

## Explanatory Note

### Clause 33: Hybrid and other mismatches

#### Summary

1. This Schedule introduces new rules to counteract tax avoidance through hybrid and other mismatch arrangements which result in a deduction for various payments where there is no corresponding inclusion in ordinary income, or in double deductions from ordinary income. These new hybrid mismatch rules will effectively replace the existing anti-arbitrage rules in Part 6 TIOPA 2010.

#### Introduction

2. The new rules introduced by this Schedule deal with hybrid mismatch arrangements. These mismatches can involve either double deductions for the same expense (double deduction mismatches), or deductions for an expense without any corresponding receipt being taxable (deduction/non-inclusion mismatches). Typically, such arrangements occur cross-border, as they seek to exploit the differences in tax treatment between two jurisdictions. However, in the case of hybrid financial instruments, mismatches can occur within jurisdictions.
3. Hybrid mismatch outcomes can arise from both hybrid financial instruments and hybrid entities.
4. An example of a hybrid financial instrument would be one which allowed the payer to deduct a payment as interest but allowed the payee to treat the receipt as an exempt dividend.
5. An example of a hybrid entity would be a partnership which is treated as transparent by one jurisdiction but treated as opaque by another jurisdiction. The effect would be that one jurisdiction would apply its tax rules to the partnership, whilst the other would look through the partnership and apply its tax rules to the partners.
6. These new hybrid mismatch rules seek to neutralise the tax mismatch created by the hybrid arrangement by changing the tax treatment of either the payment or the receipt, depending on the circumstances. The rules are designed to work whether both the countries affected by a cross-border hybrid arrangement have introduced hybrid mismatch rules, or just one.
7. In the case of double deductions, the primary response is to deny a deduction to the parent company. If this does not occur (because the tax law in the country in which the parent company is resident does not provide for this), the secondary response is to deny the deduction to the hybrid entity.
8. In the case of deduction/non-inclusion, the primary response is to deny a deduction to the payer. If this does not occur, the secondary response is to bring the receipt into charge for

the recipient.

9. The new rules targets hybrid mismatches in the following circumstances.
10. Deduction/non-inclusion outcomes involving:
  - Hybrid Financial Instruments
  - Hybrid Transfers
  - Hybrid Entity Payers
  - Hybrid Entity Payees
11. Double deduction outcomes involving:
  - Hybrid Entity Payers
  - Dual Resident Companies
12. The measure also includes rules to deter arrangements which attempt to circumvent the main hybrid mismatch rules by transferring a mismatch into a third jurisdiction - such arrangements are known as "imported" mismatches.

### Structure of the legislation

13. Chapters 3 to 9 deal with various types of mismatches. A common structure has been employed in those chapters, for ease of reference. Each chapter is divided into three parts, as follows :
  - Introduction, which sets out the scope of the chapter,
  - Application, which sets out the conditions which need to be met in order for the chapter to apply and how to identify and measure particular mismatches and
  - Counteraction, which sets out how the mismatches that fall within that chapter are to be dealt with. Depending on the type of mismatch and the circumstances of the counterparties, the counteraction will either be the restriction or denial of a tax deduction, or the charging of an amount of income to tax.

### Schedule 1

14. Schedule 1 inserts new Part 6A into Taxation International and Other Provisions Act (TIOPA) 2010

### Chapter 1 – Introduction

15. Chapter 1 provides an overview of the new rules for counteracting certain mismatches arising from arrangements involving hybrid entities and hybrid financial instruments.
16. New section 259A sets out the structure of new Part 6A TIOPA 2010.
17. Subsection 1 explains that Part 6A is intended to counteract certain mismatches which fall into two categories : cases which involve a tax deduction but no corresponding receipt, and those which involve more than one deduction.

18. Subsection 2 provides that Part 6A will cover three types of mismatches : those involving financial instruments (including hybrid transfers), those involving hybrid entities and those involving dual resident companies.
19. Subsections 3 to 12 summarise the content of each Chapter in Part 6A.

