Hybrids and other mismatch rules – HMRC guidance

International Tax

01 July 2017

The CIOT has challenged HMRC over its view on the application of the legislation to state and local taxes, saying that the draft guidance does not reflect the legislation, existing case law or the overarching policy behind the hybrid mismatch rules. HMRC's view is also inconsistent with existing legislation and practice on double tax relief and the UK's various treaty obligations.

The CIOT has written to HMRC to express concern about the use of guidance as a substitute for clear, well targeted legislation in light of the draft guidance (which will form part of the international manual) on the operation of the hybrid and other mismatch rules. In our opinion, the recently released draft guidance published on 31 March 2017 (which updates an earlier draft published in December 2016) conflicts with the wording of the legislation. Specifically, the updated guidance includes a view regarding the application of the rules where a territory can impose both provincial/state and national taxes which is contrary to the clear wording of the legislation.

The CIOT has previously corresponded with HMRC about the poor quality of recent tax legislation (for example, the hybrid mismatch rules as well as the proposed rules relating to the corporate interest restriction and carried-forward losses), which often necessitates reliance on guidance in order to achieve clarity and identify the intended scope of the legislation. We have said that this position is far from satisfactory and that we would prefer to see an improvement in the quality of legislative drafting to reduce the need to rely on guidance; guidance should be a useful tool to assist taxpayers by setting out HMRC's view of the application of the law, rather than being a necessity in order to unravel a complex and badly drafted set of rules. However, we have said that it is equally important that guidance is not published which may portray a different position which effectively extends the

legislation. This is important to avoid the perception that HMRC is attempting to legislate through guidance.

It is our view that the new comments in the updated hybrid and other mismatches guidance regarding the operation of the legislation as it applies to state and local taxes do not reflect the actual language and purpose of the legislation. We said, therefore that, if these comments remain in the guidance once this is finalised, it would lead to great uncertainty for taxpayers who would have to decide whether to apply the new rules in accordance with what they consider the law to be, or in accordance with a contrary position that is the published view of HMRC.

We said to HMRC that we do not think that the position in the updated draft guidance is consistent with the relevant legislation, existing case law or the overarching policy behind the hybrid mismatch rules. It is also inconsistent with existing legislation and practice on double tax relief and the UK's various treaty obligations. We said that this surely makes it more likely that HMRC's interpretation of the legislation, being reflected for the first time in the revised draft guidance, would not be upheld if tested, which cannot be a desirable situation. Our concern is that guidance should not be setting out a position which suggests items are taxable when the legislation does not provide for this.

The full reasoning for our views is set out in the appendix to our letter to HMRC which can be read on the CIOT website.