



An Roinn Airgeadais  
Department of Finance

# ATAD Implementation Anti-Hybrid Rules

## Feedback Statement

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# 1. Introduction

On 14 November 2018, the Department of Finance launched a public consultation on the implementation of the interest limitation and anti-hybrid rules contained in Council Directive (EU) 2016/1164 of 12 July 2016 (the Anti-Tax Avoidance Directive or ATAD), as amended by Council Directive (EU) 2017/952 of 29 May 2017 (ATAD2).

The ATAD anti-hybrid rules are largely contained in ATAD2, which extended the basic anti-hybrid provisions of the first ATAD to include hybrid Permanent Establishment mismatches, hybrid transfers, imported mismatches, reverse hybrid mismatches and dual resident mismatches, and extended the scope of the provisions to include mismatches involving third countries. The implementation deadline for the anti-hybrid rules was extended to 1 January 2020, with the exception of the anti-reverse hybrid rules which must be implemented by 1 January 2022.

The anti-hybrid provisions are aimed at preventing taxpayers from engaging in tax system arbitrage. That is, exploiting differences in the tax systems of countries to give rise to either double deduction mismatch outcome (where an expense is deductible for tax purposes twice) or deduction without inclusion mismatch outcome (where a payment is deductible but the person who receives the payment does not see it as taxable).

Many of the submissions to the public consultation noted the complexity and highly technical nature of the anti-hybrid rules, which will introduce many new concepts into Irish tax law for the first time. In some instances, clarity is also required on current domestic tax practices in order for the anti-hybrid rules to operate effectively (e.g. classifying foreign entities for the purposes of taxing income). Many submissions also noted the difficulties and unintended consequences that have been encountered in other jurisdictions where these rules have already been implemented, due to their novel and complex nature.

It was therefore a common request in the submissions that the Department consult with stakeholders to the greatest extent possible in the development of anti-hybrid legislation, and provide sufficient advance notice on technical details of the anti-hybrid rules to enable taxpayers to understand how the new rules will operate from 1 January 2020.

The Department is therefore publishing this Feedback Statement to respond to the views expressed in responses to the public consultation and to set out possible approaches to some of the technical aspects of anti-hybrid rules.

The views of stakeholders will be important in ensuring that Ireland's anti-hybrid rules, when introduced, meet the standards required under ATAD while also being clear and operable in practice and remaining consistent with Ireland's long-standing focus on the taxation of activities with substance in Ireland.

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## 2. Definitions

To implement the anti-hybrid rules, there are a number of key technical concepts that must be defined in Irish tax law for the first time. These concepts are novel and highly technical. A particular complexity arises where these definitions have to make reference to both existing Irish law terms and structures and also to terms and structures under the law of other jurisdictions. Getting these technical definitions right will ensure that the anti-hybrid rules are as clear and unambiguous as possible, giving certainty to both taxpayers and Revenue in implementing these rules from 1 January 2020.

### 2.1 Associated Entities

The anti-hybrid rules apply to transactions between associated entities, as set out in Articles 2(4) and 2(10) ATAD. While Irish tax law has many definitions of ‘associated companies’, ‘control’ and ‘groups’, which are similar to the idea of ‘associated entities’, none of the existing provisions accurately reflect the requirements of Article 2(4).

In addition to setting out certain ownership levels at which two entities will be treated as associated, Article 2(4) also provides that any entities who are consolidated into the one set of financial statements will be treated as associated. To ensure that all companies are treated fairly, it is necessary to set out how companies who are members of groups who use accounting standards other than those used by Irish companies will be treated. This definition, which is at the core of the majority of the anti-hybrid rules, could be transposed into Irish law as follows:

‘entity’ means –

- (i) a person,
- (ii) a body of persons,
- (iii) a trust including legal arrangements having a structure or functions similar to trusts,
- (iv) an undertaking, or
- (v) any other agreement or arrangement

regardless of whether or not it has legal personality;

