

Rev. Proc. 2000-13

SECTION 1. PURPOSE

This revenue procedure modifies Rev. Proc. 80-18, 1980-1 C.B. 623, by setting forth new rules and procedures for applying Articles 10(2)(a) and 23(1)(b) and (c) of the United States-United Kingdom Income Tax Convention, signed on December 31, 1975, as amended by an Exchange of Notes, signed on April 13, 1976, and Protocols, signed on August 26, 1976, March 31, 1977, and March 15, 1979 (the "Convention"), 1980-1 C.B. 394, with respect to dividends paid by corporations resident in the United Kingdom after April 5, 1999 to U.S. shareholders. Revised rules and procedures are necessary because the United Kingdom repealed its advance corporation tax ("ACT") and reduced the shareholder tax credit with respect to dividends effective April 6, 1999.

SECTION 2. BACKGROUND

.01 *Prior U.K. Law.* Under prior U.K. law, ACT was levied on a corporation resident in the United Kingdom (U.K. corporation) in respect of a dividend paid, or other qualifying distribution made, by the corporation to its shareholders. The rate of ACT varied over time, but equaled one-fourth of the amount of the dividend immediately prior to the repeal of ACT. At the corporate level, ACT was creditable against the general corporation tax liability of either the distributing corporation or a corporation related to the distributing corporation. At the shareholder level, a shareholder resident in the United Kingdom was generally entitled to a tax credit against the shareholder's income tax liability in respect of the distribution. The tax credit was calculated by reference to the ACT rate and could be paid in cash to the extent that the credit exceeded the shareholder's tax liability. Because the amount of the tax credit was calculated by reference to the ACT rate, the shareholder tax credit was commonly referred to in the United States as an "ACT refund."

The tax credit was an integral part of a system of taxation under U.K. law that partially integrated the United Kingdom's corporate and shareholder level income taxes. The shareholder tax credit was designed to eliminate or reduce a second level of tax on corporate profits at the shareholder level. In the absence of a specific tax treaty provision, tax credits were not generally available to shareholders not resident in the United Kingdom. Under its domestic law, the United Kingdom does not impose a withholding tax on dividends paid to nonresidents.

.02 *Relevant Provisions of the Convention.* Paragraph (2) of Article 10 (Dividends) of the Convention provides that, as long as an individual resident in the United Kingdom is entitled under U.K. law to a tax credit in respect of dividends paid by a U.K. corporation, U.S. residents who are the beneficial owners of dividends paid by a U.K. corporation will be entitled to receive a payment from the United Kingdom of a tax credit, subject to a deduction withheld from the payment. In the case of U.S. corporations owning, directly or indirectly, 10 percent or more of the voting stock of a distributing U.K. corporation ("direct investors"), paragraph (2)(a)(i) of Article 10 provides that the amount payable by the United Kingdom is equal to one-half of the tax credit to which an individual shareholder resident in the United Kingdom would have been entitled, reduced by 5 percent of the sum of the dividend and the amount of the tax credit. In the case of all other U.S. investors ("portfolio investors"), paragraph (2)(a)(ii) of Article 10 provides that the amount payable by the United Kingdom is equal to the full amount of the tax credit to which an individual shareholder resident in the United Kingdom would have been entitled, reduced by 15 percent of the sum of the dividend and the amount of the tax credit. Under paragraph (2)(a)(iii) of Article 10, the gross amount of the tax credit (unreduced by the 5 or 15 percent withheld) is treated as an additional dividend paid by the U.K. corporation for U.S. tax credit purposes.

Paragraph (1) of Article 23 (Elimination of Double Taxation) of the Convention generally provides that the United States shall allow to its citizens and resi-

dents a foreign tax credit for an appropriate amount of income tax paid to the United Kingdom, subject to the limitations of, and in accordance with, the laws of the United States. Paragraph (1) of Article 23 provides that, in the case of a U.S. corporation owning at least 10 per cent of the voting stock of a U.K. corporation from which it receives dividends in any taxable year, the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom by that corporation with respect to the profits out of which such dividends are paid. Paragraph (1)(b) of Article 23 provides that the United States shall treat the amount withheld under paragraphs (2)(a)(i) and (ii) of Article 10 as an income tax imposed on the recipient of the dividend. Paragraph (1)(c) of Article 23 provides that the United States shall treat the one-half of the tax credit to which an individual shareholder resident in the United Kingdom would have been entitled, but which is not paid to a U.S. direct investor, as an income tax imposed on the U.K. corporation.