## Chapter 2 –Key Definitions

20. Chapter 2 sets out key definitions in relation to the hybrid rules.
21. New Section 259B sets out certain key definitions
22. Subsection 1 defines "tax" for the purposes of Part 6A as income tax, corporation tax on income, diverted profits tax, the CFC charge, foreign tax or a foreign CFC charge.
23. Subsection 2 defines foreign tax by reference to whether it is charged on income and corresponds to UK income or corporation tax.
24. Subsection 3 provides that provincial and state taxes are included within the definition of foreign tax.
25. Subsection 4 says that the meaning of "CFC", "CFC charge" Is the same as for Part 9A and gives a definition of a "foreign CFC charge"
26. New Section 259BA is about how to construe reference to an equivalent provision to this Part under the law of a territory outside the UK
27. Subsections 1 and 2 provide that such a reference is one that it is reasonable to suppose is based on the OECD Final Report on Hybrid Mismatches published on 5th October 2015. This includes any replacement or supplementary publication.
28. Subsection 3 provides a definition of replacement or supplementary publication.
29. New Section 259BB defines the terms "payment", "payer", "payee" and "quasi-payment" and other key terms for the purposes of Part 6A.
30. Subsection 1 defines "payment" as any transfer of money or money's worth, for which a tax deduction can be claimed for a taxable period. Such deductions are referred to as "relevant deductions" and taxable periods are referred to as "payment periods".
31. Subsection 2 defines a "quasi-payment" for the purposes of Part 6A. Disregarding Part 6A or any equivalent non-UK law, a quasi-payment is where the payer may deduct an amount from ordinary income in calculating taxable profits, and (based on the assumption in subsection (4)) it may reasonably be assumed that an amount of ordinary income arises to another person or persons as a result.
32. Subsection 3 provides that a quasi-payment does not arise if the deduction is a deemed deduction for tax purposes, and the circumstances that gave rise to the deduction do not include the creation of any economic rights between the counterparties.
33. Subsection 4 sets out the assumptions required to apply subsection (2), which are that it is the law of the payer's jurisdiction that determines whether an entity is a separate and distinct entity from the payer, that any person to whom amounts arise adopts the same accountancy approach as the payer, and that any payees or potential payees are within the charge to tax in the payer jurisdiction.

34. Subsection 5 provides that references to quasi-payments, and to quasi-payment being made, refer to the circumstances which give rise to the relevant deduction, per subsection (2).
35. Subsection 6 defines "Payee" in the case of payments within subsection (1) as either a person to whom a transfer has been made, or a person to whom an amount of ordinary income arises as a result of that payment.
36. In relation to quasi-payments within subsection (2), a payee is either a person to whom it would be reasonable to expect an amount of ordinary income to arise, or a person to whom ordinary income actually arises due to the quasi-payment.
37. Subsection 7 sets out the circumstances in which a payer can also be a payee with regard to quasi-payments. This can arise, for example, where the payer is a branch of the payee company.
38. Subsection 8 defines a "payer jurisdiction" as the territory in which the relevant deduction may be made.
39. New Section 259BC Sets out the basic rules relating to "Ordinary income".
40. Subsection 2 defines ordinary income as gross income brought into account when calculating taxable profits
41. Subsection 3 excludes from ordinary income amounts that are excluded, reduced or offset by an exemption, exclusion, relief or credit that either applies specifically to all or part of the income, or that arises from a payment or quasi-payment that generates that income.
42. Subsection 4 and 5 provide that if the relevant tax charged on profits is refunded in whole or in part, the income that is brought into account in calculating the taxable profit, or a proportional part of it, is not ordinary income.
43. Subsection 6 defines when an amount of relevant tax is refunded but provides that an amount of tax that is refunded as a result of qualifying loss relief is to be ignored.
44. Subsection 7 gives the meaning of qualifying loss relief
45. Subsection 8 provides that ordinary income is included in taxable profits when it is brought into account in calculating taxable profits.
46. Subsection 9 excludes the CFC charge or the foreign CFC charge from the definition of "relevant tax", as they are dealt with separately in the following section.
47. New Section 259BD provides for amounts to be taken into account as ordinary income in relation to UK or foreign Controlled Foreign Company ("CFC") charges.
48. Subsection 2 provides that this section applies to a CFC, when certain amounts are not included in ordinary income, or, in relation to payments and quasi-payments linked to financial instruments or hybrid transfer arrangements, are included but under-taxed. The section then considers to what extent those amounts have been taken into account in computing a CFC charge. These amounts are termed "the relevant income" of the CFC.
49. Subsection 3 sets out the three steps to be taken in determining whether the relevant income of that company is ordinary income of any other companies which are subject to a CFC charge ("chargeable companies"). It does so by assessing whether and to what extent

the relevant income has been taken into account in calculating chargeable profits which create a CFC charge for one or more chargeable companies.