*...continued overleaf*

- (1) In this Part two entities shall be 'associated entities' of each other:
- (a) if one entity, directly or indirectly, possesses or is beneficially entitled to, or is entitled to acquire,
    - (i) where the other entity is a body corporate, not less than 25 per cent of the share capital of the other entity, or
    - (ii) in all other cases, an interest of not less than 25 per cent in the other entity;
  - (b) if one entity, directly or indirectly, is entitled to exercise, or is entitled to acquire the right to exercise, not less than 25 per cent of the voting power in the other entity; or
  - (c) if one entity holds such rights as would
    - (i) where the other entity is a body corporate, if the whole of the profits of that other entity were distributed entitle such entity to receive 25 per cent or more of the profits so distributed, or
    - (ii) in all other cases, if the share of the profits of that other entity, to which such entity is entitled, is 25 per cent or more of the profits of that other entityand all entities in which one entity holds at least a 25 per cent interest under paragraphs (a), (b) or (c) shall be associated entities of each other.
- (2) The rights of any entities who act together in respect of the voting rights or ownership of an entity shall, for the purposes of subsection (1) be treated as being rights of all such entities.
- (3) For the purposes of
- (a) Chapter X [double deductions],
  - (b) Chapter X [disregarded permanent establishments],
  - (c) applying this Part to hybrid entities, and
  - (d) Chapter X [imported mismatches]
- references to "25 per cent" in subsection (1) shall be read as references to "50 per cent".
- (4) (a) In this subsection, 'non-consolidating entity' is an entity which would be valued in a consolidated financial statement
- (i) using fair value accounting, or
  - (ii) on the basis that it is an asset held for sale or held for distribution,
- all within the meaning of international accounting standards. *...continued*

- (b) An entity shall also be an associated entity of any entity:
- (i) that is included in the same consolidated financial statements prepared under:
    - (I) international accounting standards, or
    - (II) Irish generally accepted accounting practice,
  - (ii) where the parent company prepares its accounts under an accounting practice other than those referred to in subparagraph (i), that would be included in the same consolidated financial statements if such financial statements were prepared under international accounting standards,
- other than a non-consolidating entity.
- (c) Where the parent company would not be required to:
- (I) prepare consolidated accounts under international accounting standards, or
  - (II) include the results of an entity in those consolidated financial accounts,
- an entity shall also be an associated entity of any entity over the management of which it exercises significant influence, within the meaning of international accounting standards, or which exercises significant influence over its management.
- (5) References in this Part to a transaction or arrangement between associated entities shall include entities which are or were associated entities at the time:
- (a) the transactions or arrangements were entered into,
  - (b) the transactions or arrangements were formed, or
  - (c) a payment arises under the transactions or arrangements.

## 2.2 Defining Mismatch Outcomes

The anti-hybrid rules apply to payments which give rise to:

- a double deduction mismatch outcome, or
- a deduction without inclusion mismatch outcome.

There are a number of key terms which need to be defined in order for these new concepts to be transposed into Irish tax law.

### 2.2.1 PAYMENT

An approach to defining a payment, which is not defined in ATAD, could be as follows:

'payment' means a transfer of money or money's worth but does not include any amount in respect of:

- (i) a transfer pricing adjustment, under provisions similar to Part 35A;
- (ii) any other payment that is deemed to arise solely for the purposes of domestic tax or foreign tax, including deemed equity deductions, and which does not involve any transfer of economic rights; or
- (iii) a movement in foreign exchange rates, other than in respect of an arrangement within the meaning of paragraph (c) of the definition of financial instrument;

and for the purposes of applying this Part to transactions or arrangements between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate, a payment shall also include the allocation of payments, profits or gains from one to another.

### 2.2.2 DEDUCTIONS

The concept of a deduction is set out in Article 2(9) 2<sup>nd</sup> (d) ATAD as an amount which is treated as deductible from taxable income. It could be given a more explicit definition in Irish law as follows:

'deduction' in respect of a payment means a payment -

- (i) which may be taken into account as expenditure or an expense in computing the profits on which tax falls finally to be borne,
- (ii) in respect of which an allowance for capital expenditure may be made, or
- (iii) which may otherwise be allowed or relieved

for the purposes of domestic tax or foreign tax, as the case may be;

'domestic tax' means income tax, corporation tax (including a charge under Part 35B) and capital gains tax;

'foreign tax' means a tax chargeable on profits or gains, under the laws of a territory other than the State, that is similar to a domestic tax, but excluding withholding taxes levied to the extent that they are refundable;



A 'double deduction', which is defined in Article 2(9) 3<sup>rd</sup> (b) ATAD, could be transposed into Irish law as follows:

'double deduction' means where —

- (i) one entity may claim a deduction in respect of a payment for the purposes of domestic tax and another entity may claim a deduction in respect of the same payment for the purposes of foreign tax, or
- (ii) one entity may claim a deduction in respect of the same payment for the purposes of both domestic and foreign tax.