.03 *Repeal of ACT and Reduction of Shareholder Tax Credit.* Effective April 6, 1999, the United Kingdom repealed the ACT. Thus, a U.K. corporation is no longer required to pay ACT in respect of a dividend or other qualifying distribution to its shareholders. Notwithstanding the repeal of ACT, the integrated system of taxation under U.K. law remains in force. A U.K. shareholder is generally still entitled to a tax credit upon the receipt of a qualifying distribution to the extent of the shareholder's tax liability, but any excess is no longer payable in cash. The amount of the shareholder tax credit is no longer determined by reference to the ACT rate, but by reference to the "tax credit fraction" in force on the date of the distribution. The current tax credit fraction is one-ninth. Thus, the U.K. shareholder tax credit has been reduced from one-fourth to one-ninth of the amount of the dividend.

Under the literal language of the Convention, paragraph (2) of Article 10 of the Convention continues to apply after the repeal of ACT because individuals resident in the United Kingdom continue to be entitled under U.K. law to a tax credit

in respect of dividends paid by a U.K. corporation. Because of the reduction in the amount of the U.K. shareholder tax credit, however, the amount of the payment due to U.S. investors will be reduced. For portfolio investors, the amount permitted to be withheld on the sum of the dividend and the tax credit pursuant to paragraph (2)(a)(ii) of Article 10 will completely eliminate the amount payable. As a result, no additional cash will be payable to the investor under the Convention. For direct investors, only a nominal amount of additional cash will be payable, because the 5-percent amount withheld on the sum of the dividend and the tax credit pursuant to paragraph (2)(a)(i) of Article 10 will almost entirely eliminate the payment.

SECTION 3. APPLICATION OF THE CONVENTION AFTER THE REPEAL OF ACT

.01 *Section 901 Credit for Tax Withheld.* A U.S. shareholder, whether a portfolio or direct investor, who invokes the provisions of paragraph (2)(a) of Article 10 of the Convention upon the receipt of a dividend or other qualifying distribution after April 5, 1999 from a U.K. corporation will continue to be entitled to receive a foreign tax credit under section 901, in accordance with Article 23, for the amount withheld pursuant to paragraph (2)(a) of Article 10. This amount is treated as a creditable withholding tax for U.S. tax purposes pursuant to paragraph (1)(b) of Article 23.

.02 *Portfolio investors.* A U.S. portfolio investor entitled to payment of a tax credit under Article 10 of the Convention upon receipt of a dividend or other qualifying distribution from a U.K. corporation may elect to be treated as receiving the amount due under the Convention without affirmatively making a claim to the United Kingdom. A portfolio investor may make this election by so indicating on Line 5 of Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) and filing the completed Form 8833 with the taxpayer's income tax return for the relevant year.

A portfolio investor making this election will be treated as having received an additional dividend equal to the gross amount of the tax credit (unreduced by amounts withheld), and as having paid the

withholding tax due under Article 10, on the date of the distribution. Thus, the investor must include in income the gross payment deemed received, and may claim a foreign tax credit under Article 23 for the withholding tax treated as paid to the United Kingdom.

The withholding tax creditable under Article 23 cannot exceed the amount of the tax credit payable under the Convention. Since the tax permitted to be withheld under paragraph (2)(a)(ii) of Article 10 can only be withheld from the amount of the tax credit due to the U.S. portfolio investor, the United Kingdom is not permitted under the Convention to withhold an amount in excess of the tax credit. Accordingly, the tax is considered due and paid only to the extent of the tax credit.

For purposes of section 905(b) of the Code (relating to proof of credits), a U.S. portfolio investor who elects to be treated as receiving a payment and paying a tax under the Convention is not required to obtain a receipt or other evidence from the United Kingdom verifying the payment of the withholding tax, but may use secondary evidence to substantiate the amount of tax treated as paid. See Treas. Reg. § 1.905-2(b)(3).

.03 *Direct Investors.* A U.S. direct investor that claims a tax credit from the United Kingdom is entitled to a small payment net of withholding tax under paragraph (2)(a)(i) of Article 10. The amount of the withholding tax creditable under Article 23 will be equal to 5 percent of the sum of the dividend and the gross amount of the tax credit. The investor must include the gross amount of the tax credit in income as a dividend and satisfy all requirements under section 905(b) and the regulations thereunder relating to the verification and computation of the foreign tax credit. The investor must also file a Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) with the taxpayer's income tax return for the relevant year disclosing the benefits claimed under Articles 10 and 23 of the Convention.

