reasonable apportionment, income or gains arose or accrued to the payer of the manufactured payment before 2 July 2004 and were within the charge to UK corporation tax.

DETAILS OF THE CLAUSE

5. Subsection (1) inserts a new paragraph (7A) into Schedule 23A Income and Corporation Taxes Act (ICTA) 1988.
6. New paragraph 7A(1) provides that the paragraph applies in any case where a company makes a manufactured payment in pursuance of arrangements that have an unallowable purpose at any time, but subject to paragraph 7A(8).
7. New paragraph 7A(2) provides that a company is not entitled to any relevant tax relief to the extent that the relief is in respect of, or referable to, the whole or any part of so much of the manufactured payment as, on a just and reasonable apportionment, is attributable to the unallowable purpose.

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8. New paragraph 7A(3) provides that arrangements have an unallowable purpose at any time where the purposes for which the company is a party to the arrangements, any related transaction, or any transaction in pursuance of the arrangements, include a purpose (the “unallowable purpose”) which is not among the business or other commercial purposes of the company.
9. New paragraph 7A(4) define the business or other commercial purposes of a company as not including the purposes of any part of its activities in respect of which it is not within the charge to corporation tax.
10. New paragraph 7A(5) provides that where one of the purposes for which a company is at any time a party to any arrangements, any related transaction in the case of any arrangements, or any transaction in pursuance of any arrangements, is a tax avoidance purpose, that purpose shall be taken to be a business or commercial purpose of the company only where it is not the main purpose, or one of the main purposes, for which the company is a party to the arrangements or transaction at that time.
11. New paragraph 7A(6) provides that one of more transactions are to be regarded as related transactions, in the case of any arrangements, if it would be reasonable to assume, from either or both of, the likely effect of the transactions, and the circumstances in which the transactions are entered into or effected, that none of the transactions would have been entered into or effected independently of the arrangements.
12. New paragraph 7A(7) provides that transactions are not prevented from being related transactions just because the transactions are not between the same parties, or are not between the parties to the arrangements.
13. New paragraph 7A(8) provides that the new rule does not apply where existing unallowable purposes rules already apply to deny relief for some or all of the manufactured payment.
14. New paragraph 7A(9) ensures that the rule applies to deemed manufactured payments.
15. New paragraph 7A(10) defines the various terms used.

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16. Subsection (2) inserts a new subsection (1C) into section 95 ICTA 1988 to make it subject to new paragraph 7A Schedule 23A ICTA.
17. Subsection (3) provides the basic commencement rule. In the case of “new” arrangements, the legislation applies to manufactured payments made on or after commencement day. In the case of “old” arrangements, the legislation applies to manufactured payments made on or after Royal Assent, but subject to subsection (4).
18. Subsection (4) provides that where a manufactured payment under old arrangements is made by a company on or after Royal Assent, the new rule does not apply to so much of the payment as, on a just and reasonable apportionment, represents any income or gains arising or accruing to the company under the old arrangements before commencement date and which were within the charge to corporation tax.
19. Subsection (5) provides that income or gains within subsection (4) includes deemed income or gains.
20. Subsection (6) defines new and old arrangements, and provides that the commencement date is 2 July 2004.
21. Subsection (7) provides further detail for defining old arrangements.

BACKGROUND NOTE

22. This new clause provides an anti-avoidance measure to stop companies obtaining a tax advantage by entering into a range of artificial schemes involving manufactured payments.
23. A manufactured payment is a payment (sometimes known as a compensation payment) made under a contract or other arrangement for the transfer of securities and which represents an interest or dividend payment on those securities.
24. Such payments often arise under normal commercial financial market transactions such as stock loans and sale and repurchase (repo) agreements.

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25. In many circumstances, a manufactured payment qualifies as a deduction either in computing income for corporation tax purposes or against total profits.
26. A range of artificial schemes have recently come to light under which companies contrive to make, or be deemed to make, manufactured payments which rank as a deduction for tax purposes but which ensure that any counterbalancing profits or gains are not taxed at all, thereby reducing their overall corporation tax liability.
27. This new clause blocks these schemes by providing that a company is not entitled to tax relief in respect of a manufactured payment to the extent that the arrangements under which the payment is made have an unallowable purpose.
28. An unallowable purpose is a purpose that is not amongst the business or commercial purposes of the company. A business or commercial purpose does not include the purposes of any activities of the company that are not within the charge to corporation tax, nor does it include a tax avoidance purpose where that is the main or one of the main purposes of the arrangements.