Two terms integral to the concept of 'double deduction', and defined in Article 2(9) 3<sup>rd</sup> (c), are 'payer territory' and 'investor territory'. These could be transposed into Irish law as follows:

'payer territory' means the territory where the payment giving rise to the deduction is incurred, sourced or made, and payer shall be construed accordingly;

'investor territory' means a territory, other than the payer territory, where the amounts are deductible for tax purposes, and investor shall be construed accordingly;

### 2.2.3 INCLUSIONS

The concept of 'inclusion' is set out in Article 2(9) 2<sup>nd</sup> (e) ATAD and is referred to in Recitals 18, 19 and 20 thereof. It could be given a more explicit definition in Irish law as follows:

'inclusion' in respect of a payment means –

- (a) an amount of profits or gains that is chargeable in the hands of the payee to domestic tax or foreign tax, as the case may be, without any further action by the payee, including receiving any amounts from remittances payable in the State,
- (b) where the payee is a pension fund, government body or other entity who, under the laws of the territory in which it is established is exempt from tax which generally applies to profits or gains in that territory, the profits or gains are treated, under the laws of that territory, as arising or accruing to that entity,

*...continued overleaf*

- (c) where the payee is established in a territory that does not impose a tax, the profits or gains are treated, under the laws of that territory, as arising or accruing to the entity;
  - (d) in respect of a controlled foreign company charge, within the meaning of Part 35B, or a charge similar to the controlled foreign company charge imposed under the laws of another territory, the amount subject to the controlled foreign company charge,
- and included shall be construed accordingly;

A term integral to setting out when a deduction without inclusion mismatch outcome arises is 'payee territory', which is defined in Article 2(9) 3<sup>rd</sup> (c). It could be transposed into Irish tax law as follows:

- 'payee' means an entity
- (a) to whom a payment is made, or
  - (b) who
    - (i) under the tax laws of the territory in which that entity is resident, established or situated or under the tax laws of another territory, or
    - (ii) under the law of such territory where that territory does not impose a tax, is treated as receiving the payment without the payment passing through the hands of another entity, or
  - (c) in the case of a controlled foreign company charge, on which that charge is made;
- 'payee territory' means a territory in which a payee is resident, established or situated;

'Dual inclusion income', which is defined in Article 2(9) 2<sup>nd</sup> (g) ATAD, could be transposed into Irish law as follows:

'dual inclusion income', subject to section XXX [section dealing with worldwide tax systems], means any payment which is included in both territories where the mismatch outcome has arisen;

Ireland currently has a worldwide system of tax, whereby an Irish resident company is taxed on its worldwide profits. This means that the profits of an overseas branch of an Irish company are taxed in Ireland. ATAD is designed to neutralise hybrid mismatches, to counter tax avoidance and should avoid an adjustment where in reality no hybrid mismatch has occurred.

To prevent transactions that do not in reality give rise to a hybrid mismatch outcome being subjected to an adjustment under anti-hybrid rules, Irish tax law could provide as follows to ensure that only actual mismatch outcomes are addressed:

- (1) This section applies where a body corporate is taxable in the investor or payee territory, as appropriate (referred to in this section as the “first mentioned territory”) on its worldwide profits such that payments between:
  - (a) the head office of the body corporate and a permanent establishment of that body corporate, or
  - (b) between two or more permanent establishments of a body corporate,are disregarded (referred to in this section as “disregarded payments”) when computing the taxable profits of the body corporate in the first mentioned territory, under a provision the effect of which is similar to section 26(1)(a).
- (2) Where this section applies, and
  - (a) a payment is deductible against profits or gains in both a payer territory and in the first mentioned territory, but
  - (b) the profits or gains against which it is deductible in the payer territory are disregarded in the first mentioned territory,then the disregarded payment referred to in paragraph (b) shall be treated as included in the first mentioned territory for the purpose of determining under this Part whether a payment has
  - (i) been deducted against dual inclusion income, or
  - (ii) given rise to a deduction without inclusion mismatch outcome

## 2.3 Referring to similar rules in foreign territories

The structure of ATAD2 requires that countries implement a primary rule to neutralise the mismatch outcome in the country where it arises. Where the mismatch outcome isn't neutralised under a primary rule, then certain defensive rules may apply.

It is therefore necessary to define when other countries' primary rules may be treated as having neutralised a mismatch outcome, to prevent the Irish defensive rules applying when the mismatch outcome has already been neutralised. Provisions in foreign jurisdictions similar to Ireland's implementation of the anti-hybrid rules in ATAD could be identified in Irish tax law as follows:

A reference to a provision similar to this Part, in whole or in part, under the law of a territory, other than the State, means a provision enacted to

- (a) implement Directive (EU) 2016/1164,<sup>1</sup> as amended by Council Directive (EU) 2017/952, as regards hybrid mismatches with third countries (hereinafter referred to as 'ATAD2'),
- (b) implement the Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements published by the Organisation for Economic Cooperation and Development on 5 October 2015,
- (c) implement the Final Report on Neutralising the Effects of Branch Mismatch Arrangements published by the Organisation for Economic Cooperation and Development on 27 July 2017, or
- (d) otherwise counteract mismatch outcomes

where the provision has a similar effect to the corresponding provision in this Part.

