# INTM552490: Hybrids: Hybrid transfers (Chapter 4): Examples: Simple repo transaction - no mismatch

This example illustrates a straightforward repo transaction between related parties, in which both parties are treated as entering into a financing transaction for tax purposes. U Co benefits from a tax deduction for the funding cost on the in-substance secured loan and C Co is taxed on a corresponding amount of income.



## Background

* U Co is resident in the UK.
* U Co holds a portfolio shareholding in I Co.
* U Co sells its shares in I Co to a related company, C Co, for £100m, subject to an agreement (the Repo) that U Co will repurchase the shareholding after 3 months for £101m.
* C Co is resident in Country CA.
* No dividends are paid or payable on the I Co shares during this 3 month period.
* U Co accounts for the transactions as a borrowing of £100m, secured on the shares in I Co, recognising a financing cost of £1m (being the excess of the repurchase cost of the shares). Under UK tax law U Co may deduct that £1m from its income for tax purposes.
* The borrowing cost for U Co is at an effective annual rate of approximately 4% and is accepted as an arm’s length cost.
* C Co also treats the repo as secured lending for tax purposes, and the in-substance interest of £1m is ordinary income of C Co in Country CA.

## Analysis – Applying the tests in s259DA TIOPA 2010

### Condition A: Is there a hybrid transfer arrangement in relation to an underlying instrument?

The agreement to sell I Co shares for £100m and repurchase them after 3 months for £101m is a repo in the ordinary sense of the term as used in the context of financial transactions. The Repo is a hybrid transfer arrangement as defined at s259DB(2) only if it provides for, or relates to, the transfer of a financial instrument and

* the dual treatment condition is met, or
* a substitute payment could be made.

The I Co shares are a financial instrument, as defined at s259N. The Repo is, therefore, an arrangement providing for the transfer of a financial instrument.

The dual treatment condition is met if, for tax purposes -

* one person regards the arrangement as equivalent to a transaction for the lending of money at interest, and a payment or quasi-payment made under or in connection with that arrangement is treated accordingly, and
* another person does not treat that payment or quasi-payment as equivalent to a transaction for the lending of money at interest.

On the facts given above, the dual treatment condition is not met because both U Co and C Co treat the payment of £1m under the Repo as a transaction under an arrangement that is equivalent to the lending of money at interest.

No dividends are paid or payable to C Co during the 3 months it holds the shares. Assuming that the Repo does not contain any provision to make a substitute payment (for example, because the period covered does not include a record date for I Co shares), no substitute payment could be made by C Co to U Co.

Condition A is not satisfied, as the dual treatment condition is not met and there cannot be a substitute payment. It is not necessary to consider the remaining conditions at s259DB.

### Conclusion

The conditions at s259DB(2) are not satisfied, so there is no hybrid transfer arrangement and there can be no counteraction under Chapter 4.

[Return to contents](https://www.gov.uk/hmrc-internal-manuals/international-manual/intm550000)