50. Subsection 4 ensures that relevant income amounts can only be treated as ordinary income by one company, so that amounts that are ordinary income of a relevant chargeable company cannot also be ordinary income of the CFC.
  51. Subsections 5 and 6 include apportioned CFC profits within the definition of "taxable profits" for the purposes of Part 6A.
  52. Subsection 7 provides that tax charged on taxable profits includes a relevant charge charged by reference to relevant chargeable profits.
  53. Subsection 8 defines an "under-taxed" amount as one where the highest rate of tax charged on that amount is less than the full marginal rate.
  54. Subsection 9 defines "full marginal rate".
  55. Subsection 10 applies the definition of ordinary income in Section 259BC(3) for the purposes of this section.
  56. Subsections 11 and 12 ensure that relevant income amounts are not counted twice when determining the ordinary income of a CFC and the relevant chargeable companies.
  57. Subsection 13 provides definitions of "chargeable companies", "chargeable profits" and "hybrid transfer arrangement".
  58. New Section 259BE sets out definitions of "hybrid entity", "investor" and "investor jurisdiction".
  59. New Section 259BF sets out permitted reasons for deduction/non-inclusion mismatches - so that certain mismatches will be disregarded for the purposes of the hybrid mismatch rules in Part 6A.
  60. Subsection 1 sets out the types of mismatches to which this section applies.
  61. Subsection 2 sets out "permitted reasons" for deduction/non-inclusion mismatches. They include a person not being liable to tax in any territory, a person not being charged to tax on income arising outside a territory, and a person not liable to tax because of sovereign immunity.
  62. Subsection 3 sets out certain definitions in relation to the permitted reasons.
- Chapter 3 – Hybrid and other mismatches from financial instruments**
63. New Section 259C provides an overview of the Chapter 3 rules, which counteract hybrid or otherwise Impermissible deduction/non-inclusion mismatches.
  64. New Section 259CA sets out four conditions (A to D) which need to be met in order for this Chapter to apply.
  65. Subsection 2 sets out Condition A, which requires that a payment or quasi-payment is made in relation to a financial instrument.
  66. Subsection 3 sets out Condition B which requires either the payer or the payee to be within the charge to corporation tax for the payment period.

67. Subsections 4 and 5 set out Condition C which asks whether it would be reasonable to assume a hybrid mismatch would occur, in the absence of this Chapter and Chapters 5 to 8, or any equivalent non-UK tax law.
68. Subsection 6 sets out Condition D which is met if the payer is also a payee (applies to quasi-payments only), the payer and payee are related or if the financial instrument, or any arrangement connected with it, is a structured arrangement.
69. Subsection 7 defines a structured arrangement for this section.
70. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
71. New Section 259CB provides that there is a "hybrid or otherwise impermissible deduction/non-inclusion mismatch" if either or both of Cases 1 or 2 apply.
72. Subsection 2 provides for Case 1 to apply where deductions exceed the total payments or quasi-payments recognised as taxable income, and where the excess arises from the terms or features of a financial instrument.
73. Subsection 3 provides for Case 2 to apply where payments or quasi-payments result in amounts being included as taxable income, but under-taxed as a result of the terms or features of a financial instrument. Such amounts are "under-taxed amounts."
74. Subsection 4 disregards mismatches which arise for a permitted reason (see section 259BF).
75. Subsection 5 defines a permitted taxable period for a payee.
76. Subsections 6 and 7 define "under-taxed" taxable profits and "full marginal rate".
77. Subsection 8 sets the amount of a Case 1 mismatch as the excess that arises as a result of the hybrid transfer arrangement.
78. Subsection 9 sets the amount of a Case 2 mismatch amount by reference to a formula which takes into account the under-taxed amount, the full marginal tax rate and the actual tax rate applied.
79. Subsection 10 provides that where there is both a Case 1 and a Case 2 amount, the mismatch amount is the sum of the Case 1 and Case 2 amounts.
80. New Section 259CC provides the primary response: the counteraction if a payer is within the charge to corporation tax is that the relevant deduction is reduced by the mismatch amount.
81. New Section 259CD provides the secondary response: the counteraction if a payee is within the charge to corporation tax, and it is reasonable to suppose that the mismatch is not fully counteracted under section 259CC or any equivalent non-UK tax law. The amount calculated in accordance with subsection 3 is treated as income arising to the payee, or payees, for the counteraction period, and is charged to tax as income not otherwise charged to tax. This amount is "the relevant amount."
82. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.

83. Subsection 7 charges the relevant amount to tax under Chapter 8 Part 10 CTA 2009.
84. Subsection 8 defines the "counteraction period."