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<sup>1</sup> OJ No. L144, 7.6.2017, page 1

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## 3. The anti-hybrid rules

For most rules, ATAD Article 1(1) sets out to whom the rule must be applied while Article 2(9) 2<sup>nd</sup> (c) sets out the transactions or arrangements to which the rules must be applied.

Different anti-hybrid rules apply in slightly different situations so it is important that the rules governing the application of each rule are clearly set out to avoid confusion. Therefore, for each rule below the scope must be clearly set out, to ensure that there is clarity on the circumstances in which each rule applies.

### 3.1 The rule against double deductions

#### 3.1.1 THE NORMAL RULE

Article 9(1) sets out that countries must implement both a primary and a defensive rule to counteract double deduction mismatch outcomes. The rule against double deduction could be set out in Irish tax law as follows:

#### **Chapter X. Mismatch outcomes – double deductions**

##### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to domestic tax.
- (2) This Chapter shall only apply to a transaction or arrangement that is:
  - (a) a transaction or arrangement between associated entities; or
  - (b) a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate.

##### **XXX. Double deduction**

- (1) A double deduction mismatch outcome will arise where it would be reasonable to consider that there is, or but for this section there would be, a double deduction, to the extent the payment is not, or would not be, deductible against dual inclusion income.

*...continued overleaf*

- (2) To neutralise a double deduction mismatch outcome that arises under this Chapter–
- (a) where the State is the investor territory, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the investor shall not be entitled to a deduction for the purposes of domestic tax; or
  - (b) where the State is the payer territory and a deduction has not been denied in the investor territory through the operation of a provision similar to paragraph (a), notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the payer shall not be entitled to a deduction for the purposes of domestic tax.

### 3.1.2 THE TAX RESIDENCY RULE

Article 9b provides that countries must neutralise double deduction outcomes that arise out of tax residency mismatches where a taxpayer is resident for tax purposes in two or more jurisdictions, to the extent that the double deduction is not offset against dual-inclusion income. Recital (11) ATAD2 provides that the Directive should not affect the allocation of taxing rights between jurisdictions under double tax agreements.

Article 9b, taking account of Recital (11), could be transposed into Irish law as follows:

#### **Chapter X Mismatch outcomes – tax residency mismatch**

##### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to
  - (a) domestic tax because it is tax resident in Ireland under section 23A, and
  - (b) foreign tax in a territory outside of the State because it is regarded as tax resident in that territory under the tax laws of that territory.
- (2) This Chapter shall only apply to a transaction or arrangement that is:
  - (a) a transaction or arrangement between associated entities; or
  - (b) a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate;

*...continued overleaf*

**XXX. Tax residency mismatch**

- (1) A tax residency double deduction mismatch outcome will arise where
- (a) there is, or but for this section would be, a double deduction, to the extent the amount is not, or would not be, deductible against dual inclusion income, and
  - (b) the double deduction outcome referred to in paragraph (a) is attributable to the body corporate being within the charge to both domestic tax and foreign tax.
- (2) Subject to subsection (3), to neutralise a tax residency double deduction mismatch outcome that arises under this Chapter –
- (a) where the other territory is a relevant Member State, with the government of which arrangements having the force of law by virtue of section 826(1) have been made, and under those arrangements the company is tax resident in that other territory, or
  - (b) the other territory is not a relevant Member State and
    - (i) under arrangements with the government of which, having the force of law by virtue of section 826(1), the company is not tax resident in Ireland, or
    - (ii) under arrangements with the government of which, having the force of law by virtue of section 826(1), the company is tax resident in the State but a deduction has not been denied in the investor territory through the operation of a provision similar to paragraph (a),
- notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the body corporate shall not be entitled to a deduction for the purposes of domestic tax.
- (3) Where the tax residence of a body corporate must be determined by mutual agreement between the competent authorities of both territories which are party to an arrangement referred to in subsection (2), then any adjustment to the return, filed pursuant to Section 959I, required to give effect to subsection (2) shall be made without unreasonable delay upon that agreement, notwithstanding any time limits in Part 41A.

