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Hybrid mismatches under the CCTB/ATAD II Proposal

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Panel 5: Anti-Mismatch Rules in CCTB and ATAD II

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Objective of the new hybrid mismatch rules



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Paragraph 2 Preamble ATAD I:

‘*…only a common framework could prevent a fragmentation of the market and put and end to currently existing mismatches”*

Explanatory Memorandum ATAD II:

‘*…it is still necessary to adopt binding rules to ensure that Member States effectively tackle these mismatches.*’

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Anti-mismatch rule under ATAD I & II and CCTB



Article 9, paragraph 1, ATAD II (Article 61 CCTB): Double Deduction

To the extent that a hybrid mismatch between Member States results in a double deduction of the same payment, expenses or losses, the deduction shall be given only in the Member State where such payment has its source, the expenses are incurred or the losses are suffered.

DD ⟶ Only deduction in Source Member State

To the extent that a hybrid mismatch involving a third country results in a double deduction of the same payment, expenses or losses, the Member State concerned shall deny the deduction of such payment, expenses or losses, unless the third country has already done so.

DD ⟶ Member State concerned shall deny deduction

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Anti-mismatch rule under ATAD I & II and CCTB



Article 9, paragraph 2, ATAD II (Article 61 CCTB): Deduction No Inclusion

To the extent that a hybrid mismatch between Member States results in a deduction without inclusion, the Member State of the payer shall deny the deduction of such payment.

DNI ⟶ deduction denied by payer Member State

To the extent that a hybrid mismatch involving a third country results in a deduction without inclusion:
(i) if the payment has its source in a Member State, that Member State shall deny the deduction, or
(ii) if the payment has its source in a third country, the Member State concerned shall require the taxpayer to include such payment in the taxable base, unless the third country has already denied the deduction or has required that payment to be included.

DNI ⟶ Source Member State shall deny deduction or Member State concerned shall include

7. […] 'payer' means the entity or permanent establishment where the payment has its source, the expenses are incurred or the losses are suffered.

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What is a hybrid mismatch?



Article 2, para. 9, Hybrid Mismatches

'hybrid mismatch' means a situation between a taxpayer and an associated enterprise or a structured arrangement between parties in different tax jurisdictions where any of the following outcomes (DD, DNI or non-taxation without inclusion) is attributable to differences in the legal characterisation of a financial instrument or entity, or in the treatment of a commercial presence as a permanent establishment.

A hybrid mismatch only arises to the extent that the same payment deducted, expenses incurred or losses suffered in two jurisdictions exceed the amount of income that is included in both jurisdictions and which can be attributed to the same source.

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OECD, Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report, 5 October 2015.



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Recommendation 6

1. Neutralise the mismatch to the extent the payment gives rise to a DD outcome

The following rule should apply to a hybrid payer that makes a payment that is deductible under the laws of the payer jurisdiction and that triggers a duplicate deduction in the parent jurisdiction that results in a hybrid mismatch:

(a) The parent jurisdiction will deny the duplicate deduction for such payment to the extent it gives rise to a DD outcome.

(b) If the parent jurisdiction does not neutralise the mismatch, the payer jurisdiction will deny the deduction for such payment to the extent it gives rise to a DD outcome.

(c) No mismatch will arise to the extent that a deduction is set-off against income that is included in income under the laws of both the parent and the payer jurisdictions (i.e. dual inclusion income).

(d) Any deduction that exceeds the amount of dual inclusion income (the excess deduction) may be eligible to be set-off against dual inclusion income in another period. In order to prevent stranded losses, the excess deduction may be allowed to the extent that the taxpayer can establish, to the satisfaction of the tax administration, that the excess deduction in the other jurisdiction cannot be set-off against any income of any person under the laws of the other jurisdiction that is not dual inclusion income.

