# INTM550086 C: Hybrids: Introduction: Examples: Interaction with transfer pricing - Hybrid payee

These two examples demonstrate how Part 6A and the Transfer Pricing rules apply in the case of a hybrid payee. The diagram is the same for both fact patterns.



**Background 1**

* A payment of 100 is made by the Payer in Country D to the Hybrid Payee in Country C.
* Investor 1 in Country A sees the Hybrid Payee as transparent.
* Investor 2 in Country B sees the Hybrid Payee as opaque.
* Under arm’s length terms, the payment from Payer to Hybrid Payee would be 60, not 100.

**Analysis**

**Applying transfer pricing with Part 6A factored in**

**Step 1: Test outcome of actual provision, disregarding transfer pricing rules**

Payer makes payment of 100. This is the relevant deduction for Part 6A purposes. Total payee ordinary income is 50. Counteraction under Chapter 7 would therefore be reduction of relevant deduction by 50. Total relief available to payer would therefore be 50.

**Step 2: Test outcome of arm’s length provision**

Payer makes payment of 60. This is the relevant deduction for Part 6A purposes. Total payee ordinary income would be 30. Counteraction under Chapter 7 would therefore be reduction of relevant deduction by 30. Total relief available to payer would therefore be 30.

**Step 3: Test if payer is a potentially advantaged person for transfer pricing purposes**

Payer’s tax relief under the actual provision would be 50, but under the arm’s length provision it is 30. Payer is therefore potentially advantaged.

**Step 4: Recompute payer’s tax position as if the arm’s length provision was imposed**

Payer is taxed as if it has made a payment of 60. Deductibility of the payment is reduced by 30 due to counteraction under Chapter 7. Payer therefore claims deduction of 30.

To the extent relevant, corresponding adjustments would be available under s.174 as if the arm’s length payment of 60 had been made.

**Applying Part 6A (Chapter 7) to consider whether a further counteraction is required.**

**Step 1: Identify relevant deduction (i.e. relief available disregarding hybrids rules)**

Payer makes payment of 100. However, this exceeds the arm’s length amount so transfer pricing would require re-computation of payer’s tax position as if it was paying 60. Relevant deduction is therefore 60.

**Step 2: Identify payees’ total ordinary income**

Only Investor 1 is recognising ordinary income. It receives 50. So the total ordinary income of all payees is 50.

**Step 3: Test if there is a hybrid payee deduction/non-inclusion mismatch**

The relevant deduction is 60 and the total ordinary income of payees is 50. There is therefore a hybrid payee deduction/non-inclusion mismatch of 10.

**Step 4: Apply counteraction**

The relevant deduction (of 60) which may be deducted by the payer is reduced by the mismatch amount of 10. The maximum the payer may deduct is therefore 50. However, since the application of the transfer pricing rules has led to a claimed deduction of only 30, the counteraction has no effect in practice.

Note that if a corresponding adjustment claim was made by Investor 1, Part 6A would have imposed a counteraction of 30 (as total payee ordinary income would have been reduced to 30), setting a maximum deduction of 30, leading to the same outcome as Part 4. Part 6A would therefore have had no effect in its own right.

**Background 2**

* Investor 1 sees the Hybrid Payee as transparent.
* Investor 2 sees the Hybrid Payee as opaque.
* Under arm’s length terms, the payment from Payer to Hybrid Payee would be 40, not 100.

**Analysis**

**Applying transfer pricing with Part 6A factored in.**

**Step 1: Test outcome of actual provision, disregarding transfer pricing rules**

Payer makes payment of 100. This is the relevant deduction for Part 6A purposes. Total payee ordinary income is 50. Counteraction under Chapter 7 would therefore be reduction of relevant deduction by 50. Total relief available to payer would therefore be 50.

**Step 2: Test outcome of arm’s length provision**

Payer makes payment of 40. This is the relevant deduction for Part 6A purposes. Total payee ordinary income would be 20. Counteraction under Chapter 7 would therefore be reduction of relevant deduction by 20. Total relief available to payer would therefore be 20.

**Step 3: Test if payer is a potentially advantaged person for transfer pricing purposes**

Payer’s tax relief under the actual provision would be 50, but under the arm’s length provision it is 20. Payer is therefore potentially advantaged.

**Step 4: Recompute payer’s tax position as if the arm’s length provision was imposed**

Payer is taxed as if it has made a payment of 40. Deductibility of the payment is reduced by 20 due to counteraction under Chapter 7. Payer therefore claims deduction of 20.

To the extent relevant, corresponding adjustments would be available under s.174 as if the arm’s length payment of 40 had been made.

**Applying Part 6A (Chapter 7) to consider whether a further counteraction is required.**

**Step 1: Identify relevant deduction (ie relief available disregarding hybrids rules)**

Payer makes payment of 100. However, this exceeds the arm’s length amount so transfer pricing would require re-computation of payer’s tax position as if it was paying 40. Relevant deduction is therefore 40.

**Step 2: Identify payees’ total ordinary income**

Only Investor 1 is recognising ordinary income. It receives 50. So the total ordinary income of all payees is 50.

**Step 3: Test if there is a hybrid payee deduction/non-inclusion mismatch**

The relevant deduction is 40 and the total ordinary income of payees is 50. There is therefore no hybrid payee deduction/non-inclusion mismatch.

Since there is no hybrid payee deduction/non-inclusion mismatch, there is no counteraction. Payer claims deduction of 20 in accordance with the outcome of applying the transfer pricing rules.

Note that if a corresponding adjustment claim was made by Investor 1, Part 6A would have imposed a counteraction of 20 (as total payee ordinary income would have been reduced to 20), setting a maximum deduction of 20, leading to the same outcome as Part 4. Part 6A would therefore have had no effect in its own right.

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