# Clause 1 and Schedule 1: Hybrid and other mismatches: deemed dual inclusion income

## Summary

1. This clause and Schedule make amendments to the hybrid mismatch rules which cause certain amounts of taxable income received by corporation tax payers to be treated as dual inclusion income for the purposes of those rules, in circumstances where no tax deduction is available to the entity making payment of the amounts in question. The amendments will have retrospective effect (being exclusively relieving in nature) and so the existing hybrid mismatch rules will apply as amended since their 1 January 2017 commencement date.

## Details of the clause

2. Clause 1 introduces Schedule 1 which makes provision for income to be treated as dual inclusion income for the purposes of Part 6A of Taxation (International and Other Provisions Act) 2010 (TIOPA 2010) (hybrid and other mismatches).

## Details of the Schedule

3. Paragraph 1 provides that the amendments introduced by the rest of the clause shall be retrospective, being treated as having been in place since Part 6A Taxation (International and Other Provisions Act) 2010 (TIOPA 2010) was first enacted.

4. Paragraph 2 adds a series of new subsections to s259EC TIOPA 2010 as follows.

5. New Subsection (6) specifies that inclusion/no deduction income is to be regarded as dual inclusion income of a hybrid entity insofar as that is not already the case. Normally, an amount received is treated as dual inclusion income because it is required to be brought into account as ordinary income in both the jurisdiction where the hybrid entity is resident and an investor jurisdiction. As such it is unobjectionable for a doubly deductible expense to be set against it. The extension of the definition of dual inclusion income will enable amounts which are taxable in the hands of the hybrid entity but not deductible for its investor to be treated the same way. This is also unobjectionable since such an inclusion/no deduction mismatch is a tax disadvantage resulting from hybridity, so it is fair to allow a potential advantage deriving from hybridity (i.e. a doubly deductible payment) to offset it.

6. New Subsection (7) defines inclusion/no deduction income. There are three tests to be satisfied in order for income to fall within the definition. The first, in subsection (7)(a), is that the income must be ordinary income of the hybrid entity. Since the question of dual inclusion income is only relevant where the hybrid entity is a corporation taxpayer, this test effectively means that in any case to which the section

could have an impact on the tax position, the UK must classify the hybrid entity as opaque. The second test, in subsection (7)(b), is that the payment must not be deductible from ordinary income of the investor or any other person for a relevant taxable period. The third test has the effect that the non-deductibility of the payment would not have arisen but for an investor jurisdiction classifying the hybrid entity as transparent. This ensures that the inclusion/no deduction mismatch must arise solely due to the hybridity of the entity. The test will therefore not be satisfied if, for example, the payment would not be deductible on general principles in the investor jurisdiction, even if the entity were not a hybrid.

7. New Subsection (8) defines relevant taxable period as any period beginning before the date 12 months from the end of the corporation tax accounting period of the company in which the taxable amount was recognised, or such later period within which it is just and reasonable for the company to recognise a deduction in respect of the amount concerned.

8. Paragraph 3 makes amendments to Chapter 6 of Part 6A TIOPA 2010.

9. Sub Paragraph 3(1) introduces the changes.

10. Sub Paragraph 3(2) adds new subsections to section 259FB TIOPA 2010 as follows.

11. New Subsection (5) provides that excessive PE inclusion income shall be treated as dual inclusion income of the company to the extent this is not already the case.

12. New Subsection (6) provides that "excessive PE inclusion income" is defined in new section 259FC TIOPA 2010. The provisions will mirror those relating to excessive PE deductions which already exist in Chapter 6 Part 6A TIOPA 2010.

13. Sub Paragraph 3(3) adds a new section 259FC to Chapter 6 Part 6A TIOPA 2010, containing provisions as follows.

14. New Subsection (1) defines "excessive PE inclusion income" by reference to subsection (4). The provisions will mirror those relating to excessive PE deductions which already exist in Chapter 6.

15. New Subsection (2) defines "PE inclusion income" as an amount meeting conditions set out in subsections (3) and (4).

16. New Subsection (3) contains Condition A, that an amount is ordinary income of the company which is in respect of a transfer of money or money's worth from the company overseas to its UK permanent establishment that is either actually made, or is in substance treated as being made for corporation tax purposes.

17. New Subsection (4) contains Condition B, that the circumstances giving rise to the amount will not lead to reduced profits or increased losses in the overseas jurisdiction, or, if they do, that the amount exceeds the aggregate effect on taxable profits.

18. New Subsection (5) defines the aggregate effect on taxable profits as the sum of any reductions in profits or increases in losses arising in the overseas jurisdiction as a result of the circumstances giving rise to the amount.

19. New Subsection (6) provides that any reduction in profit or increase in losses is to be

ignored for the purposes of subsections (4) and (5) if the company is subject to a nil rate of tax in the overseas jurisdiction.