.04 *Section 902 or 960 Credit for Corporate-Level Tax.* Under paragraph (1)(c) of Article 23 of the Convention, the portion of the tax credit to which a U.K. shareholder would be entitled upon a qualifying distribution, but which is not paid to a U.S. direct investor, is treated as an in-

come tax imposed on the U.K. corporation paying the dividend. This paragraph made clear that the one-half of the ACT paid by the U.K. corporation that was not paid out to the U.S. investor was to be treated as an income tax imposed on the U.K. corporation for which the U.S. investor could claim an indirect credit under paragraph 1 of Article 23 (and pursuant to sections 902 and 960 of the Code). See S. Exec. Rep. No. 18, 95th Cong., 2d Sess. (1980), *reprinted in* 1980-1 C.B. 411, 428. However, because paragraph (1) of Article 23 and section 901 of the Code specifically limit the allowable indirect credit to the appropriate amount of creditable U.K. income taxes actually paid by the U.K. corporation, the one-half of the ACT not paid out to the U.S. investor was creditable only to the extent it was actually paid by the U.K. corporation.

Under current U.K. law, a U.K. corporation is liable for corporation tax on the corporation's profits, but is not liable for ACT or any other creditable income tax in respect of its profits. Under Article 23, and in accordance with section 902 or 960 of the Code, a direct investor is eligible to claim an indirect foreign tax credit for the U.K. corporation tax paid by the corporation. Because no additional U.K. income tax is paid by the U.K. corporation under current law, no portion of the shareholder tax credit is treated as additional tax paid by the U.K. corporation for which the investor may claim an indirect foreign tax credit under Article 23 and in accordance with section 902 or 960 of the Code.

.05 *Effect of Tax Credit Paid Under the Convention on U.K. Corporation's Earnings and Profits and Foreign Income Taxes.* Under paragraph (2)(a)(iii) of Article 10, the gross amount of the tax credit (unreduced by amounts withheld) due from the United Kingdom under paragraphs (2)(a)(i) and (ii) of Article 10 is characterized as a dividend from the distributing U.K. corporation for U.S. tax credit purposes. The characterization of this amount as a dividend means that the U.K. corporation must be treated as receiving from the United Kingdom an equivalent amount out of which it pays the dividend. Prior to the repeal of ACT, the distributing U.K. corporation was treated as receiving from the United Kingdom a refund of the ACT paid (or one-half of the ACT paid in the case of a

distribution to a U.S. direct investor), out of which it paid the tax credit due under the Convention to its U.S. shareholder. See Treasury Explanation, *reprinted in* 1980-1 C.B. 455, 474 (prescribing this treatment under pre-1987 law).

While ACT is no longer payable by U.K. corporations, the shareholder tax credit due under the Convention is still funded out of U.K. corporate tax revenues and is determined by reference to the amount of the dividend, which is a portion of the base used to compute the U.K. corporation's tax. Thus, the payment of the shareholder tax credit gives rise to a refund or indirect subsidy for U.S. tax purposes. See section 901(i) and Treas. Reg. § 1.901-2(e)(3). These purposes include the computation of the corporation's earnings and profits (E&P) and foreign income taxes and corresponding effects on the corporation's U.S. shareholders, which may include the computation of the indirect credit under paragraph 1 of Article 23 (and pursuant to sections 902 and 960 of the Code) and the subpart F provisions under sections 951 through 964 of the Code. Accordingly, for distributions after April 5, 1999 with respect to which a U.S. direct investor applies for benefits under Article 10 of the Convention, the U.K. corporation will be treated as receiving a tax refund in an amount equivalent to the gross amount of the tax credit (unreduced by amounts withheld) payable to the U.S. shareholder under the Convention. This treatment ensures that the U.S. shareholder does not receive combined direct and indirect foreign tax credits in an amount exceeding the income taxes actually paid by the U.K. corporation.

The deemed refund of tax to the U.K. corporation is considered allocable to a separate limitation category in proportion to the ratio of post-1986 foreign income taxes in such category to the total amount of post-1986 foreign income taxes of the U.K. corporation, determined as of the close of the year in which the shareholder tax credit is paid or accrued and prior to accounting for the effect of distributions and deemed distributions during the year. To the extent the refund exceeds the U.K. corporation's total post-1986 foreign income taxes, the refund is treated as attributable to foreign income taxes previously deemed paid on a last-in, first-out basis (*i.e.*, the refund reduces the foreign income taxes most recently deemed paid by

the U.S. shareholder). Thus, the U.K. corporation must, in the year the shareholder tax credit is paid or accrued, reduce its post-1986 foreign income taxes in the separate limitation category (or categories) to which the refund relates and correspondingly increase its post-1986 undistributed earnings in the same category (or categories) by the gross amount of the tax credit payable under the Convention. See Treas. Reg. sections 1.905-3T(a)(3) and (4).