## Chapter 4 – Hybrid transfer deduction/non-inclusion mismatches

85. Chapter 4 provides the detailed rules for countering certain mismatches arising from hybrid transfer arrangements.
86. New Section 259D provides an overview of Chapter 4.
87. New Section 259DA sets out the circumstances in which the Chapter applies.
88. Subsection 1 sets out five conditions (A to E) which need to be met for the hybrid mismatch rules to apply. All five conditions need to be met in order for this Chapter to apply.
89. Subsection 2 sets out Condition A, which requires there to be a hybrid transfer arrangement in relation to an underlying instrument.
90. Subsection 3 sets out Condition B, which requires a payment or quasi-payment to be made in relation to that arrangement or instrument.
91. Subsection 4 sets out Condition C, which requires that either the payer or the payee is within the charge to corporation tax.
92. Subsection 5 sets out Condition D, which is that it is reasonable to assume that in the absence of Part 6A or any equivalent non-UK rules, there would be a hybrid transfer deduction/non-inclusion mismatch.
93. Subsection 6 sets out Condition E, which is met if the payer is also a payee (applies to quasi-payments only), the payer and payee are related, or if the hybrid transfer arrangement is a structured arrangement.
94. Subsection 7 defines a structured arrangement for this section.
95. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
96. New Section 259DB provides definitions for "hybrid transfer arrangements" and related terms.
97. Subsections 2 and 3 define a "hybrid transfer arrangement" by reference to the transfer of an "underlying instrument" where either the "dual treatment" condition is met, or a "substitute payment" could be made.
98. Subsection 4 defines the "dual treatment" condition. The condition is met if, for the purposes of a tax charged on a person, the arrangement is treated as equivalent, in substance, to the lending of money at interest, and is not so treated for the purposes of a tax charged on another person.
99. Subsection 5 defines a "substitute payment". The definition covers, for example, a manufactured dividend.
100. Subsection 6 includes within the definition circumstances where an arrangement involves a financial instrument effectively being replaced by a second financial instrument, so that

the second instrument is treated as being transferred between the two parties.

101. New Section 259DC sets out two types of hybrid transfer deduction/non-inclusion mismatch which fall within Chapter 4 - denoted as Case 1 and Case 2.
102. Subsection 2 provides for Case 1 to apply where deductions exceed the total payments or quasi-payments recognised as taxable income, and where the excess is a result of either the dual treatment condition or substitute payment condition set out in subsection (4).
103. Subsection 3 provides for Case 2 to apply where amounts are included as taxable income, but under-taxed, as a result of either the dual treatment condition or substitute payment condition being met as set out in subsection (4).
104. Subsection 4 sets out whether the dual treatment condition is met, and whether a payment or quasi-payment is a substitute payment, for the purposes of Case 1 and Case 2 above.
105. Subsection 5 disregards Case 1 and Case 2 mismatches which either fall within the financial trader exclusion, or which arise for a permitted reason (as defined in Section 259BF).
106. Subsection 6 sets out the financial trader exclusion, which applies for substitute payments where the difference in treatment is the result of a person recognising both the underlying return and the substitute payment as trading income.
107. Subsection 7 disapplies the financial trader exclusion in cases where, if the payees had received the underlying return, Chapter 3 or equivalent non-UK rules would apply, or where the relevant hybrid transfer arrangement is a structured arrangement.
108. Subsection 8 sets out the time period for a payee, within which amounts of ordinary income can be considered - the "permitted taxable period". This period has to either begin within 12 months of the end of the payment period, or, if later, a claim is made on a just and reasonable basis.
109. Subsection 9 defines "under-taxed"
110. Subsection 10 defines "full marginal rate"
111. Subsection 11 sets the amount of a Case 1 mismatch as the excess that arises as a result of the terms of the financial instrument.
112. Subsection 12 sets the amount of a Case 2 mismatch by reference to a formula which takes into account the under-taxed amount, the full marginal tax rate and the actual tax rate applied.
113. Subsection 13 provides that where there is both a Case 1 and a Case 2 amount, the mismatch amount is the sum of the Case 1 and Case 2 amounts.
114. New Sections 259DD and 259DE set out the counteractions to be applied in relation to Chapter 4.
115. New Section 259DD provides the primary response : where the UK is the payer jurisdiction and the payer is liable to UK corporation tax, the relevant deduction is reduced by the mismatch amount.