### 3.1.3 CARRY FORWARD

Where the anti-hybrid rules deny a deduction for a payment, that amount can be carried forward to future years, where it may be offset against dual inclusion income in those years. The carry forward provision could be framed as follows:

#### **XXX. Carry forward**

To the extent a deduction has been denied under this Part (the 'denied amount'), the body corporate may make a claim requiring that the denied amount be set off for the purposes of domestic tax against dual inclusion income in succeeding tax periods of the body corporate, and amounts so carried forward shall be relieved first against profits or gains of an earlier tax period in advance of profits or gains of a later tax period.



## 3.2 Deduction without inclusion outcomes

Article 9(2) sets out the rules which aim to prevent deduction without inclusion outcomes.

### 3.2.1 FINANCIAL INSTRUMENTS

ATAD2 contains a number of special rules which must be applied when looking at transactions involving financial instruments. Financial instruments, which are defined in Article 2(9) 1<sup>st</sup> (j) and 1<sup>st</sup> (k), could be defined in Irish tax law as:

'financial instrument' includes

- (a) securities, within the meaning of section 135(8),
- (b) shares,
- (c) other arrangements where it is reasonable to consider that such arrangements are, in substance, equivalent to a transaction for the lending of money, or money's worth, at interest, and
- (d) hybrid transfers.

'hybrid transfer' means any arrangement to transfer a financial instrument where

- (a) notwithstanding the legal form of the arrangement, one party to the arrangement has regard to the substance of the arrangement for domestic or foreign tax purposes, as the case may be, and
- (b) the other party to the transaction has regard to the legal form of the transaction for domestic or foreign tax purposes, as the case may be;

The first special rule which applies to financial instruments is that the definition of when a payment can be treated as 'included' is narrower than it is for other payments. The narrower treatment is set out in Article 2(9) 1<sup>st</sup> (a) and 2<sup>nd</sup> (e) and in and could be transposed into Irish tax law as:

A payment shall not be treated as included if

- (a) under the tax laws of the payee territory the amount that is charged to foreign tax is subject to any reduction computed by reference to the way the payment is characterised,
- or

*...continued overleaf*

- (b) (i) the payment has not been included in a tax period which commences within twelve months of the tax period in which the deduction occurred, or
- (ii) where the payment is not so included, it would not be reasonable to consider that:
  - (I) the payment will be included in a subsequent tax period, and
  - (II) the terms of the payment are those that would be entered into by way of a bargain made at arm's length.

Detailed aspects of the rule against a deduction without inclusion mismatch outcome for financial instruments are set out in Article 2(9) 1<sup>st</sup> (a), 2<sup>nd</sup> (a), 2<sup>nd</sup> (c), 3<sup>rd</sup> (c), 1<sup>st</sup> (k), and 1<sup>st</sup> (m). These rules could be implemented into Irish tax legislation as follows:

#### **Chapter X Mismatch outcomes – financial instruments**

##### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to domestic tax;
- (2) This Chapter:
  - (a) shall apply to a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate; and
  - (b) shall not apply to on-market hybrid transfers.

'on-market hybrid transfer' means any hybrid transfer that is entered into by a financial trader in the ordinary course of its trade of buying and selling financial instruments, provided the payer territory requires the financial trader to include as income all amounts received in relation to the transferred financial instrument;

'financial trader' means a body corporate who has entered into the financial instrument as part of a trade which involves regularly buying and selling financial instruments on that person's own account;

*...continued overleaf*

**XXX. Financial instruments**

- (1) A financial instrument deduction without inclusion mismatch outcome will arise where -
- (a) it would be reasonable to consider that there is, or but for this section would be, a deduction in the payer territory without inclusion of a corresponding amount in a payee territory; and
  - (b) the deduction without inclusion outcome referred to in paragraph (a) is attributable to differences in the characterisation
    - (i) of the instrument, or
    - (ii) of payments made under the instrumentfor the purposes of domestic tax and foreign tax.
- (2) To neutralise a deduction without inclusion mismatch outcome that arises under this Chapter
- (a) where the State is the payer territory, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the payer shall not be entitled to a deduction for the payment for the purposes of domestic tax, to the extent it is not included for the purposes of foreign tax, or
  - (b) where the State is the payee territory and a deduction has not been denied in the payer territory through the operation of a provision similar to paragraph (a),
    - (i) where the non-inclusion arises because of any provision of the Tax Acts or the Capital Gains Tax Acts, that provision shall be disapplied in calculating the amount on which the payee is charged to tax, and
    - (ii) in any other case, the payee shall be charged to tax under Case IV of Schedule D in its first tax period which commences within twelve months of the tax period in which the deduction occurred in respect of the amount of the deduction.