20. New Subsection (7) defines relevant taxable period as any period beginning before the date 12 months from the end of the corporation tax accounting period of the company in which the taxable amount was recognised, or such later period within which it is just and reasonable for the company to recognise a deduction in respect of the amount concerned.

21. Paragraph 4 makes amendments to Chapter 9 Part 6A TIOPA 2010.

22. Sub Paragraph 4(1) introduces the clause.

23. Sub Paragraph 4(2)(a) deletes words from existing section 259IC(4) TIOPA 2010.

24. Sub Paragraph 4(2)(b) adds new subsections to section 259IC as follows.

25. New Subsection (12) specifies that inclusion/no deduction income is to be regarded as dual inclusion income of a hybrid entity insofar as that is not already the case. Normally, an amount received is treated as dual inclusion income because it is required to be brought into account as ordinary income in both the jurisdiction where the hybrid entity is resident and an investor jurisdiction. As such it is unobjectionable for a doubly deductible expense to be set against it. The extension of the definition of dual inclusion income will enable amounts which are taxable in the hands of the hybrid entity but not deductible for its investor to be treated the same way. This is also unobjectionable since such an inclusion/no deduction mismatch is a tax disadvantage resulting from hybridity, so it is fair to allow a potential advantage deriving from hybridity (ie a doubly deductible payment) to offset it.

26. New Subsection (13) defines inclusion/no deduction income. There are three tests to be satisfied in order for income to fall within the definition. The first, in subsection (13)(a), is that the income must be ordinary income of the hybrid entity. Since the question of dual inclusion income is only relevant where the hybrid entity is a corporation taxpayer, this test effectively means that in any case to which the section could have an impact on the tax position, the UK must classify the hybrid entity as opaque. The second test, in subsection (13)(b), is that the payment must not be deductible from ordinary income of the investor or any other person for a permitted taxable period. The third test has the effect that the non-deductibility of the payment would not have arisen but for an investor jurisdiction classifying the hybrid entity as transparent. This ensures that the inclusion/no deduction mismatch must arise solely due to the hybridity of the entity. The test will therefore not be satisfied if, for example, the payment would not be deductible on general principles in the investor jurisdiction, even if the entity were not a hybrid.

27. New Subsection (14) defines relevant taxable period as any period beginning before the date 12 months from the end of the corporation tax accounting period of the company in which the taxable amount was recognised, or such later period within which it is just and reasonable for the company to recognise a deduction in respect of the amount concerned.

28. Sub Paragraph 4(3) repeals the existing section 259ID TIOPA 2010.

29. Paragraph 5 makes amendments to Chapter 10 Part 6A TIOPA 2010.

30. Sub Paragraph 5(1) introduces the changes.

31. Sub Paragraph 5(2) adds two new subsections to s.259JD TIOPA 2010 as follows.

32. New Subsection (10) provides that excessive PE inclusion income shall be treated as dual inclusion income of the company to the extent this is not already the case.

33. New Subsection (11) indicates that "excessive PE inclusion income" is defined in new section 259JE TIOPA 2010.

34. Sub Paragraph 5(3) adds a new section 259JE to Chapter 6 Part 6A TIOPA 2010, containing provisions as follows.

35. New Subsection (1) defines "excessive PE inclusion income" by reference to subsection (4). The provisions will broadly mirror those relating to excessive PE deductions which already exist in Chapter 6.

36. New Subsection (2) defines "PE inclusion income" as an amount meeting conditions set out in subsections (3) and (4).

37. New Subsection (3) contains Condition A, that an amount is ordinary income of the company which is in respect of a transfer of money or money's worth from the company overseas to its UK permanent establishment that is either actually made, or is in substance treated as being made for corporation tax purposes.

38. New Subsection (4) contains Condition B, that the circumstances giving rise to the amount will not lead to reduced profits or increased losses in the overseas jurisdiction, or, if they do, that the amount exceeds the aggregate effect on taxable profits.

39. New Subsection (5) defines the aggregate effect on taxable profits as the sum of any reductions in profits or increases in losses arising in the overseas jurisdiction as a result of the circumstances giving rise to the amount.

40. New Subsection (6) provides that any reduction in profit or increase in losses is to be ignored for the purposes of subsections (4) and (5) if the company is subject to a nil rate of tax in the overseas jurisdiction.

41. New Subsection (7) defines relevant taxable period as any period beginning before the date 12 months from the end of the corporation tax accounting period of the company in which the taxable amount was recognised, or such later period within which it is just and reasonable for the company to recognise a deduction in respect of the amount concerned.

# Background note

42. This clause and Schedule are being introduced to mitigate economic double taxation that can arise due to the operation of aspects of the UK's hybrid mismatch rules, most commonly in relation to payments to UK companies by their US parents which have been checked open for US tax purposes.

43. If you have any questions about this change, or comments on the legislation, please contact hybrids.mailbox@hmrc.gov.uk.