

Explanatory Note

Amendments 1-131 and 154-160 to Clause 65: Hybrid and other mismatches

Summary

1. These Amendments make a number of changes to the Hybrids and other mismatches legislation in clause 65 and Schedule 10. These amendments are intended to clarify the scope and application of this anti-avoidance legislation.
2. Amendments 1 to 125 seek to amend paragraph 1 of Schedule 10, which inserts Part 6A into TIOPA 2010. Amendments 126 to 131 seek to make consequential amendments to paragraph 2 of Schedule 10.
3. For ease of reference, this explanatory note sets out each key change, and groups the amendments accordingly.
4. The key changes introduced by these amendments are as follows.
 - Amendments in relation to mismatches involving permanent establishments (PEs), which clarify the interaction between the hybrid mismatch rules and the existing UK foreign PE exemption rules.
 - Amendments which clarify the treatment of income and expenses allocated within a company.
 - Amendments which clarify the interaction between the hybrid mismatch rules and the existing UK rules in relation to foreign PE losses. These amendments ensure that excess deductions incurred in an overseas PE can continue to be claimed against other UK profits, so long as those excess deductions are not used overseas against the profits of another person.
 - Amendments which deal with certain timing differences, which clarify the circumstances in which timing differences are outside the scope of the hybrid and other mismatches legislation.
 - Amendments which deal with a number of technical issues, including the treatment of certain investment funds, the application of existing UK loan relationship legislation, and the interaction with existing UK anti-avoidance rules.

Mismatches involving Permanent Establishments

5. The following amendments deal with mismatches involving permanent establishments (PEs).
6. Amendments 33 to 45 limit the scope of Chapter 6, Part 6A TIOPA, by removing references to permanent establishments outside the UK.
7. Amendment 33 inserts a reference to permanent establishments in the UK into Section 259F (1).
8. Amendments 34 to 37 remove references to deductions and the PE jurisdiction from Chapter 6.
9. Amendments 38 and 39 amend the definition of a multinational national company in Section 259FA(3)(b), so that for the purposes of Chapter 6, such a company has to be resident in a territory outside the UK, and within the charge to corporation tax by carrying on a business through a permanent establishment in the UK.
10. Amendments 40 to 45 make a number of consequential changes to Chapter 6, removing references to the PE jurisdiction, and inserting references to the UK.
11. Amendment 58 removes Section 259FC from Chapter 6, which related to circumstances where the UK was the parent jurisdiction. This removes the secondary counteraction, and ensures that the hybrid mismatch rules do not conflict with the UK foreign permanent establishment exemption rules.
12. Amendments 65 to 70 limit the scope of Chapter 8, Part 6A TIOPA, by removing references to multinational companies within the charge to UK corporation tax, and by excluding any mismatches which arise in relation to permanent establishments in jurisdictions where there is no corporate tax system.
13. Amendment 65 removes the reference to a multinational company within the charge to corporation tax in Condition C, Section 259HA.
14. Amendment 66 inserts new Section 259HB(3)(a) which excludes from any mismatch any excess which arises because there is no corporate taxation in the PE jurisdiction.
15. Amendments 67 to 69 are minor consequential amendments.
16. Amendment 70 removes Section 259HD, which related to the secondary counteraction where the UK was the parent jurisdiction.
17. The overall effect of these amendments is to ensure that the hybrid and other mismatch rules do not override the existing UK rules in relation to foreign permanent establishments. The amendments do this by limiting the scope of the hybrid and other mismatch rules for PEs within Chapter 6 and Chapter 8, so that they only apply in relation to PEs where the UK is the payer jurisdiction. In addition, the amendments exclude any mismatch which arises because the PE jurisdiction has no corporate tax system.

Allocation of income and expenses within a company

18. The following amendments deal with the allocation of income and expenses within a company (between a company and its permanent establishments (PEs)).
19. Amendment 47 removes references to ordinary income from Section 259FA(7), Condition C, and introduces a comparison between the PE deduction and the "aggregate effect on profits", which is defined in new subsection (7A) in section 259FA as the sum of any increase in profits and reduction in losses in the parent jurisdiction as a result of the PE deduction.
20. Amendments 48 and 49 are consequential amendments.
21. Amendment 50 amends section 259FA(9) to replace a reference to ordinary income with a reference to the PE deduction with regard to making a claim for a permitted taxable period in relation to section 259FA(7) and (7A).
22. Amendments 47 to 50 ensure that where income and expenses are allocated within a company, and there is no actual mismatch in terms of income which falls out of account, such allocations do not give rise to mismatches within the terms of the hybrid mismatch legislation. Consideration of the aggregate effect on profits determines whether the allocation of income and expenses within a company gives rise to a mismatch in terms of missing income.