116. New Section 259DE provides the secondary response : countering the hybrid mismatch arrangement where the UK is a payee jurisdiction, the payee is liable to UK corporation tax, and it is reasonable to suppose that the mismatch is not fully counteracted under section 259DD or any equivalent non-UK tax law. The amount calculated in accordance with subsection 3 is treated as income arising to the payee, or payees, for the counteraction period, and is charged to tax as income not otherwise charged to tax. This amount is "the relevant amount."
117. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.
118. Subsection 7 charges the relevant amount to tax under Chapter 8 Part 10 CTA 2009.
119. Subsection 8 defines the "counteraction period."

## Chapter 5 – Hybrid deduction/non-inclusion mismatches

120. Chapter 5 provides the detailed rules for countering certain mismatches arising from payments or quasi-payments where the payer is a hybrid entity, which result in a deduction with no matching inclusion of income.
121. New Section 259E provides an overview of the Chapter.
122. New Section 259EA sets out the five conditions (A to E) for the Chapter to apply.
123. Subsections 2 to 7 set out conditions A to E. All of these conditions must be met for the Chapter to apply.
124. Condition A requires a payment or quasi-payment to be made in connection with an arrangement.
125. Condition B requires that the payer is a hybrid entity.
126. Condition C requires that the hybrid payer or the payee to be within the charge to corporation tax.
127. Condition D requires that it is reasonable to assume that there would be a hybrid mismatch in the absence of Chapters 5 to 8, or any equivalent non-UK tax law.
128. Condition E, which is met if the payer is also a payee (applies to quasi-payments only), the hybrid payer and payee are related, or if the arrangement is a structured arrangement.
129. Subsection 8 defines a structured arrangement for this section.
130. Subsection 9 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
131. New Section 259EB defines hybrid payer mismatches, and their quantum. There is a mismatch where a deduction exceeds the total amounts included in the ordinary income of the payees, and where some or all of the excess is as a result of the hybridity of the payer.
132. Subsection 2 provides that the size of the mismatch is determined by the extent to which it is caused by hybridity.
133. Subsection 3 disregards mismatches which arise for a permitted reason (see section

259BF).

134. Subsection 4 defines a permitted taxable period of a payee.
135. New Section 259EC provides the primary response : counteraction of hybrid payer mismatches where the UK is the payer jurisdiction.
136. Subsection 2 provides that the relevant deduction equal to the mismatch amount (the "restricted deduction") cannot be deducted unless it is deducted from dual inclusion income.
137. Subsection 3 provides that restricted deductions can be carried forward at set against dual inclusion income in future accounting periods.
138. Subsection 4 defines "dual inclusion income" as amounts which arise due to an arrangement which are included as ordinary income of the payer for tax purposes in both the UK and another territory, so that such amounts are brought to charge twice.
139. New Section 259ED provides the secondary response : counteraction of hybrid payer mismatches where the payee is within the charge to corporation tax.
140. Subsection 1 applies the section where the payee is within the charge to corporation tax and it is reasonable to suppose that either no non-UK law equivalent to Section 259EC applies.
141. Subsection 2 determines whether, despite a non-UK tax law equivalent to Section 259EC , a mismatch still exists.
142. Subsection 3 defines "the relevant amount".
143. Subsection 4 provides that an amount equal to the relevant amount, less any dual inclusion income of the hybrid payer, is treated as income of the payee for that period.
144. Subsections 5 , 6 and 7 allocate the relevant amount between multiple payees on a just and reasonable basis and allocate the relevant proportion of any dual inclusion income of the hybrid payer on the same basis.
145. Subsection 8 provides that the amount given by the calculation in subsection (4) is treated as income of the payee for the counteraction period and charged to tax under Chapter 8, Part 9 CTA 2009.
146. Subsection 9 defines the counteraction period and "dual inclusion income".

#### Chapter 6 – Hybrid payee deduction/non-inclusion mismatches

147. New Section 259F provides an overview of Chapter 6, which deals with mismatches in relation to hybrid entity payees. Mismatches are counteracted either by amending the corporation tax treatment of the payer, or by charging corporation tax on hybrid entity limited liability partnership payees.
148. New Section 259FA sets out five conditions (A to E) which all have to be met for this Chapter to apply.
149. Condition A Is that there is a payment or quasi-payment linked to an arrangement.
150. Condition B is that a payee is a hybrid entity.