### **3.2.2 BANKING SECTOR – LOSS ABSORBING FINANCIAL INSTRUMENTS**

ATAD Article 9(4)(b) provides that Member States may exclude from the scope of deduction without inclusion rules mismatches resulting from a payment of interest under certain financial instruments. It references instruments with conversion, bail-in or write down features, issued for the sole purpose of satisfying loss absorbing capacity requirements applicable to the banking sector. ATAD provides that this exemption would cease on 31 December 2022.

However, it is also required that Member States implement the ATAD in a manner that is compliant with EU law, and it can be the case that specific targeted measures require consideration of State aid compatibility.

Having regard also to the time limit on the exemption, the Department is open to views from stakeholders on the potential to introduce this provision.

### **3.2.3 HYBRID ENTITIES**

Hybrid entities are entities which one country views as opaque and one views as transparent. The opportunity for tax system arbitrage therefore arises. The definition of a hybrid entity, which is defined in Article 2(9) 1<sup>st</sup> (i) ATAD, and the related definition of 'regarded as a person' could be transposed into Irish law as:

'hybrid entity' means

- (a) an entity that is regarded as a person for the purposes of domestic tax or foreign tax, as the case may be, under the law of any territory, and
- (b) where some or all of that entity's profits or gains are treated (or would be if there were any) for the purposes of tax charged under the laws of another territory, as arising or accruing to the beneficial owners of the entity without passing through the hands of the entity referred to in paragraph (a);

'regarded as a person' in respect of an entity means an entity that is regarded as owning or managing assets, including profits or gains derived therefrom, for the purposes of domestic tax or foreign tax, or under the laws of the territory in which an entity is established where that territory does not levy tax;

### **3.2.3.1 Foreign entity classification**

As a first step in determining whether or not an entity is a hybrid entity, clarity is required on how Ireland classifies that foreign entity for the purposes of the charge to income tax and corporation tax. That is, whether Ireland would view the entity as being opaque or transparent.

Submissions received to the public consultation process indicated a strong preference for foreign entity classification to be put on a statutory footing, and that the approach Ireland should take in viewing such entities is to follow the tax classification of the territory in which the entity is established.

In framing such legislation, the term “entity” would be interpreted consistently with the anti-hybrid rules, as suggested in Section 2 above. Tax legislation to provide that a foreign entity should have the same Irish tax classification as is provided for in the country of its establishment could be framed as follows:

- (i) where in respect of an entity:
  - (I) under the tax laws of the territory in which it is established, or
  - (II) if that territory does not impose a tax similar to income tax or corporation tax, under the law of that territory, any income, profits or gains are treated, or would be so treated but for an insufficiency of income, profits or gains, as arising or accruing to the beneficial owner(s) of that entity without passing through the hands of the entity, then those beneficial owners shall be treated, for the purpose of the Tax Acts, as the entity to whom that income, those profits or those gains arise or accrue, and
- (ii) in all other cases, the entity shall be treated, for the purpose of the Tax Acts, as a person, to whom that income, those profits or those gains arise or accrue.”

In determining the tax classification of foreign trusts, the term 'beneficial owner' must be defined and could be drafted as follows:

'beneficial owner'–

- (i) in the case of trusts means;
  - (I) the settlor(s);
  - (II) the trustee(s);
  - (III) the protector(s), if any;
  - (IV) the beneficiaries or where the individuals benefiting from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates; or
  - (V) any other natural person exercising ultimate control over the trust by means of direct or indirect ownership or by other means; and
- (ii) in the case of legal entities such as foundations and legal arrangements similar to trusts, means the natural person(s) holding equivalent or similar positions to those referred to in (i);

### **3.2.3.2 Anti-hybrid rules**

The rules to prevent a deduction without inclusion mismatch outcome in respect of a hybrid entity are found in Article 9(2) and Article 2(9) 1<sup>st</sup> (b), in respect of payments to a hybrid entity, and Article 2(9) 1<sup>st</sup> (e), in respect of payments by a hybrid entity. These rules could be implemented into Irish tax law as follows:

#### **Chapter X Mismatch outcomes – hybrid entities**

##### **XXX. Application of Chapter X**

This Chapter shall apply to

- (a) a transaction or arrangement between associated entities; or
- (b) a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate;

*...continued overleaf*

### **XXX. Payments to hybrid entities**

This section applies to a body corporate which is within the charge to domestic tax;

- (1) A deduction without inclusion mismatch outcome will arise in respect of a payment to a hybrid entity where -
  - (a) there is, or but for this section would be, a deduction in the payer territory without inclusion of a corresponding amount in the payee territory; and
  - (b) the deduction without inclusion outcome referred to in paragraph (a) is attributable to differences in the characterisation of the hybrid entity in the payee and payer territories.
- (2) To neutralise a deduction without inclusion mismatch outcome that arises under this Section where the State is the payer territory, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the payer shall not be entitled to a deduction for the payment for the purposes of domestic tax, to the extent it is not included for the purposes of foreign tax.