OECD
BETTER POLICIES FOR BETTER LIVES

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Terminology & Scope



- Source Member State / Payer Member State
- Double Deduction / Deduction No Inclusion
- Taxpayer / Associated Enterprise / Entity
- Legal characterization

ATAD II, paragraph 13:

"*It is also necessary to clarify that the legal characterisation relates to the qualification of an entity or financial instrument for tax law purposes. A legal characterisation should also include a qualification of an entity under entity classification election regulations also known as check-the-box rules*."

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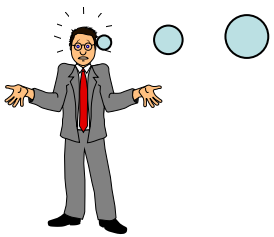
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Out of scope

- Mismatches with not associated enterprises and individuals
- Neutralise double taxation due to mismatches
- Timing differences

Paragraph 14 Preamble ATAD II:

"It is therefore necessary to clarify that as such these timing differences should not be treated as giving rise to mismatches in tax outcomes. However, it is necessary to provide that if a payment is not recognised in the same or overlapping tax period as it is recognised in the Member State of the taxpayer, which in principle leads to a deduction without inclusion, the taxpayer ensure that the payment be recognised within a reasonable period of time in the other jurisdiction."



What about deferral structures?

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Double deduction with hybrid mismatch in EU [DD]



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A Co

Member State A: views entity as transparent

Member State B: views entity as non-transparent

Hybrid Entity

Loan

Interest

Compatible with C-18/11 Philips Electronics?



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Double deduction: third country or intra-EU?



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Member State A

A Co

Member State B



B Hybrid Entity

Third Country C



Loan

Interest

C Hybrid Entity

Art. 9(1) ATAD (intra-EU):
'the deduction shall be given only in the Member State where such payment has its source'

Art. 9(1) ATAD (third country):
'the Member State concerned shall deny the deduction of such payment'

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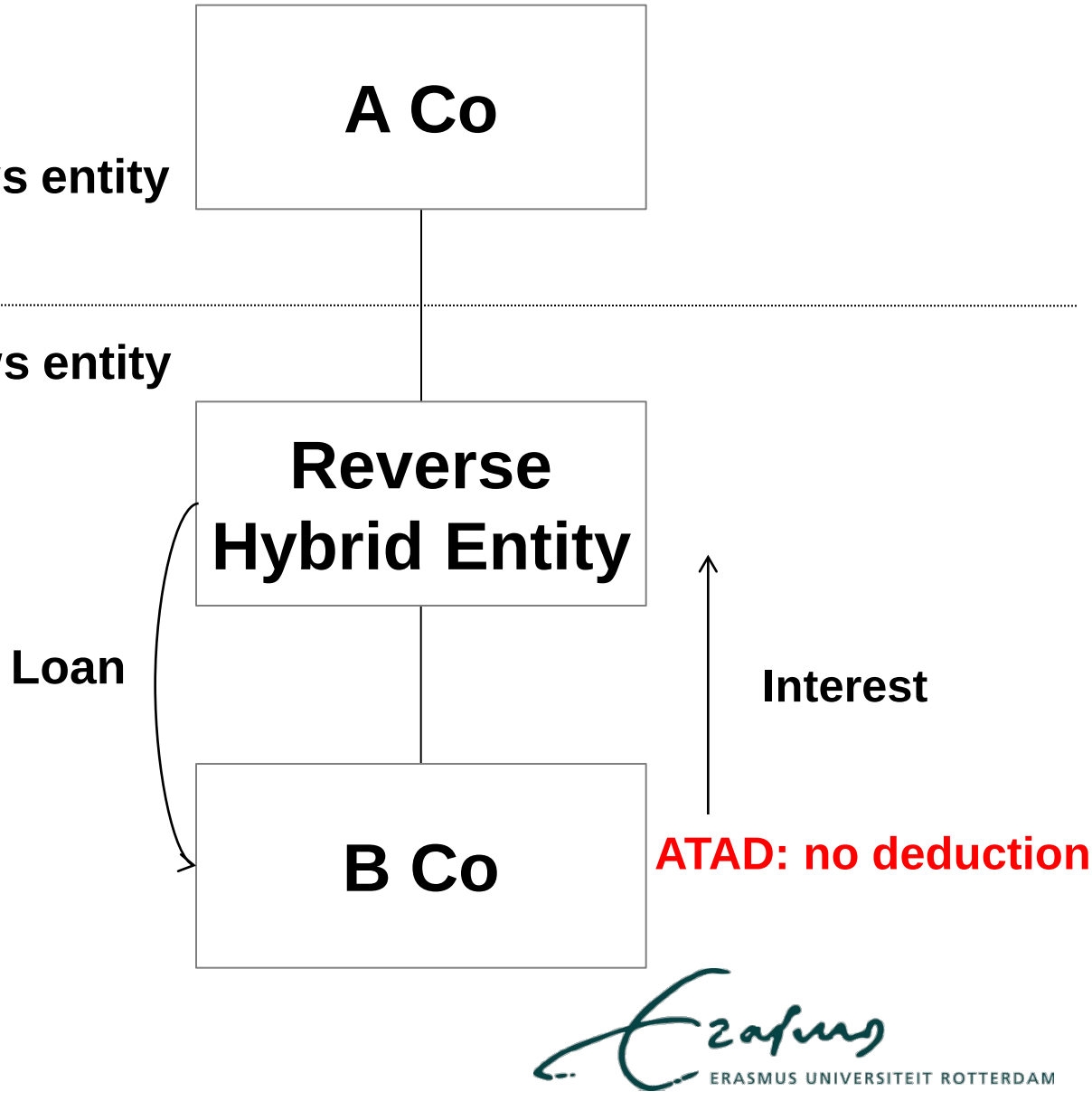
Disregarded payment to reverse hybrid entity [DNI]



