

Amendments to the EU-ATAD suggested to cover hybrid mismatches with third countries

The European Commission issued a proposal for an amendment to the EU ATAD (Anti Tax Avoidance Directive). It is targeting hybrid mismatches with third countries and would require Member States to enact domestic legislation by December 31, 2018 at the latest.

EU Anti Tax Avoidance Directive

On June 20, 2016, agreement was reached at European Level on the EU Anti Tax Avoidance Directive ("ATAD"). The ATAD sets a minimum standard for (EU) Member States and includes rules that target hybrid mismatches between Member States. Currently, hybrid mismatches with third (i.e. non-EU) countries are out of scope of the ATAD. Simultaneously, however, the ECOFIN Council requested the European Commission ("EC") to put forward a proposal on hybrid mismatches involving third countries by October 2016. Such proposal was to provide for rules consistent with and no less effective than the rules recommended by the OECD BEPS report on Action 2 (i.e. hybrid mismatches), with a view to reaching an agreement by the end of 2016.

On October 25, 2016 the EC issued their proposal for an amendment to the ATAD ("the ATAD2-Proposal"). The key aspects thereof are outlined below.

Proposed amendments to the ATAD

The Proposal would amend the ATAD in two main articles: it would significantly extend the definition of hybrid mismatches and it would amend and extend the rules that would deal with hybrid mismatches. The current definition and rules only cover the following mismatches: (i) hybrid entity mismatches and (ii) hybrid financial instrument. By extending the definition and rules, the following new mismatches would also be covered by the directive: (iii) hybrid transfers, (iv) hybrid permanent establishment mismatches, (v) imported mismatches and (vi) dual resident mismatches. Except for imported mismatches and dual resident mismatches, as a minimum standard all of the mismatches regard both situations involving Member States only as well as those involving a Member State and a third country. Imported mismatches require a payment by a taxpayer from a Member State to a third country and the involvement of at least another third country because in an intra-EU-situation, the mismatch should no longer arise as Member States should implement the other hybrid mismatch rules. Dual resident mismatches require that the taxpayer is a resident for tax purposes in both a Member State and a third country.

The situations reflected above could have double deductions ("DD"), deductions without inclusion ("D/NI"), non-taxation without inclusion ("NT/NI") or double tax relief at source ("DTR") as an outcome. The Proposal therefore sets forth the measures to be taken by Member States should any of the above mismatches and outcomes occur, with specific measures for situations where the mismatch involves third countries. These measures are, depending on the situation, the denial of a deduction, inclusion of income or a limitation of tax relief at source. The following table summarizes the proposed measures:

Outcome type	Solution (EU only)	Solution (3rd country situations)
Art. 9.1: DD (hybrid entity and financial instrument)	Deduction only in source Member State ("MS")	MS to deny deduction unless already denied by 3rd country
Art. 9.2: D/NI (hybrid entity and financial instrument)	MS of payer to deny deduction	i) MS to deny deduction if MS is source state of payment; or ii) MS to include payment in tax base if 3rd country is source state unless 3rd country already denied deduction
Art. 9.3: NT/NI (permanent establishment)	MS of taxpayer's residency to include income attributed to PE in tax base	MS to include income attributed to 3rd country PE in tax base

Art. 9.4: DD (imported mismatch)	N/A, as Art. 9.1 should prevent mismatch to result in DD	MS to deny deduction unless already denied by one of the third countries
Art. 9.5: D/NI (imported mismatch)	N/A, as Art. 9.2 should prevent mismatch to result in D/NI	MS to deny deduction unless already denied by one of the third countries
Art. 9.6: DTR (hybrid transfer)	MS to limit benefit of relief in proportion to net taxable income	MS to limit benefit of relief in proportion to net taxable income
Art. 9a: DD (dual resident)	N/A	MS to deny deduction unless already denied by 3rd country

Effective date

It is proposed that the Member States have to enact the necessary legislation to comply with the amended directive by December 31, 2018 and apply these rules as of January 1, 2019 at the latest. This is the same effective date as for the major part of the ATAD which was already enacted.

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