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BEPS Action 2: Neutralise the effects of hybrid mismatch arrangements (recommendations for domestic laws)

On behalf of our members, the International Securities Lending Association (ISLA) appreciates the opportunity to provide its initial comments on the OECD Public Discussion Draft (referred to below as the hybrid mismatch paper).

ISLA is a trade association established in 1989 to represent the common interests of participants in the securities lending industry. It has approximately 100 full and associate members principally from across Europe comprising banks, securities dealers, asset managers, insurance companies and pension funds. For more information please visit the ISLA website www.isla.co.uk.

We write in connection with one specific aspect of the hybrid mismatch paper, namely in reference to the discussion in that document concerning stock lending and repo transactions.

We recognise that, in the terms of the document, a stock lending or repo transaction could give rise to a hybrid effect. This possibility arises due to the fact that some tax authorities may choose to treat payments under a stock lending or repo arrangement (e.g dividend compensation payments) as a deductible expense (or taxable receipt) whilst others may seek to assimilate them to the income (typically dividends in a stock loan transaction) forgone by the lender by lending out those securities over a dividend record date and such income may in some cases fall to be treated as an exempt receipt (or non-deductible payment) by virtue of the relevant domestic tax system concerned.

In the light of this situation, we are concerned at the risk that this theoretical possibility, if it leads to a wide application of the proposed and highly complex hybrid regime to stock lending and repo transactions, will lead to major adverse impacts on ordinary over the counter (off-Exchange) stock lending and repo transactions which play a vital role in facilitating market liquidity.

In the event any anti-hybrid rule were enacted to apply broadly to stock loan and repo transactions, it would require parties to such transactions to have access to continuous and up-to-date knowledge of the tax systems of the numerous markets in which securities are borrowed and lent. Further, given the prevalence in this market of chains of various counterparties acting in either an agency or a principal capacity, then the potential for administrative complexity would be enormous and unmanageable.

These issues - and our concerns - are not limited to transactions between unrelated parties. The structure of the financial markets and the purpose of stock lending and repo transactions (being to access and utilise available pools of stock and liquidity for daily flow business) inevitably mean that there are also significant levels of related party (such as intercompany) stock borrow and loan transactions.

The transactions described above, whether involving unrelated or related parties, have overwhelmingly no tax driver and we are concerned that if brought into the hybrid regime the costs and adverse impact on the global financial markets would be appreciably out of all proportion to any anti-tax avoidance benefits secured.

We would also add that the examples of stock loan and repo transactions given in the hybrid mismatch paper do not by any means reflect ordinary market transactions but seem rather to be highly structured transactions geared to deliver tax, not liquidity, benefits. Accordingly, they would by no means be representative of the market transactions discussed in this letter.

For the reasons set out above, we would suggest that a complete carve-out from the hybrid regime is required for ordinary market stock loan and repo transactions, including those between related parties. This might mean that the use of a structured purpose or motive test needs to be considered. This would inevitably increase the level of uncertainty (and therefore still negatively effect) ordinary stock loan and repo transactions, but it may be possible to devise safe harbour parameters which would reduce the unwarranted impact of any tax anti-avoidance rules on such transactions. If it would be helpful, we would be pleased to develop our thoughts in this regard, although our strong preference is for a clear carve-out as indicated above.

Yours sincerely,

John Billige
Chair ISLA sub-group tax