151. Condition C is that either the payer is within the charge to corporation tax during the payment period, or that a hybrid payee is a limited liability partnership.
152. Condition D is that it is reasonable to assume that in the absence of Chapters 6, 7 or 8, or any equivalent non-UK rules, there would be a hybrid payee deduction/non-inclusion mismatch.
153. Condition E which is met if the payer is also the hybrid payee (applies to quasi-payments only), the payer and hybrid payee are related, or if the arrangement is a structured arrangement.
154. Subsection 8 defines a structured arrangement for this section.
155. Subsection 9 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
156. New Section 259FB defines hybrid payee deduction/non-inclusion mismatches, and their quantum.
157. Subsection 1 provides that there is a mismatch where a deduction exceeds the total amounts included in the ordinary income of the payees, and where some or all of the excess is as a result of the hybridity of one or more of the payees.
158. Subsection 2 provides that the size of the mismatch is determined by the extent to which it is caused by hybridity.
159. Subsection 3 disregards mismatches which arise for a permitted reason (see section 259BF)
160. Subsection 4 defines a permitted taxable period for a payee.
161. New Section 259FC sets out the counteraction where the payer is within the charge to corporation tax. The relevant deduction of the payer must be reduced by an amount equal to the hybrid payee mismatch.
162. New Section 259FD sets out the counteraction where the hybrid payee is a limited liability partnership ("LLP").
163. Subsection 1 applies the section to a hybrid payee where it is reasonable to suppose that either no non-UK tax law equivalent to Section 259FC applies, or that it does, but a mismatch still exists.
164. Subsection 2 determines whether a non-UK tax law does not fully counteract the mismatch.
165. Subsection 3 defines "the relevant amount."
166. Subsection 4 provides that if the hybrid payee is the only hybrid payee, an amount equal to the mismatch is treated as income arising to the hybrid payee on the last day of the payment period.
167. Subsections 5 and 6 allocate the relevant amount between multiple payees on a just and reasonable basis.
168. Subsection 7 provides that the amount given by the calculation in subsections (4) or (5) is treated as income of the hybrid payee and charged to tax under Chapter 8, Part 10 CTA

2009.

169. Subsection 8 disapplies section 863 ITTOIA 2005 and section 1273 CTA 2009 so far as is necessary to apply the charge under subsection (7).
170. Subsection 9 disregards Section 259FD when considering whether the hybrid payee is within the charge to corporation tax in relation to the rest of the hybrid mismatch rules in Part 6A.

## Chapter 7 – Hybrid Entity Double Deduction Mismatches

171. New Section 259G provides an overview of Chapter 7.
172. New Section 259GA sets out three conditions (A to C), all of which need to be met for the Chapter to apply.
173. Condition A is that, disregarding Chapters 7 and 8, and any equivalent non-UK tax law, an amount could be deducted both from the ordinary income of a hybrid payer, and from the ordinary income of an investor in a different jurisdiction. This amount is the "hybrid entity double deduction amount".
174. Condition B is that either the hybrid entity or the investor is within the charge to corporation tax during the relevant deduction period.
175. Condition C is that the investor and the hybrid entity are related at any time during either the hybrid entity deduction period, or the investor deduction period. Alternatively, that there is a structured arrangement.
176. Subsection 7 defines a structured arrangement for this section.
177. Subsection 8 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
178. New Section 259GB sets out the counteraction where the investor is within the charge to corporation tax.
179. Subsection 9 provides that the hybrid entity double deduction amount can only be deducted from the dual inclusion income of the investor, so that the deduction can only be used to cancel out any dual inclusion income.
180. Subsection 10 allows for any investor deduction that cannot be set against ordinary income to be carried forward to future accounting periods.
181. Subsection 4 allows for circumstances where investors will not have any future dual inclusion income. In those circumstances, the "stranded deduction" can be deducted from the investor's taxable total profits.
182. Subsection 5 allows for any unrelieved stranded deductions to be carried forward and set against future profits.
183. Subsections 6 and 7 provide that if it is reasonable to suppose that a hybrid entity double deduction amount is deducted from ordinary income (other than dual inclusion income) for any person for non-UK tax purposes, that amount is termed an "illegitimate overseas deduction" and any amounts that may be deducted by the investor for UK tax purposes is reduced by that amount. An amount equal to the illegitimate overseas deduction is

deemed to have already been deducted in a previous accounting period, so that amount is no longer available for the current taxable period.

184. Subsection 8 defines "dual inclusion income" as an amount which is ordinary income for the investor in the UK, and also ordinary income for the hybrid entity in another territory, so that such amounts are brought into charge twice.

