



International Tax

EU Tax Alert

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ATAD proposed to be broadened to address hybrid mismatches with third countries

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On 25 October 2016, the European Commission issued a proposal to amend the EU Anti-Tax Avoidance Directive (ATAD) to prevent companies in the EU from using “hybrid mismatches” with non-EU member states to avoid being taxed in either country. The ATAD currently sets a minimum standard for EU member states and targets only hybrid mismatches between companies located in member states.

At the time ECOFIN agreed on the ATAD (20 June 2016), it asked the European Commission to put forward, by October, a proposal on hybrid mismatches involving third countries. The proposal should provide for rules consistent with, and no less effective than, the rules recommended in the OECD’s final report on action 2 (i.e. hybrid mismatches) of the BEPS project, with a view to reaching an agreement on the amended directive by the end of 2016.

Overview of proposal

The proposal put forward by the commission would expand the definition of hybrid mismatches to encompass the following:

- Hybrid entity mismatches;
- Hybrid financial instrument mismatches;
- Hybrid transfers;
- Hybrid permanent establishment (PE) mismatches;
- Imported mismatches; and
- Dual resident mismatches.

The first two mismatches already are included in the ATAD, but the other four are new. Except for imported mismatches and dual resident mismatches, the other mismatches can involve transactions between EU member states or 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. Dual resident mismatches require that the taxpayer be a resident for tax purposes in both a member state and a third country.

The above situations could have the following effects: double deductions (DD), deductions without inclusion (D/NI), nontaxation without inclusion (NT/NI) or double tax relief at source (DTR). The European Commission has proposed that member states be required to introduce rules to address any of the above mismatches, even where non-EU member states are involved in the transaction. Such rules include the disallowance of a deduction, the inclusion of income or a limitation of DTR.

The following table summarizes the various options:

Outcome	Rule (EU situation)	Rule (Third country situation)
DD (hybrid entity and financial instrument)	Deduction only in source member state (MS)	MS is to disallow a deduction unless the deduction already has been disallowed by the third country
D/NI (Hybrid entity and financial instrument)	MS of payer is to disallow a deduction	MS is to disallow a deduction if the MS is the source state of the payment, or the MS is to include payment in the tax base if the third country is the source state, unless the third country already disallowed the deduction
NT/NI (PE)	MS where the taxpayer is resident is to include income attributed to the PE in its tax base	MS is to include income attributed to the third country PE in its tax base
DD (Imported mismatch)	N/A	MS is to disallow a deduction unless the deduction already has been disallowed by the third country
D/NI (Imported mismatch)	N/A	MS is to disallow a deduction unless the deduction already has been disallowed by one of the third countries
DTR (Hybrid transfer)	MS is to limit the benefit of relief in proportion to the net taxable income	MS is to limit the benefit of relief in proportion to the net taxable income
DD (Dual resident)	N/A	MS is to disallow a deduction unless the deduction already has been disallowed by the third country

Effective date

EU member states have until 31 December 2018 to transpose the current ATAD into domestic law so that the rules would apply as from 1 January 2019 (except for the exit taxation rules, for which member states have until 31 December 2019). In addition, member states that have targeted rules that are equally effective to the interest limitation rules may apply them until the OECD agrees on a minimum standard, or 1 January 2024 at the latest. If adopted, the proposal is scheduled to become effective no later than 1 January 2019.

Comments

The proposal to amend the ATAD is part of a broader package announced by the commission of plans to overhaul the way in which

companies are taxed in the single market (the package includes a re-launching of the common consolidated corporate tax base project and a proposed directive on double taxation dispute resolution) and another tool for governments in the international fight against BEPS.

Changes still may be made to the commission's proposal, and it is unclear whether the member states will agree to the changes. In its current form, the proposal could have a significant impact on businesses. Also, taking into account that the OECD BEPS report on Action 2 is not a minimum standard, an item for potential further discussion is the proposed effective date, transitional periods and/or the need for grandfathering rules.

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