

**EXPLANATORY MEMORANDUM TO**  
**THE HYBRID AND OTHER MISMATCHES (FINANCIAL INSTRUMENTS:  
EXCLUDED INSTRUMENTS) REGULATIONS 2019**

**2019 No. 1345**

**1. Introduction**

- 1.1 This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs (HMRC) on behalf of Her Majesty's Treasury and is laid before the House of Commons by Command of Her Majesty.

**2. Purpose of the instrument**

- 2.1 These Regulations replace existing legislation exempting regulatory capital issued by financial institutions from counteraction under the hybrid and other mismatch rules (see 7.4 below). United Kingdom (UK) tax policy allows deductions for the costs of regulatory capital securities which financial institutions are required to hold to provide stability for the financial sector and for the wider UK economy. The existing exemption supports this policy. These Regulations introduce more detailed requirements in order for the exemption to apply, including limiting the exemption to the banking sector. This change is required to ensure that the UK rules comply with the minimum standards set out in the European Union (EU) Anti-Tax Avoidance Directive.

**3. Matters of special interest to Parliament**

*Matters of special interest to the Select Committee on Statutory Instruments*

- 3.1 None.

*Matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business (English Votes for English Laws)*

- 3.2 As the instrument is subject to the negative resolution procedure there are no matters relevant to Standing Orders Nos. 83P and 83T of the Standing Orders of the House of Commons relating to Public Business at this stage.

**4. Extent and Territorial Application**

- 4.1 The territorial extent of this instrument is the United Kingdom.  
4.2 The territorial application of this instrument is the United Kingdom.

**5. European Convention on Human Rights**

- 5.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

**6. Legislative Context**

- 6.1 The hybrid and other mismatches legislation contained in Part 6A of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010) is an anti-avoidance regime that seeks to counteract mismatches in the tax treatment of instruments and

structures across jurisdictions. Until it was amended by the Finance Act 2019 (FA 2019) on 12 February 2019, section 259N(3)(b) TIOPA 2010 included an exemption for ‘anything that is a regulatory capital security for the purposes of the Taxation of Regulatory Capital Securities Regulations 2013 (S.I. 2013/3209) (as amended from time to time)’ (the RCS Regulations).

- 6.2 The RCS Regulations provided rules for the taxation of hybrid regulatory capital for financial institutions. Broadly speaking, those rules provided a tax deduction for the interest costs of such regulatory capital. Schedule 20 FA 2019 revoked the RCS Regulations with effect from 1 January 2019 and introduced new rules on the taxation of hybrid capital instruments which apply to all sectors, not just banks and insurers.
- 6.3 Section 19(4) FA 2019 removed the existing exemption for regulatory capital from counteraction under the hybrid and other mismatches rules and replaced it with a power to make Regulations specifying exclusions from the meaning of “financial instrument” which may also be exempted from counteraction.
- 6.4 The Hybrid and Other Mismatches (Financial Instrument: Exclusions) Regulations 2019 (S.I. 2019/1251) were laid on 10 September 2019 which have effect from 1 January 2019, and ensure that anything that was a regulatory capital security for the purposes of the RCS Regulations is still exempt from counteraction under the hybrid and other mismatches legislation, and also covered certain new categories of regulatory financial instrument. They will be superseded by these Regulations.
- 6.5 The EU Anti-Tax Avoidance Directive (ATAD) includes specific detailed requirements in relation to the exemption of regulatory capital from hybrid mismatch regimes. The Directive requires that these requirements are met from 1 January 2020 onwards. The Directive also requires that EU Member States shall not apply any exemption after 31 December 2022. These specific requirements are set out in these Regulations.
- 6.6 These Regulations will come into force on 1 January 2020 and take effect in relation to payments made on or after 1 January 2020 and quasi-payments (amounts which arise or accrue that give rise to allowable tax deductions) in relation to which the payment period begins on or after that date, in accordance with section 19(8) FA 2019.
- 6.7 These Regulations operate by cross-referencing to the detailed requirements set out in paragraph 4, Article 9 of Directive (EU) 2016/1164 – the Anti-Tax Avoidance Directive (ATAD).