### **XXX. Payments by hybrid entities**

This section applies to a body corporate which is within the charge to foreign tax or domestic tax.

- (1) A deduction without inclusion mismatch outcome will arise in respect of a payment by a hybrid entity where -
  - (a) there is, or but for this section would be, a deduction in the payer territory without inclusion of a corresponding amount in the payee territory; and
  - (b) the deduction without inclusion outcome referred to in paragraph (a) is attributable to differences in the characterisation of the hybrid entity in the payee and payer territory.
- (2) To neutralise a deduction without inclusion mismatch outcome that arises under this Section -
  - (a) where the State is the payer territory, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, the payer shall not be entitled to a deduction for the payment for the purposes of domestic tax, to the extent it is not included for the purposes of foreign tax, or

*...continued overleaf*

- (b) where the State is the payee territory, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts,
- (i) where the non-inclusion arises because of any provision of the Tax Acts or the Capital Gains Tax Acts, that provision shall be disapplied in calculating the amount on which the payee is charged to tax, and
  - (ii) in any other case, the payee shall be charged to tax under Case IV of Schedule D in its first tax period which commences within twelve months of the tax period in which the deduction occurred in respect of the amount of the deduction.

### **3.2.4 THE RULE AGAINST DISREGARDED PERMANENT ESTABLISHMENTS**

Article 9(5), and how it interacts with Article 9(2), and paragraphs 1<sup>st</sup> (c), 1<sup>st</sup> (d) and 1<sup>st</sup> (f) of Article 2(9), set out the rule against deduction without inclusion mismatches arising from disregarded Permanent Establishments (PEs).

As Ireland has a worldwide system of taxation, an Irish tax resident company cannot have a disregarded PE in another jurisdiction. However it is possible that a company established in another jurisdiction with a territorial tax system may have a disregarded PE in Ireland. Ireland has the option to implement the defensive rule to prevent disregarded PEs being located in Ireland. The rule against disregarded PEs could be framed as follows:

#### **Chapter X Mismatch outcomes – disregarded permanent establishments**

##### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to foreign tax or domestic tax.
- (2) (a) For the purposes of this Chapter, “permanent establishment” means a permanent establishment within the meaning of Article 5 of the OECD’s Model Tax Convention on Income and on Capital: Condensed Version 2017, as it read on 21 November 2017;
- (b) This Chapter shall only apply to a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate.

*...continued overleaf*



### **XXX. Disregarded permanent establishments**

- (1) In this Section a 'disregarded permanent establishment' means any arrangement whereby -
  - (a) for the purposes of foreign tax, a body corporate that is not resident in the State is treated as having a permanent establishment in the State, and any of the profits or gains of that permanent establishment are not included, for the purposes of foreign tax; and
  - (b) that body corporate is not charged to domestic tax under section 25 in respect of the profits or gains referred to in paragraph (a).
- (2) A deduction without inclusion mismatch outcome will arise where, as a result of a disregarded permanent establishment, there is, or but for this section would be, a deduction for the purposes of foreign tax without inclusion of a corresponding amount for the purposes of domestic tax.
- (3) To neutralise a deduction without inclusion mismatch outcome that arises under this Chapter, where
  - (a) the State is the payee territory, and
  - (b) a deduction has not been denied through the operation of a similar provision in the payer territory which neutralises deduction without inclusion mismatch outcomesthen notwithstanding section 25, the profits and gains referred to in subsection (1)(a) shall be charged to corporation tax on the body corporate as if the business carried on in the State by the disregarded permanent establishment was carried on by a company resident in the State.

### 3.3 The rule against aggressive withholding tax arbitrage

Article 9(6) provides that, where two entities enter into a transaction with a view to tax relief being granted twice for the underlying withholding tax, then the amount of withholding tax relief which a country gives should be restricted to the amount of taxable income they recognise from that transaction.

It has been identified since the passing of ATAD2 that a transposition as required by the Directive may not be sufficient to counteract some identified hybrid mismatch schemes, therefore careful consideration is required to ensure the final legislation is robust and does not facilitate avoidance activities.

The scope of this rule is wider than the majority of the other anti-hybrid rules, in that it is the first of two rules which is not restricted to transactions between associated entities and in that it is not restricted to body corporates. Potential legislation could include:

#### **Chapter X Mismatch outcomes – withholding tax**

##### **XXX. Application of Chapter X**

This Chapter applies to an entity which is within the charge to domestic tax.