Treatment of excess deductions arising in foreign Permanent Establishments

23. Amendment 102 introduces new Section 259JBA, which relates to the counteraction for multinational companies where the UK is the payer jurisdiction.
24. New Section 259JBA(2) limits the dual territory double deduction amount that can be deducted by a UK company by reference to the "impermissible overseas deduction", which is an amount which has also been deducted from the income of any person in another territory.
25. New subsection (3) allows any necessary adjustment to be made by assessment, amendment or claim.
26. New subsection (4) defines "dual inclusion income".
27. New subsection (5) excludes certain timing differences by reference to a permitted taxable period, in line with other amendments in relation to timing differences set out below.

28. The effect of this amendment is to limit the scope of the dual territory double deduction rules in Chapter 10, so that overseas permanent establishment excess deductions can be used in the UK unless those deductions have also been used overseas against the profits of another person. This ensures that the hybrid mismatch rules do not override the existing UK rules in relation to the availability of overseas losses. If the deduction is subsequently used overseas against the profits of another person, any deduction allowed against the profits of the UK company will be reduced accordingly.

Timing Differences

29. The following amendments deal with timing differences, and ensure that mismatches which only arise as a consequence of certain timing differences can be excluded from the hybrid mismatch rules.
30. Amendment 30 inserts a definition of a permitted taxable period for the purposes of Section 259EC.
31. Amendments 31 and 32 insert a definition of a permitted taxable period for the purposes of Section 259ED.
32. Amendment 76 inserts a definition of a permitted taxable period of a hybrid entity when the investor is within the charge to corporation tax into section 259IB(9), for the purposes of Chapter 9.
33. Amendment 84 inserts a definition of a permitted taxable period when a hybrid entity is within the charge to corporation tax into section 259IC(11), for the purposes of Chapter 9.
34. Amendment 101 inserts a definition of a permitted taxable period of a dual resident company into section 259JB(9), for the purposes of Chapter 10.
35. Amendment 113 inserts a definition of a permitted taxable period of a multinational company where the UK is the PE jurisdiction into section 259JC(9), for the purposes of Chapter 10.
36. Amendments 27 to 29, 72 to 75, 81 to 83, 98 to 100 and 110 to 112 insert references to income, accounting and payment periods in relation to the treatment of timing differences, to ensure that the permitted taxable period amendments detailed above can apply.
37. The overall effect of these amendments is to ensure that timing mismatches which are reversed within a period which begins within 12 months of the period in which the mismatch arises are excluded from the scope of the legislation. In addition, if the mismatch is reversed after that period, the taxpayer can make a claim for a longer period to be disregarded. Such claims will be considered on a just and reasonable basis, having regard to the facts of each case.

Other Technical Amendments

38. Amendments 4 and 5 clarify the application of the financial trader exclusion, by amending section 259CB(3) to include reference to the terms or any other feature of a financial instrument.
39. Amendments 3 and 13 insert new sub-section (2A) into section 259CB, and new section 259CBA. These amendments disregard certain mismatches which are excluded under loan relationship provisions ("relevant debt relief provisions")
40. Section 259CB(2A) disregards excess amounts which arise as a result of a relevant debt provision. Such amounts are treated as not arising as the result of the terms or features of a financial instrument.
41. Amendment 10 inserts new sub-section (6A) into section 259CB. This sub-section disregards any excess or under-taxed amounts which arise as a result of a payee being a "relevant investment fund". Such amounts are treated as not arising as a result of the terms or features of a financial instrument.
42. New section 259CBA(3) provides a definition of "relevant debt relief provisions". The rest of Section 259CBA consists of sub-sections moved from Section 259CB.
43. Amendments 21 to 23 move sub-sections (9) to (12) of section 259DC into new section 259DCA.
44. Amendment 123 inserts new section 259NZA, which provides a definition of a "relevant investment fund".
45. Amendment 7 inserts new subsection (4A) into section 259CB, which disregards certain UK tax provisions when applying the relevant assumption that a company is resident in the UK for the purposes of Chapter 3. Disregarding those UK tax provisions (loan relationship and derivative contract unallowable purpose rules, transfer pricing rules, tax treatment of financing costs and income and the hybrid mismatch rules) enable the hybrid mismatch rules to determine whether a mismatch has arisen as a result of the terms of the hybrid financial instrument. Amendment 17 inserts new subsection (4A) into section 259DC, which has the same effect for the purposes of Chapter 4.
46. Amendment 60 inserts new subsections (4A) and (4B) into Section 259GB. This amendment provides that where a payment is made to a hybrid entity which is not within the charge to tax in any territory, then, unless the income of the hybrid entity is included within the calculation of a CFC charge, any mismatch will be within the scope of the hybrid mismatch legislation.
47. Amendment 118 inserts new Section 259KAA, and provides definitions of a "dual territory double deduction" and an "excessive PE deduction" for the purposes of Chapter 11 (imported mismatches). Subsection 5 defines a permitted taxable period in line with other amendments in relation to timing differences as set out above. This amendment clarifies the treatment of imported mismatches involving PEs.
48. Amendment 124 refines the "acting together" control test in section 259NC(7), which sets out the circumstances in which the parties can be considered to be acting together. This amendment is designed to strengthen the control test.

Consequential Amendments

49. There are a number of minor consequential amendments which take account of the more substantial amendments detailed above, including updating cross-references.

Further Amendments

50. Amendments 154-160 deal with technical issues raised by stakeholders in connection with the amendments set out above. These further amendments ensure that the legislation works as intended.
51. Amendment 154 supersedes Amendment 30 by inserting a reference to the taxable period of an investor, for the purposes of Section 259EC. This ensures that the permitted period rule works as intended.
52. Amendment 155 supersedes Amendment 32 by inserting a reference to the taxable period of an investor, for the purposes of Section 259ED. This ensures that the permitted period rule works as intended.
53. Amendment 156 supersedes Amendment 60 (see paragraph 46 above) which ensures that a payment to a hybrid entity which is not within the charge to tax in any territory falls within the scope of the hybrid mismatch rules, unless the income of the hybrid entity is included in a calculation of CFC chargeable profits. This amendment provides a definition of CFC chargeable profits by inserting sub-section (4C) into Section 259GB.
54. Amendment 157 is a consequential amendment which inserts a revised cross-reference to new section 259KAA.
55. Amendment 158 inserts revised conditions E and F into section 259KA, for the purposes of the imported mismatch rules in Chapter 11.
56. Amendment 159 supersedes Amendment 118 (see paragraph 47 above) by inserting a revised new section 259KAA, which provides definitions for the purposes of the imported mismatch rules in Chapter 11. This amendment flags up the inclusion of a definition of a "PE jurisdiction" within Section 259KAA(3)(a).
57. Amendment 160 is a consequential amendment which inserts a cross-reference to the definition of "PE jurisdiction" in Chapter 11 of the hybrid mismatch rules.

Background note

58. Clause 65 introduces legislation to counteract mismatches involving hybrid instruments, hybrid transfers, hybrid entities, dual resident companies and permanent establishments. The legislation is consistent with the recommendations on Action Point 2 (Neutralising the Effects of Hybrid Mismatch Arrangements) of the G20/OECD BEPS project.
59. The government is proposing a number of amendments to Clause 65 which respond to points raised on the legislation by stakeholders particularly with respect to the rules dealing with mismatches involving permanent establishments, which were first published at Budget 2016. Detailed consultation with stakeholders on this aspect of the rules has only taken place recently.
60. These amendments take into account a number of issues raised by stakeholders.
61. In particular, these amendments adjust the scope of the hybrid and other mismatch rules in relation to permanent establishments (PEs), in order to preserve the existing treatment of certain PE losses, and to clarify the interaction with the existing UK foreign PE exemption rules.
62. In addition, there are a number of technical amendments which are required to ensure that the legislation operates as intended.
63. Amendments 154-160 take account of additional issues raised by stakeholders after the publication of amendments 1-131. These further amendments deal with a small number of specific technical points, and are necessary to ensure that the legislation operates as intended.