Finance Bill 2016 cl 62 – hybrid and other mismatches

International Tax | Large Corporate

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The CIOT supports the policy behind the new rules intended to prevent the reduction of tax liabilities by multinational enterprises by the use of hybrid instruments and entities. However, we have concerns that the provisions may apply in normal commercial situations.

The CIOT wrote to HMRC about the new Pt 6A Taxation (International and Other Provisions) Act 2010 (TIOPA 2010), which will be inserted by FB 2016 cl 62 and Sch 10. These provisions introduce rules to counteract tax avoidance through hybrid and other mismatch arrangements. That is, they aim to prevent multinational companies taking advantage of differences between laws in different countries to artificially reduce their tax bill by using techniques such as claiming the same deduction twice.

This legislation implements recommendations made by the G20/OECD project to tackle Base Erosion and Profit Shifting (BEPS project). This legislation will translate into statute a specific policy intention, which is to prevent the reduction of tax liabilities by multinational enterprises by the use of hybrid instruments and entities. The CIOT supports the policy intention. Our comments were thus focused on whether the legislation translates the policy intention into statute accurately and effectively and without unintended consequences.

In this regard we have concerns that the provisions may apply in normal commercial situations and have unintended consequences for branches where there is no mismatch involved. In addition, the provisions go beyond the scope of the actions recommended by the BEPS project. When they do so, although they may counteract arrangements that lead to base erosion, the counteraction may be so disproportionate that it questions whether this is the right legislative response.

Our concerns relate largely to the most recently published additions to the legislation on hybrid instruments for permanent establishments, which bring into scope more arrangements involving transactions for goods and services. We would not argue that the base erosion arrangements involving goods and services should not be tackled, but we believe it is likely that more suitable methods could be used than those in this legislation and suggested what these may be.

Finally, given that the provisions may conflict with European law, the provisions may not be effective and will create legislative uncertainty, and we also commented on this aspect.

Foreign branches

We commented on TIOPA 2010 (Taxation (International and Other Provisions) Act 2010), ch 8, new Pt 6A which ‘contains provision that counteract deduction/non-inclusion mismatches that it is reasonable to suppose would otherwise arise from payments or quasi-payments because a payee is a multinational company’ (new s 259H(1)).

The proposed rules would have unintended consequences for branches when there is no mismatch involved. We set out an example of circumstances when we are concerned that, as currently drafted, this chapter would apply to normal commercial payments that have no tax avoidance purpose.

We suggested that the Bill should be amended to ensure bone fide commercial trading payments are not caught. We suggested that this amendment should be made because the BEPS project, from which this new legislation derives, was not intended to lead to measures adversely affecting commercial transactions that simply result in value being recognised where it is created. It is therefore not clear to us why the anti-hybrid rules in TIOPA 2010 Pt 6A should apply in commercial situations.

UK distributor companies

We also commented on the new ch 11 (s 259K), which ‘contains provision denying deductions in connection with payments or quasi-payments that are made under, or in connection with, imported mismatch arrangements where the payer is within the

charge to corporation tax for the payment period’.

In our view, the effect of these measures on some common centralised intellectual property (IP) ownership and sales models may be viewed as disproportionate (resulting in an effective tax on turnover) and, from the perspective of other countries, a ‘tax grab’ by the UK. Although these models do raise base erosion concerns and are thus a legitimate target for action, we suggested a better way to address this.

We said we appreciated that this counteraction may be in line with policy given that the hybrid rules are intended to deny deductions. However, a counteraction that results in a UK distributor being taxed, in effect, on turnover rather than an arm’s-length commercial trading profit goes beyond the remit of BEPS Action 2.

Control

Our final area of specific concern is the definition of ‘control group’ in TIOPA 2010 s 259NA. This does not include an exclusion for ‘control’ arising only as a result of a loan creditor relationship.

We are concerned that the legislation could apply in circumstances in which a UK taxpayer has no tax avoidance motive, in particular new Pt 6A ch 11, which ‘*contains provision denying deductions in connection with payments or quasi-payments that are made under, or in connection with, imported mismatch arrangements where the payer is within the charge to corporation tax for the payment period*’.

In our view, the definition of control group should be amended to include a loan creditor exclusion when the only connection between the UK borrower and anyone else who is a party to the over-arching arrangements is the fact that the borrower is a borrower under a loan facility.

EU law

As a final point, we believe that the legislation may be susceptible to challenge under EU law because it will deny a deduction for payments when there would not be a denial for a corresponding domestic payment, and the basis for the denial is the tax treatment of the transaction outside the UK, specifically that the corresponding

receipt is not taxed in any other jurisdiction.

There is thus a potential clash between what the legislation seeks to achieve and principles set down by the Court of Justice of the EU in cases such as *Verkooijen* (C-35/98), *Amurta* (C-379/05) and *Philips* (C-18/11).There may be a need for further action at a European level to resolve this clash, especially since other member states are also likely to introduce anti-hybrid legislation.

The full text of our submission can be found on the CIOT website.