##### **XXX. Withholding tax on hybrid transfers**

- (1) A withholding tax mismatch outcome will arise where an entity
  - (a) enters into a hybrid transfer [as defined for the purposes of ‘financial instrument’ in 3.2.1 above] and
  - (b) it is reasonable to consider that the purpose of the hybrid transfer is to secure relief for an amount of tax withheld at source for more than one party.
- (2) To neutralise a withholding tax mismatch outcome arising under this Chapter, notwithstanding anything in Schedule 24 to the contrary, the relief available in respect of an amount of tax withheld at source shall be reduced by the following fraction

$$A / B$$

where

A is the profits of the entity from the hybrid transfer on which domestic tax finally falls to be borne, and

B is the gross income of the entity under the hybrid transfer.

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## 4. Anti-avoidance rules

Article 9(3) contains two anti-avoidance rules to prevent taxpayers circumventing the other rules contained within the Directive.

### 4.1 The rule against imported mismatches

An imported mismatch is defined in Article 9(3) (as are the operable parts of this rule), and referred to in Recital (25). An imported mismatch arises where the Irish taxpayer does not enter into a hybrid transaction, but they enter into series of transactions that gives rise to a hybrid mismatch outside of Ireland, the benefit of which is 'imported' into Ireland. The imported mismatch rules could be transposed into Irish tax law as follows:

#### **Chapter X Imported mismatch**

##### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to domestic tax;
- (2) This Chapter shall only apply to a transaction or arrangement that is:
  - (a) a transaction or arrangement between associated entities; or
  - (b) a transaction or arrangement between the head office of a body corporate and a permanent establishment of that body corporate, or a transaction or arrangement between two or more permanent establishments of a body corporate.

##### **XXX. Imported mismatch**

- (1) An imported mismatch outcome will arise where it would be reasonable to consider that
  - (a) a body corporate enters into an imported mismatch arrangement, being a transaction, or series of transactions, involving a mismatch outcome where a payment by that body corporate directly or indirectly funds the mismatch outcome, and
  - (b) the mismatch outcome has not been wholly neutralised through the operation of provisions similar to section 831 or this Part in another territory.
- (2) To neutralise an imported mismatch outcome that arises under this Chapter, the body corporate shall not be entitled to a deduction for so much of the payment as corresponds to the mismatch outcome which has not been neutralised in another territory.

## 4.2 The rule against structured arrangements

A structured arrangement is defined in Article 2(11), and the rule against structured arrangements is set out in Article 9(3). This is the second of two anti-hybrid rules which is not restricted to transactions with associated entities.

The structured arrangement rules could be implemented as follows:

### **Chapter X Structured arrangements**

#### **XXX. Application of Chapter X**

- (1) This Chapter applies to a body corporate which is within the charge to domestic tax;
- (2) This Chapter shall apply to a structured arrangement, which is an arrangement involving a transaction, or series of transactions, involving a mismatch outcome where
  - (a) the mismatch outcome is priced into the terms of the arrangement or
  - (b) the arrangement was designed to produce a hybrid mismatch outcome;

#### **XXX. Structured arrangements**

- (1) A structured arrangement mismatch outcome will arise where a body corporate, referred to in section X (section relating to structured arrangements) would reasonably be expected to be aware that
  - (a) it entered into a structured arrangement,
  - (b) it shared in the value of the tax benefit resulting from the mismatch outcome, and
  - (c) the mismatch outcome has not been wholly neutralised through the operation of provisions similar to this Part in another territory.
- (2) To neutralise a structured arrangement mismatch outcome that arises under this Chapter, the taxpayer shall not be entitled to a deduction for so much of the payment as corresponds to the mismatch outcome which has not been neutralised in another territory.

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## 5. Next Steps

The issues addressed in this document will continue to be considered by the Department until Friday 6<sup>th</sup> September 2019. However stakeholders are encouraged to contact the Department at the earliest opportunity in the event of any queries or comments, in order to ensure the timely preparation of legislation for publication in Finance Bill 2019.

Any queries on the material enclosed can be directed to the Department via the original consultation email address: [ctreview@finance.gov.ie](mailto:ctreview@finance.gov.ie)

Alternatively, responses may be directed by post to:

ATAD Implementation – Hybrids Feedback Statement  
Business Tax Team  
Department of Finance  
Government Buildings  
Upper Merrion Street  
Dublin 2, D02 R583

## Freedom of Information

Any interested parties are reminded that such contact is subject to the provisions of the Freedom of Information Acts.



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