



TAXREP 24/14 (ICAEW REPRESENTATION 59/14)

BEPS ACTION 2: NEUTRALISE THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

ICAEW welcomes the opportunity to comment on the public discussion drafts BEPS Action 2: Neutralise the effects of hybrid mismatch arrangements [recommendations for domestic law](#) and [treaty issues](#) published by OECD on 19 March 2014.

This response of 1 May 2014 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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GENERAL COMMENTS

1. The two discussion drafts run to nearly 100 pages of extremely dense, and very complicated, analysis of the totality of the hybrid mismatch area and we commend OECD for the diligence and comprehensive nature of this work. But it represents an attempt to deal with all potential problems arising from hybrid mismatches without taking account of the work on other Actions, most notably Action 3 Strengthen CFC rules, Action 4 Limit base erosion via interest deduction and other financial payments and Action 5 Counter harmful tax practices more effectively, taking into account transparency and substance.
2. The length of the discussion draft is also a product of the two separate approaches to addressing hybrid mismatches: top down or bottom up both of which are covered in the current discussion draft. Under the top down approach the rules would apply to all transactions involving hybrid instruments with certain limited exceptions. Under the bottom-up approach the rules would apply to instruments held between related parties and instruments entered into as part of a tax-motivated “structured” arrangement.
3. The Press Release issued at the time the discussion drafts were published noted “the recommendations set out in the discussion drafts do not represent the consensus view of [OECD] but rather are intended to provide stakeholders with substantive proposals for analysis and comment.”
4. We understand from the presentation of Pascal Saint-Amans at the IFS/ETPF Conference in London on Monday 28 April on International Taxation: Base erosion, profit shifting and distortions to real activity that the bottom-up approach is going to be adopted and the result of that, and more targeted provisions, is that the discussion draft will be reduced in size to some 35 pages and that it may eventually be restricted to no more than 20 pages. This will also, we understand, be the result of dealing with the issues raised in the current discussion draft through the other Actions in the BEPS Action Plan.
5. We warmly welcome the revised, and more targeted, approach.
6. As so much in the current proposals is likely to change we have not made comments on the detailed proposals in the discussion drafts in the current Representation.
7. We note that two of the design principles set out in the discussion draft are to be workable for taxpayers and to keep compliance to a minimum and to be easy for tax authorities to administer.
8. We also note that hybrid arrangements are only one of the factors that create cross-border mismatches and there needs to be a proper analysis of these other factors so that any solution is both proportionate and effective as well as tying in with the other BEPS actions.

SPECIFIC COMMENTS

9. Whatever rules are finally put forward need to be compliant with EU law on the free movement of capital not least because more than half of the G20/OECD countries involved in the BEPS Action Plan as also members of the EU. Specifically, this is likely to require a commercial justification test as part of any rule counteracting the use of hybrids. See the CJEU’s decisions in the Thin Cap GLO case C-524/04, and paragraph 92 in particular, and in Itelcar C-282/12 and paragraph 37 in particular.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see [icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx](https://www.icaew.com/en/technical/tax/tax-faculty/~media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx))