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PLATFORM FOR TAX GOOD GOVERNANCE

**Discussion paper on hybrid mismatches in relation to third
countries**

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HYBRID MISMATCHES IN RELATION TO THIRD COUNTRIES - THE WAY FORWARD

Hybrid mismatch arrangements exploit differences in the tax treatment of an entity (for example a partnership) or an instrument (for example a subordinated bond loan) under the laws of two or more tax jurisdictions to achieve double non-taxation in the form of a double deduction or a deduction without inclusion. A hybrid mismatch may also occur in case of a different treatment of branch activities leading to non-taxation without inclusion (hybrid permanent establishment mismatch). Hybrid mismatch arrangements are widespread and result in a substantial erosion of the taxable bases of corporate taxpayers in the EU. Therefore, it is necessary to lay down rules against this kind of tax base erosion.

What has been done?

The hybrid mismatch rules in the Anti-tax avoidance directive (hereinafter: ATAD) tackle the most widespread forms of hybrid mismatches, but only within the EU: the ATAD rules target hybrid entity mismatches and hybrid financial instrument mismatches between a taxpayer in a MS and an associated enterprise in another MS or from a structured arrangement between parties in MSs.

What remains to be done?

While the rules in the ATAD are an important step in countering hybrid mismatch arrangements it is critical that further work is undertaken on hybrid mismatches involving third countries. Also other hybrid mismatches such as those involving permanent establishments should be addressed in both their intra-EU and third-country dimension.

As part of the final compromise proposal for the ATAD that was agreed on 20 June 2016, the ECOFIN Council issued a statement on hybrid mismatches. In this statement the ECOFIN Council requests the Commission to put forward by October 2016 a proposal on hybrid mismatches involving third countries in order to provide for rules consistent with and no less effective than the rules recommended by the OECD BEPS report on Action 2¹, with a view to reaching an agreement by the end of 2016.

Scope

The proposal for the directive could take the form of an amendment to the ATAD. This means that the elements of the scope of the new directive would be the same. As recommended in said OECD report the rules on hybrid mismatches in the ATAD apply only if there is a situation between a taxpayer and an associated enterprise or in case of a structured arrangement between parties. Furthermore, the ATAD applies to all taxpayers subject to corporate tax in one or more MS. Consequently, the provisions of the proposal should only apply to existing corporate taxpayers in the EU involved in a hybrid mismatch arrangement and thus not include new categories of taxpayers.

In recital 13 of the ATAD it is stated that rules on hybrid mismatches are not intended to affect the general features of the tax system of a Member State. It is considered that the proposal will follow the same approach. Consequently, the proposal will not be intended to address situations in which little or no tax has been paid due to a low tax rate or the tax system of a third country. Those situations were intended to be dealt with by the switch-

¹ <http://www.oecd.org/ctp/beps-2015-final-reports.htm>

over clause in the COM proposal for the ATAD. However, during the discussions in Council it turned out that a vast majority of MSs did not favour such a clause.

The OECD report also includes recommendations for rules on hybrid transfers (as part of the rules on hybrid financial instruments), imported mismatches and dual resident mismatches. The proposal for a Directive could also comprise these categories of hybrid mismatches.

Approach

The recommendations in the OECD report on neutralising hybrid mismatch arrangements take the form of rules which neutralise the effect of a hybrid mismatch. The hybrid mismatch rules as agreed in the final compromise on the ATAD are based on the OECD approach in the sense that they neutralise the effect of a hybrid mismatch. Against this background and given the ECOFIN Council statement it would be obvious that the rules in the proposal should be based on the same approach.

POINTS FOR DISCUSSION

Question

- 1. What are Platform members' views on the forthcoming proposal on hybrid mismatches?**
- 2. Do Platform members agree that the proposal should be an amendment to the ATAD?**
