# INTM559430: Hybrids: Imported mismatches (Chapter 11): Examples: Loan funded by equity



## Background

* A Co (resident in Country X) funds B Co (resident in Country Y) with hybrid debt through a hybrid financial instrument (HFI)
* B Co pushes the funds down to C Co as equity
* C Co makes a plain vanilla loan to UK Co.
* B Co and C Co are resident in the same jurisdiction (Country Y).
* B Co surrenders the hybrid loan deductions to C Co which C Co uses to shelter the interest received from UK Co.

For the purpose of this example, the UK is the country of residence of UK Co. Neither Country X nor Country Y has adopted rules based on the OECD’s Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements published on 5 October 2015 or any replacement of supplementary publication.

**Analysis - Applying the tests in s259KA TIOPA 2010**

Are the relevant conditions satisfied to bring this example within the scope of the Imported Mismatches rules?

### Condition A: Are there payments, or quasi-payments, made under, or in connection with, an arrangement (the imported mismatch arrangement)?

The payment of interest from UK Co to C Co and the payment of interest from B Co to A Co are payments made under, or in connection with, an arrangement.

Condition A is therefore satisfied.

### Condition B: Is the payer, in relation to that imported mismatch arrangement, within the charge to corporation tax for a relevant payment period?

UK Co is a payer in relation to the UK Co to C Co arrangement and is within the charge to corporation tax.

Condition B will therefore be satisfied.

### Condition C: Is this arrangement one of a number of arrangements which are each entered into in pursuance of, or in relation to, an over-arching arrangement (a series of arrangements)?

As identified in Condition A, the interest payment from UK Co to C Co is a relevant arrangement, and it forms part of a number of related arrangements that includes the interest payment from B Co to A Co.

The over-arching arrangement here, as defined in s259KA(5) TIOPA 2010, includes the payment from UK Co to C Co and the interest payment from B Co to A Co.

In this example, the funds lent under the hybrid financial instrument are passed as equity to C Co before being lent on to UK Co. As a question of fact, there is a connection between the arrangements and they are pursuant to an over-arching arrangement.

Condition C will therefore be satisfied in relation to the interest payment from B Co to A Co.

[Note: If, in this example, B Co did not surrender the hybrid loan deductions to C Co but instead used them against its other profits, with the result that C Co paid tax on the interest it received, Condition C would still be satisfied. While C Co’s interest receipt would not be sheltered by a hybrid deduction, the hybrid debt would still be used to fund the loan to UK Co, and (as a question of fact) there would be a connection between the arrangements and they would be pursuant to an over-arching arrangement].

[Note: If the facts were the same as for this example, except that B Co did not pass on the funds lent under the HFI to C Co as equity, but instead C Co used funds from a different source that were not connected to the HFI loan (as a question of fact) to lend to UK Co, then the steps would not have been taken pursuant to an overarching arrangement and Condition C would not be satisfied]

### Condition D: Under an arrangement within this series (other than the imported mismatch arrangement), is there a payment or quasi-payment in relation to which it is reasonable to suppose that there would be a relevant mismatch (as targeted by the Part 6A TIOPA 2010 rules)?

As stated above, with the funding between A Co and B Co being in the form of a hybrid financial instrument, there is a hybrid or otherwise impermissible deduction/non-inclusion mismatch in relation to a payment or quasi-payment where B Co has a deduction which exceeds the amount of ordinary income that arises to A Co, and all or part of that excess arises by reason of the terms, or any other features, of the financial instrument. There is thus a payment or quasi-payment in relation to which there would be a relevant mismatch which might be countered by the rules in Chapter 3 of Part 6A TIOPA 2010.

The relevant arrangement in the series is therefore the interest payment by B Co to A Co and the mismatch payment would be a hybrid financial instrument deduction/non-inclusion mismatch within Chapter 3.

Condition D is therefore satisfied in respect of the interest paid from B Co to A Co.

The relevant mismatch here is the extent of the mismatch as computed under Chapter 3.

### Condition E: Is it reasonable to suppose that the relevant mismatch is not capable of counteraction? (INT559250 explains that ‘old’ Condition E is relevant for payments made after the date of Royal Assent of the Finance Bill 2021, or in the case of quasi-payments, to payment periods beginning after the date of Royal Assent. The analysis in this example is unaffected however)

As stated in the Background above neither Country X nor Country Y have adopted rules that are OECD mismatch complaint s

Condition E is therefore satisfied.

### Condition G: Is the relevant payer that is within the charge to UK corporation tax within the same control group as the payee (A Co) of the mismatch payment within the relevant period, or is there a structured arrangement?

All the companies are within the same control group, as defined at s259NB TIOPA 2010.

Condition G is met.

### Conclusion

As all the relevant conditions are satisfied to characterise the imported mismatch payments under the B Co to A Co arrangement as giving rise to a relevant mismatch. The relevant counteraction under the Imported Mismatch rules must be considered.

## Counteraction

Where there is more than one relevant payment in relation to the relevant mismatch arising, each company’s share of the relevant mismatch will be determined by apportioning it on a just and reasonable basis, having regard to the extent that it funds the Imported Mismatch.

Section 259KC will apply to deny UK Co a deduction to the extent that it directly or indirectly funds the relevant mismatch.

Therefore s259KC will apply to deny UK Co a deduction for the interest payments made to C Co, to the extent that they do not exceed the interest payments made by B Co to A Co.

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