185. New Section 259GC sets out the counteraction where the hybrid entity is within the charge to corporation tax.

186. Subsection 1 applies this section where the hybrid entity is within the charge to corporation tax, and it is reasonable to suppose that either no non-UK provision equivalent to Section 259GB applies, or that if it does, a mismatch still remains and the condition in subsection (2) is met.

187. Subsection 2 sets out the second counteraction condition. This requires that either the hybrid entity and an investor are within the same control group, or that the hybrid entity or any investor are party to a structured arrangement.

188. Subsection 3 provides that the "restricted deduction" is either the hybrid entity double deduction amount, or the remaining amount after any non-UK law has been applied.

189. Subsection 4 provides that the restricted deduction can only be deducted from the dual inclusion income of the hybrid entity.

190. Subsection 5 provides for restricted deductions to be carried forward and set against dual inclusion income of later periods.

191. Subsection 6 allows for circumstances where the hybrid payer will not have any future dual inclusion income. In those circumstances, the "stranded deduction" can be deducted from total profits.

192. Subsection 7 allows for any unrelieved stranded deductions to be carried forward and set against future profits.

193. Subsections 1 and 2 provide that if it is reasonable to suppose that a hybrid entity double deduction amount (the illegitimate overseas deduction) is deducted from ordinary income for any person for non-UK tax purposes, that amount is not dual inclusion income. As a result, amounts that may be deducted by the hybrid entity are reduced by that amount. An amount equal to the illegitimate overseas deduction is deemed to have already been deducted in a previous accounting period.

194. Subsection 10 defines "dual inclusion income".

## Chapter 8 – Dual Resident Company Double Deduction Cases

195. New Section 259H provides an overview of Chapter 8.

196. New Section 259HA sets out two conditions (A and B) which both have to be met for the Chapter to apply.

197. Condition A is that a company is a dual resident company.

198. Subsection 3 defines a dual resident company for the purposes of this Chapter.

199. Condition B is that it is reasonable to assume, in the absence of Chapter 8 and any equivalent non-UK law, that an amount can be deducted for both UK and non-UK tax purposes. This amount is the "dual residence double deduction amount".
200. New Section 259HB sets out the counteraction to dual residence double deduction mismatches.
201. Subsection 1 provides that the dual residence double deduction amount can only be deducted against dual inclusion income.
202. Subsection 2 provides that any surplus mismatch can be carried forward to subsequent accounting periods, and set against dual inclusion income.
203. Subsection 3 allows for any stranded deduction to be set against taxable total income, if the company ceases to be dual resident.
204. Subsection 4 allows surplus stranded deductions to be carried forward.
205. Subsections 5 and 6 provide that if it is reasonable to suppose that a dual residence double deduction amount is deducted from ordinary income (other than dual inclusion income) for any person for non-UK tax purposes, that amount (the illegitimate overseas deduction) is deemed to have already been deducted in a previous accounting period. As a result, any dual residence double deduction amounts or stranded amounts that could otherwise be deducted in the UK are reduced by that amount.
206. Subsection 7 defines "dual inclusion income".

## Chapter 9 – Imported Mismatches

207. New Section 259I contains an overview of Chapter 9, which denies deductions in relation to imported mismatch payments.
208. New Section 259IA sets out six conditions (A to F) which all have to be met in order for this Chapter to apply.
209. Condition A is that the payment or quasi-payment is made under, or in connection with, an arrangement. These are termed "imported mismatch payments" and "imported mismatch arrangements".
210. Condition B is that the payer ("P") is within the charge to corporation tax.
211. Condition C is that the imported mismatch arrangement is part of a series of arrangements.
212. Subsection 5 defines a series of arrangements as a number of arrangements which are part of a wider, overall arrangement ("the over-arching arrangement").
213. Condition D is that under another arrangement in the series, there is a payment or quasi-payment which it is reasonable to assume involves another hybrid mismatch. This can be any of the various mismatches detailed in the rest of Part 6A.
214. The "relevant mismatch" is defined in subsection 6 as the mismatch which may arise under another arrangement in the series.
215. Condition E requires that it is reasonable to assume that none of Chapters 3 to 7, or any

overseas equivalents, apply, but that such provisions would apply if the Payer (P) was a payer, a payee, or, where appropriate, an investor.

