Chartered Institute of Taxation

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Base Protection Policy Hybrids Team
HMRC

Via email: *mailboxhybrids@hmrc.gov.uk*

Dear Sirs

Hybrid and other mismatches regime for Corporation Tax – draft Finance Bill clauses

We welcome the *Amendments to the hybrid and other mismatches regime for Corporation Tax* announced in the Policy Paper on 12 November 2020, and the draft clauses for Finance Bill 2021 which will implement some of the changes.

The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our response.

Many of the changes set out in the Policy Paper were consulted on during Summer 2020 and we welcome the constructive approach that HMRC have taken that is reflected in the draft clauses. These changes will, in our view, ensure that the hybrids rules better reflects the policy objectives of the regime and will provide greater certainty, so businesses can plan ahead with confidence. However, we do have some concerns, particular with regard to those aspects of the proposed changes for which draft legislation has not yet been published, which we discuss below.

All statutory references below are to Taxation (International and Other Provisions) Act 2010.

Mechanism for amending prior years' corporation tax returns

We welcome that many of the changes are retrospective and will have effect from 1 January 2017, when the rules were introduced. However, it is unfortunate that the amendments are being made some four years after the

introduction of the legislation, as this means that since the introduction of the rules companies have had to take action based on legislation which does not now apply.

It is important, therefore, that HMRC also introduces a simple mechanism for earlier years' computations to be amended: we are outside the normal 12 month time limit for 2017 and 2018 computations, and need a simple way to refile and obtain any repayments. This is particularly relevant for smaller UK companies who have suffered from the s259ID issues around dual inclusion income, because they have a UK cost plus entity with a small number of employees.

Dual inclusion income and related points

With regard to the amendments relating to dual inclusion income and related points, it would also be very helpful for HMRC to include some updated examples in their guidance, including some simple diagrams to explain which situations would be covered/not covered.

One area of particular concern remains the 'in connection with' requirement in Chapter 5 of the rules which, although not part of the consultation, we would like to see removed or relaxed as it is felt to be unnecessarily onerous. It is understood that this requirement has caused considerable difficulty in interpreting the rules and the process of seeking clearance from HMRC that the legislation should not apply. We note there is no 'in connection with' requirement in other Chapters of the legislation that include the concept of dual inclusion income which makes Chapter 5 appear inconsistent and it is difficult to understand the policy objective behind this anomaly.

Definition of foreign tax

The Policy Paper proposes amending the definition of foreign tax in s259B(2) to ensure that income should not be regarded as charged to a foreign tax where that income is deemed to arise to, and be taxed in the hands of, an entity other than that to which it arose. We hope that the amended rules will contain safeguards so as to not apply unfairly or operate in such a way as to give rise to genuine economic double taxation, for example in situations where there is ultimately foreign tax but only after having looked through a series of intermediary holding companies.

Interaction with loan relationship rules (for example write-off of connected party debt)

We understand HMRC's intention (set out in their response to the consultation) is to make it clear that the hybrids rules should not bring back into tax amounts that would be exempt under the loan relationship rules, for example write-off of connected party debt. As this remains an area of some uncertainty for our membership when providing advice on the rules, we look forward to seeing the draft legislation dealing with this so that we can provide feedback as to whether it achieves the intended objectives.

'Acting together'

We understand the proposal regarding a new 10% interest threshold is, in effect, to modify the part of the definition of 'acting together' in s259ND(7)(c) and (d) so that these sub-subsections do not apply to an investor in a transparent fund that is a collective investment scheme where that investor holds 10% or less of the interest in the fund.

We have the following comments on this:

- Although HMRC's Policy Paper refers to the new 10% threshold applying to partners in a partnership that is a collective investment scheme, we are aware that HMRC have intimated this may be expanded to cover other transparent vehicles that are collective investment schemes. We would welcome such an expansion, and in anticipation of such an expansion we refer here to 'investors in a transparent fund' rather than 'partners in a partnership'.

- It is not clear from HMRC's Policy Paper what would constitute the investor for these purposes as we would expect there to be anti-fragmentation rules. However, we hope the new legislation is drafted so that a fund is able to readily identify whether it needs to aggregate the interests of different investors in determining whether the 10% threshold is met, notwithstanding that the fund may not know the detailed ownership structure of each of the persons investing into it.
- If the modification is limited to s259ND(7)(c) and (d), a general partner with an interest of 10% or less would still be in the same control group as the fund's investments. This is because the participation condition in s259NB(4) will be met (the 'acting together' conditions in s259ND(7)(a) and (b) may also be met). The rules should be modified so that a general partner with 10% or less interest (for example through partnership profit share or carry) is not within the control group. Absent this being addressed we are concerned that there could be different outcomes for different types of transparent vehicles, and different outcomes depending on whether a priority profit structure is used or not.
- Chapter 7 could be read such that when a general partner is a hybrid payee, a hybrid payee deduction/non-inclusion mismatch that may be counteracted arises in respect of all payments to hybrid payees (regardless of whether the particular hybrid payee is within the control group or not). The reading of the legislation coming to this conclusion is that:
    - The gateway test for Condition E in s259GA(7)(b) is met since a hybrid payee (that is the general partner) is in the same control group as the payer (as the participation condition in s259NB(4) is met);
    - The definition of 'hybrid payee deduction/non-inclusion mismatch' in s259GB(1) looks at payments to each hybrid payee, and not just each hybrid payee for which Condition E applies.

  Whilst the wording of s259GB(1) could support such an interpretation, we do not believe this is the correct reading of s259GB(1). Rather, we believe s259GB(1) as it currently stands should be interpreted as applying in to each hybrid payee for which all the Conditions in s259GA (including Condition E) are met. However, this point could be usefully clarified by HMRC.

  We note that, if we are wrong, such that the former interpretation is correct, the new 10% threshold rule would be otiose unless s259GB(1) is also modified. Also, a similar issue, where the general partner is the hybrid payer, would apply to Chapter 9, and, of course, there would also be an issue for the Chapter 7 and 9 elements of the imported mismatch rules.

Conclusion

We trust the above comments are helpful. As noted above, draft legislation effecting all of the proposed changes in the Policy Paper has not yet been published. We hope and assume that we will have an opportunity to comment further once we see the full draft legislation.

Yours faithfully

David Murray
Chair, International Taxes Committee

The Chartered Institute of 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. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.

Our stated objectives for the tax system include:

- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
- Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
- Greater certainty, so businesses and individuals can plan ahead with confidence.
- A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
- Responsive and competent tax administration, with a minimum of bureaucracy.

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.

Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.