



International Tax

United Kingdom Tax Alert

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Anti-hybrid legislation included in finance bill for 2016

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As expected, the UK anti-hybrid rules are included in the draft clauses for Finance Bill 2016 published for consultation on 9 December 2015. The anti-hybrid clauses run to 48 pages and will completely replace the existing arbitrage rules as from 1 January 2017. The UK tax authorities are to publish examples on the application of the rules on 22 December 2015. The closing date for comments is Wednesday 3 February 2016, and Deloitte will be submitting comments.

The draft UK clauses very closely follow the OECD recommendations, and their publication will provide groups with more clarity in this area. However, uncertainty remains around what, if anything, other countries will do, and it may be necessary to consider various scenarios when applying the imported mismatch rules.

Overview of the draft UK rules

Mismatch	Arrangement	Primary response	Defensive rule	Scope
Deduction/ no inclusion (D/NI)	Hybrid financial instrument	Deny payer deduction	Include as "income not otherwise charged"	Related parties and structured arrangements
	Hybrid transfer	Deny payer deduction (special rules for financial traders)	Include as "income not otherwise charged"	Related parties and structured arrangements
	Payment made by a hybrid entity	Deny payer deduction	Include as "income not otherwise charged"	Control group and structured arrangements
	Payment made to a reverse hybrid	Deny payer deduction	Only applies to limited liability partnerships (LLPs). The LLP is not treated as transparent for these purposes only, and has taxable "income not otherwise charged"	Control group and structured arrangements

Double deduction (D/D)	Deductible payments made by a hybrid entity	Deny parent deduction	Deny hybrid entity a deduction	Related parties and structured arrangements
	Deductible payments made by a dual resident	Deny resident deduction		
Indirect D/NI and D/D	Imported mismatches	Deny payer deduction		Control group and structured arrangements

There are certain exceptions from the anti-hybrid rules for payments to a person that is not liable to tax on any income or profits, is subject to a territorial system of taxation, is not liable to tax on the grounds of sovereign immunity or is an eligible authorized offshore fund.

The main differences from the existing arbitrage rules are:

- The removal of the purpose test;
- The new rules will need to be self-assessed; and
- The introduction of explicit imported mismatch rules.

The new anti-hybrid rules are expected to generate additional tax revenue of GBP 15 million in 2016/17 (the rules will only have been in effect for three months in 2016/17), GBP 70 million in 2017/18, GBP 85 million in 2018/19 and GBP 90 million in 2019/20. These do not appear to be particularly large numbers, bearing in mind the changes to the existing rules.

Hybrid financial instrument rule

Payee/payer jurisdiction can be the same: Although D/NI outcomes most commonly arise where the payer and payee jurisdictions are different (as per the relevant OECD report), this would not be a requirement of the UK rules, which could apply to a purely UK domestic arrangement.

Ordinary income: The inclusion part of the deduction/no inclusion test would be measured by reference to ordinary income. Ordinary income is income that is subject to income tax or corporation tax, or an overseas equivalent. Therefore, it would not include amounts subject to capital gains tax or an overseas equivalent. Any exclusions; reductions; offsets by way of exemption, exclusion, relief or credit; or repayments of tax would reduce the amount of ordinary income.

CFC income: The draft rules would allow a controlled foreign company (CFC) income pick-up (UK or foreign) to be included in ordinary income for the purposes of determining whether there is a hybrid mismatch.

Timing differences: A payment generally would not be treated as giving rise to a mismatch if it will be required to be included in the payee's ordinary income in an accounting period that commences within 12 months of the end of the payer's accounting period. A claim would be able to be made to take into account a later period where it is just and reasonable that the ordinary income arises in that period, rather than an earlier one.

Hybrid entity double deduction and dual resident company double deduction cases

As drafted, the rules would apply to amounts for which a double deduction can be taken, and are not limited to payments. The rules, therefore, could apply to deductions such as capital allowances/tax depreciation.

Imported mismatch rule

It is possible for groups to have a hybrid mismatch arrangement between two countries, which do not introduce the rules, and then transfer the benefit to a third country using an arrangement that does not give rise to a hybrid mismatch. The imported mismatch rules would deny a deduction in the third country. The UK will introduce such a rule.

Where the mismatch payment is funded from various sources, a “just and reasonable” approach would be taken to determine the disallowance in the UK. It is hoped that the examples to be published on 22 December 2015 will comprehensively cover the imported mismatch rules.

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