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Member State A: views entity as non-transparent

Member State B: views entity as transparent



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Transparent entities under the CCTB



Article 62 Allocation of the income of transparent entities to taxpayers holding an interest

1. Where an entity is treated as transparent in the Member State where it is established, a taxpayer holding an interest in the entity shall include its share in the income of the entity in its tax base. […].

Member State B's tax allocation is decisive



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Disregarded payment to reverse hybrid entity [DNI] ⟶ [NDI]!

Member State A: views entity as non-transparent

Member State B: views entity as transparent

A Co

CCTB: Inclusion

Reverse Hybrid Entity

Loan

Interest

B Co

ATAD: no deduction

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What previously happened…..



Possible elements of a technical outline', CCCTB/WP/057, prepared for the CCCTB Working Group meeting on 27-28 September 2007.

83. *Where an entity owned by a taxpayer is treated as non-transparent by the MS of the entity, this would be recognised by the state of residence of the taxpayer.*

Initial January 2016 ATAD Proposal

'Where two Member States give a different legal characterisation to the same taxpayer (hybrid entity) […] the legal characterisation given to the hybrid entity by the Member State in which the payment has its source […] shall be followed by the other Member State.'

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Deduction without inclusion or deduction/non-taxation?



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Member State A
(C = non-transparent)

A Co

B C0

Loan and interest disregarded due to fiscal unity

Member State B
(C = transparent)

C Reverse Hybrid Entity

Interest allocated to PE

+100 income
- 100 interest
0

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Anti-mismatch rule under ATAD I & II and CCTB



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Article 9 ATAD: paragraph 2 or paragraph 3?

2. To the extent that a hybrid mismatch between Member States results in a **deduction without inclusion**, the Member State of the payer shall deny the deduction of such payment.

3. To the extent that a hybrid mismatch between Member States **involving a permanent establishment** results in **non-taxation without inclusion**, the Member State in which the taxpayer is resident for tax purposes shall require the taxpayer to include in the taxable base the income attributed to the permanent establishment.

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Observations



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- No holistic approach to neutralise mismatches
- Terminology and lack binding guidance provides risk inconsistent implementation
- Interrelation ATAD I & II vs. CC(C)TB unclear

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