## **7. Policy background**

### *What is being done and why?*

- 7.1 The hybrid and other mismatches legislation is an anti-avoidance regime that seeks to counteract mismatches in tax treatment of instruments and structures across jurisdictions. Banks issue hybrid regulatory capital instruments that include some features which may mean there is a mismatch in tax treatment across jurisdictions.
- 7.2 Banks are required to hold regulatory capital so that when they are in financial difficulties they can call upon this capital to remain in business. This protects customers' interests and avoids disrupting the economy. It acts like a buffer, absorbing losses and preventing the capital position becoming depleted to critical levels.

- 7.3 The more stringent interim minimum requirement for own funds and liabilities that the Bank of England set from 1 January 2019 go further than this, requiring global systemically important banks to hold sufficient capital and debt so they can continue to provide critical services when the bank is already failing. Both debt and capital instruments can be written down or converted to shares to absorb losses and recapitalise the bank without recourse to government funds.
- 7.4 The UK treats these instruments as debt but some countries treat these as equity giving rise to a mismatch in tax treatment. The mismatch arises because the UK will give a tax deduction for payments under such instruments, whilst the overseas jurisdiction will treat the corresponding receipts as non-taxable dividends or distributions. The hybrid and other mismatch rules deal with such mismatches by denying the deduction where the corresponding receipt is untaxed. Without an exemption from the hybrid and other mismatches legislation, companies issuing these instruments which give rise to a tax mismatch would not get a deduction for the interest they pay on these instruments.
- 7.5 UK tax policy is to allow deductions for the cost of instruments which are issued to support these regulatory requirements which provide stability for the financial sector and for the entire UK economy. The exemption from the hybrid and other mismatches legislation supports this policy by allowing a deduction for interest paid on these instruments. However, EU Member States are also required to meet the minimum standards set out in ATAD from 1 January 2020 onwards. The purpose of the minimum standards in the Directive is to prevent corporate tax avoidance.
- 7.6 ATAD includes a specific requirement that an exemption for regulatory capital can only apply in relation to the banking sector. However, in practice the existing exemption was only relevant to banking entities.

## **8. European Union (Withdrawal) Act/Withdrawal of the United Kingdom from the European Union**

- 8.1 These Regulations do not relate to withdrawal from the European Union.

## **9. Consolidation**

- 9.1 There are no plans to consolidate the legislation.

## **10. Consultation outcome**

- 10.1 The approach taken in these Regulations was subject to informal consultation, which was considered appropriate as they relate to a technical change affecting a small number of businesses in the financial sector. Stakeholders (banks and financial sector representative bodies) indicated that they were content with the approach of cross-referencing to the detailed conditions within ATAD.

## **11. Guidance**

- 11.1 Stakeholders have been made aware of these Regulations. HMRC will issue guidance on the application of the application of the detailed requirements of ATAD, which the Regulations refer to, prior to the Regulations coming into force on 1 January 2020.

## **12. Impact**

- 12.1 The impact on business, charities or voluntary bodies is limited to banks who have issued hybrid instruments to overseas associates in countries where the interest receipt is not taxed in full. These Regulations ensure that an exemption from the hybrid legislation continues to apply to qualifying instruments, subject to the detailed requirements of ATAD. The small number of businesses impacted by this change will incur insignificant one-off costs of familiarisation with the amendment. There are not expected to be any ongoing costs to those businesses from the amendment.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax Information and Impact Note covering this instrument will be published on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

## **13. Regulating small business**

- 13.1 These Regulations do not apply to activities that are undertaken by small businesses.

## **14. Monitoring & review**

- 14.1 These Regulations will be kept under review through communication with affected taxpayer groups.
- 14.2 These Regulations do not include a statutory review clause. They amend UK tax legislation and therefore fall within the exceptions at section 28(3)(a), Small Business, Enterprise and Employment Act 2015.

## **15. Contact**

- 15.1 Mark Bryan at HMRC (Telephone: 03000 585607 or email: [mark.bryan@hmrc.gov.uk](mailto:mark.bryan@hmrc.gov.uk)) can be contacted with any queries regarding the instrument.
- 15.2 Lizzie Arnold, Deputy Director, Base Protection Policy at HMRC can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 Jesse Norman MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.