216. Condition F is that P and the payer, or a payee, are members of the same group, or alternatively that either the imported mismatch arrangement, or the over-arching arrangement, is a structured arrangement.
217. Subsection 9 defines a structured arrangement for this section.
218. Subsection 10 provides that an arrangement may be a structured arrangement whether or not there is also a commercial or other purpose.
219. New Section 259IB sets out the counteraction for an imported mismatch payment, which is the denial of relevant deductions.
220. Subsection 2 provides that a relevant deduction for P is reduced by an amount of the relevant mismatch.
221. Subsection 3 applies where there are one or more relevant payments in relation to the relevant mismatch - in which case, the deduction from P's ordinary income is reduced by P's share of the mismatch.
222. Subsections 4 and 5 determine the share of the relevant mismatch by reference to the extent to which the imported mismatch payment funds the mismatch, as opposed to being funded by the relevant payments.
223. Subsection 6 defines a relevant payment.
224. Subsection 7 sets out that in relation to formal court or tribunal proceedings, P will need to demonstrate that there are relevant payments in relation to the relevant mismatch, and demonstrate that a mismatch payment is funded by relevant payments rather than by an imported mismatch payment.

## Chapter 10 – Adjustment of Reasonable Suppositions

225. New Section 259J sets out the circumstances when it is possible for taxpayers to amend or correct their position, where further facts indicate that a reasonable supposition on which the application of Part 6A was based no longer applies.
226. Subsection 1 refers to cases where a reasonable supposition is mistaken, or is no longer reasonable, and allows for just and reasonable adjustments to correct the position.
227. Subsection 2 enables such adjustments to be made.
228. Subsection 3 provides that the normal UK time limits apply to this section.

## Chapter 11 – Interpretation

229. This chapter provides a number of definitions for the purposes of Part 6A.
230. New Section 259K provides a definition of "financial instrument".
231. Subsection 3(a) excludes hybrid transfer arrangements from the definition of financial instruments.



232. Subsection 3(b) excludes regulated capital securities in relation to banking and insurance (as defined by the Taxation of Regulatory Capital Securities Regulations 2013) from the definition of financial instruments, so that, subject to subsection 4, such securities are not within the scope of the new hybrid mismatch rules.
233. Subsection 4 provides that subsection 3(b) is subject to regulations made under section 221 of FA 2012. This will enable the new hybrid mismatch rules to be applied to any securities that are specified in those regulations.
234. New Section 259KA provides a definition of Control Groups.
235. New Section 259KB provides a definition of Related Persons.
236. New Section 259KC provides a definition of 50% and 25% investment.
237. New Section 259KD sets out the treatment of partnership member.
238. New Section 259KE sets out a number of definitions in relation to the new hybrid mismatch rules.

## Part 2 Consequential amendments

239. Part 2 sets out various amendments to other UK legislation, including the omitting of Part 6, to take account of Part 6A.

## Part 3 Commencement

240. This part provides the commencement provisions for Part 6A.
241. Paragraph 16 provides that, in relation to Chapter 3 to 6, the rules will have effect for payments made on or after the commencement date, and for quasi-payments where the payment period begins on or after the commencement date.
242. Paragraph 17 provides that, in relation to Chapter 7 and 8, the rules will have effect for accounting periods beginning on or after the commencement date.
243. Paragraph 18 provides that, in relation to Chapter 9, the rules will have effect for imported mismatch payments made on or after the commencement date, and for quasi-payments where the payment period begins on or after the commencement date.
244. Paragraph 19 provides for commencement in relation to various consequential amendments.
245. Paragraph 20 sets out the treatment in relation to Chapters 3 to 6 and Chapter 9 where a payment period begins before the commencement date and ends on or after that date (straddling periods)
246. Paragraph 21 sets out the treatment in relation to Chapters 7 and 8 where a company has an accounting period that begins before the commencement date and ends on or after that date (straddling periods)
247. Paragraph 22 sets the commencement date as 1 January 2017.



## Background note

248. Hybrid mismatch arrangements can be used to achieve double non-taxation and erode the UK tax base. These new rules replace the arbitrage rules in Part 6 TIOPA 2010 and will ensure that deduction/non-inclusion and double deduction mismatch arrangements are counteracted. From 1st January 2017 the new provisions will put an end to multiple deductions for a single expense and for deductions in one country without a corresponding taxation in another.

249. New rules are being introduced multilaterally and the UK legislation contains provision for counteraction in the UK where exceptionally the other country does not counteract the mismatch.

250. If you have any questions about this change, or comments on the legislation, please contact Yasmin Ali on 03000 543326 (email: [Yasmin.Ali@hmrc.gsi.gov.uk](mailto:Yasmin.Ali@hmrc.gsi.gov.uk))

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