As explained in the Treasury Technical Explanation accompanying the Convention, where a U.S. direct investor owns less than all the stock of the distributing U.K. corporation, the indirect credit due under Article 23 and in accordance with sections 902 and 960 will be calculated with reference solely to the proportionate amount of E&P and foreign taxes attributable to that investor. Thus, the amount of the indirect credit will not vary according to the status of any other shareholder or the amount of distributions made, or payments of tax credits under the Convention, to any other shareholder. See Treasury Explanation, *reprinted in* 1980-1 C.B. 455, 473.

06. *Procedures for Direct Investors To Claim a Tax Credit Payment Under the Convention.* Prior to the repeal of ACT, the United Kingdom Inland Revenue could enter into arrangements with a U.K. corporation that paid a dividend or other qualifying distribution, authorizing it to pay the tax credit due under the Convention directly to its U.S. shareholders. The U.K. corporation could offset the amount of the tax credit paid against its ACT liability. Because U.K. corporations no longer pay ACT, this procedure is no longer available.

Because of the changes in U.K. law, all claims for payments of tax credits must be made on the appropriate United Kingdom form and filed directly with the United Kingdom Inland Revenue. The appropriate United Kingdom form is U.S./Corporation/Credit. In the United States, the forms may be obtained from the Internal Revenue Service, Office of Assistant Commissioner (International), Attn: Customer Service OP:IN:D:CS, 950 L'Enfant Plaza South, S.W., Washington, D.C. 20024. In the United Kingdom, the forms may be obtained from the Financial Intermediaries and Claims Office ("FICO"),

P.O. Box 46, Fitz Roy House, Nottingham NG2 1BD. The forms may be ordered from the United Kingdom by telephone on (011 44) 115 974 2000 or by fax on (011 44) 115 974 1863.

If a U.S. direct investor has never made a claim for a tax credit under the Convention, the investor should file a completed United Kingdom form (in duplicate) with the Philadelphia Service Center, Foreign Certification Unit, P.O. Box 16347, DP535B, Philadelphia, PA 19114. The Service Center will provide the required certification and transmit the form to the United Kingdom Inland Revenue. If a U.S. investor has previously filed a claim for a tax credit under the Convention, subsequent claims do not require certification by the Philadelphia Service Center. In such cases, the United Kingdom form should be filed directly with the United Kingdom Inland Revenue at the address shown above.

SECTION 4. EXCHANGE RATES

Under section 986(a)(1), as amended by the Taxpayer Relief Act of 1997 (TRA 97), P.L. 105-34, section 1102(a)(1) (1997), taxpayers claiming foreign tax credits on an accrual basis generally must translate foreign taxes, including withholding taxes, into U.S. dollars at the average exchange rate for the taxable year to which the taxes relate. Previously, taxpayers claiming foreign tax credits on an accrual basis translated foreign taxes into U.S. dollars at the so-called "spot" rate on the date the taxes were paid. The spot rate reflects a fair market value rate of exchange available to the public for currency under a spot contract in a free market and involving representative amounts. See Treas. Reg. § 1.988-1(d)(1). TRA 97 did not change this translation rule for taxpayers claiming foreign tax credits on the cash basis. Thus, these taxpayers still translate foreign taxes into U.S. dollars at the spot rate on the payment date. See section 986(a)(2).

Nonfunctional currency dividends, including the tax credit treated as a dividend under paragraph (2)(a)(iii) of Article 10, are treated as property distributions and are included in income on the date of payment. In accordance with section 989(b)(1), such dividends are translated into dollars at the spot rate on the payment date, regardless of whether the tax-

payer claims foreign tax credits on an accrual or cash basis.

Thus, for taxpayers claiming foreign tax credits on an accrual basis, the gross dividend is translated into U.S. dollars and included in income at the spot rate on the payment date, but taxes withheld from the dividend are translated into U.S. dollars at the average rate for the taxable year for foreign tax credit purposes. A taxpayer claiming foreign tax credits on the cash basis translates both the dividend and withholding tax into U.S. dollars at the spot rate on

the date the dividend is paid.

SECTION 5. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies the relevant portions of sections 3.01 through 3.07 of Rev. Proc. 80-18, 1980-1 C.B. 623 (as modified by Rev. Proc. 81-58, 1981-2 C.B. 678 and Rev. Proc. 84-60, 1984-2 C.B. 504, and as clarified and amplified by Rev. Proc. 90-61, 1990-2 C.B. 657).

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective on

the date of publication and applies to distributions to U.S. shareholders made on or after April 6, 1999 by corporations resident in the United Kingdom.

DRAFTING INFORMATION

The principal author of this revenue procedure is Trina Dang of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Dang at (202) 622-3850 (not a toll-free call).
