Representation from the Chartered Institute of Taxation
for Finance Bill 2021 Committee Stage

Hybrid and other mismatches
Clause 36 (and Schedule 7)

Chartered Institute of Taxation
Excellence in Taxation

Executive Summary

This measure introduces changes to the hybrids and other mismatches regime, part of the G20/OECD project to tackle Base Erosion and Profit Shifting by multinational companies.

We welcome these changes, in particular the mechanism to allow taxpayers to elect to make the changes retrospective and to make necessary amendments to claims, returns and elections already submitted.

The changes to this regime since it was introduced mean that an update of HMRC guidance is needed.

1 Clause 36 (and Schedule 7): Hybrids and other mismatches

1.1 Clause 36 introduces changes to the corporation tax rules for hybrids and other mismatches and the detail of the changes is in Schedule 7.

1.2 The hybrids and other mismatches regime was introduced in the UK with effect from 1 January 2017. The rules seek to tackle tax avoidance arrangements that take advantage of the difference in tax treatment between two or more jurisdictions. In the absence of the hybrid rules, such arrangements could allow a deduction to be claimed twice for the same expense (double deductions), or a deduction in one jurisdiction without a matching taxable receipt in another jurisdiction (deductions/non-inclusions). Considering how to neutralise the effect of hybrid and other mismatch arrangements was one of the actions (Action 2) of the G20/OECD Base Erosion and Profit Shifting (BEPS) project. The UK was the first jurisdiction to fully implement the BEPS Action 2 recommendations.

1.3 In the years since their introduction, however, it became apparent that in some circumstances the rules did not work as expected. In particular:

- the rules in relation to double deductions are disproportionate, and
- the acting together rules are too widely drawn, with taxpayers in some cases unable to obtain the necessary third party information required in order to fully comply with the legislative requirements.

1.4 The changes made by clause 36 and Schedule 7 include amendments to address these concerns, while ensuring that the rules operate in a way that is consistent with the policy objectives of both the UK anti-hybrid rules and the OECD principles.

ARTILLERY HOUSE
11-19 ARTILLERY ROW
LONDON SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)844 251 0830
Fax: +44 (0)844 579 6701
E-mail: technical@tax.org.uk
Web: www.tax.org.uk

UK REPRESENTATIVE BODY ON THE CONFEDERATION FISCALE EUROPEENNE

1.5 The aim of the rules dealing with double deductions is to ensure that deductions do not exceed corresponding income subject to tax and, where a hybrid arrangement generates such mismatches, the legislation is intended to counteract that mismatch. In certain cases, a counteraction may be prevented by offsetting the mismatch against 'dual inclusion income' (that is income that is brought into charge in more than one relevant jurisdiction). The purpose of this mechanism is to prevent disproportionate outcomes in situations where there is corresponding income that is being charged to tax twice, income has been included and taxed but no deduction allowed or the mismatch has already been counteracted by the counterparty jurisdiction. However, these rules did not work as expected, and, in some circumstances, resulted in a tax charge where there was not, economically, any deduction/non-inclusion or double deduction amount. In certain cases, the structures used suffered an inclusion without a corresponding deduction, but did not meet the dual inclusion income criteria and, therefore, this amount could not be offset against the counteraction. We welcome the changes in Schedule 7 that will now allow certain amounts of taxable income received to be treated as dual inclusion income for the purposes of these rules, and ones that provide for the allocation of deemed dual inclusion income within a group, if certain conditions are met. These changes address the concerns around the additional tax burden that was being imposed on certain UK based entities and will remove the adverse economic impact on their UK operations.

1.6 The acting together provisions are intended to ensure that the hybrid rules can apply to certain arrangements where parties are connected via commonality of ownership, or are otherwise acting as if they are. The acting together rules are, however, currently too widely drawn, with the consequence that the legislation can apply in cases where there is no such cooperation. We welcome the proposed changes to the acting together rules, which address the concerns of third party lenders, such as funds investing in debt instruments in private equity and venture capital backed companies, that at the moment can be inadvertently brought within the scope of the rules. The changes to the rules will provide clarity to borrowers (and lenders) when analysing these rules.

1.7 Some of the amendments will have retrospective effect and so the existing hybrid mismatch rules will apply as amended since their 1 January 2017 commencement date, while others will take effect from the date on which this Act is passed.

1.8 We welcome these changes, which reflect the constructive approach taken by HMRC during the consultations on the rules last year. These changes will, in our view, ensure that the hybrids rules better reflect the policy objectives of the regime, ensuring that it operates proportionately and as intended for the most common situations and circumstances, and will provide greater certainty, so businesses can plan ahead with confidence.

2 Mechanism for amending prior years' corporation tax returns

2.1 As noted above, some of the changes are retrospective and will have effect from 1 January 2017, when the rules were first introduced. While we welcome this, prior to this change, and since the introduction of the rules, companies have had to take action based on the existing legislation. In our responses to the consultations on the changes last year, we said that it would be important to introduce a simple mechanism for earlier years' computations and corporation tax returns to be amended. We are pleased that this has been dealt with by the introduction of a provision allowing a taxpayer to make an election to make the changes

retrospective, and for the necessary administrative changes to reflect that position in relation to corporation tax returns etc to flow from that election. This should provide an effective mechanism to deal with the prior year returns.

2.2 Paragraph 40 of Schedule 7 provides taxpayers with the option of claiming to make the amendments in Part 5 of the Schedule (deemed dual inclusion income) retrospective. The taxpayer can make an election to make those changes retrospective, in which case they will be deemed to always have been in place. A taxpayer must make a "Part 5 retrospection election" by 31 December 2021. Taxpayers also have until 31 December 2021 to make any amendments to claims, returns and elections already submitted (if they would otherwise be outside the time limits to makes such an amendment) as are reasonable to give effect to the retrospective change in law following any Part 5 retrospection election.

3 HMRC Guidance

3.1 With regard to the amendments relating to dual inclusion income and related points, it would be very helpful for HMRC to include some updated examples in their guidance, including some simple diagrams to explain which situations would or would not be covered. As a result of these changes (and small technical changes made to the rules in 2017 and 2018 to ensure that the rules operated as intended, and changes in 2019 to ensure compliance with the EU Anti-Tax Avoidance Directive), the current HMRC guidance is in need of general updating to be of more use to taxpayers and advisers.

4 The Chartered Institute of Taxation

4.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 19,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

For further information, please contact:
George Crozier, CIOT Head of External Relations
gcrozier@tax.org.uk 020 7340 0569

The Chartered Institute of Taxation
13 April 2021