An Roinn Airgeadais
Department of Finance

ATAD Implementation

Article 9a Reverse Hybrid Mismatches

Feedback Statement

July 2021

Prepared by the Tax Division
Department of Finance
www.gov.ie/finance

Contents

1 Introduction

1.1 Background

In order to lay down rules against tax avoidance practices that directly affect the functioning of the internal market, the EU passed Council Directive (EU) 2016/1164 (the Anti-Tax Avoidance Directive or ATAD) on 12 July 2016 and subsequently Council Directive (EU) 2017/952 (ATAD2) on 29 May 2017.

The anti-hybrid rules are largely contained in ATAD2, which extended the basic anti-hybrid provisions of the first ATAD and extended the scope of those provisions to include mismatches involving third countries.

Broadly, the anti-hybrid rules are aimed at preventing taxpayers from engaging in tax system arbitrage. The provisions seek to neutralise tax advantages, or mismatch outcomes, that arise due to arrangements that exploit differences in the tax treatment of an instrument or entity arising from the way in which that instrument or entity is characterised under the tax laws of two or more territories.

The first and most substantial part of the anti-hybrid rules was introduced in Finance Act 2019, as required by ATAD2. This Feedback Statement considers the remaining part of the rules, dealing with reverse hybrid mismatches, which must be implemented by 1 January 2022.

The Department of Finance first launched a public consultation on the implementation of the anti-hybrid rules (and the interest limitation rule) on 14 November 2018. While many of the submissions focused on the technical nature of the first part of the anti-hybrid rules, due to their earlier implementation date of 1 January 2020, it was a common request that the Department consult with stakeholders at a later date regarding reverse hybrid mismatches to enable taxpayers to understand how that rule will operate from 1 January 2022.

The Department is therefore publishing this Feedback Statement to respond to the views expressed in responses to the public consultation of 2018 and to set out possible approaches to some of the technical aspects of the anti-reverse hybrid rule.

1.2 Reverse hybrid mismatches (Article 9a)

Reverse hybrid mismatches are dealt with in Article 9a of ATAD, as inserted by ATAD2.

A reverse hybrid mismatch arises where an entity, referred to as a reverse hybrid entity, is treated as tax transparent in the territory in which it is established but is treated as a separate taxable person by some, or all, of its investors such that some, or all, of its income goes untaxed.

Article 9a (1) sets out the rule to address reverse hybrid mismatches. In broad terms, it provides that where, one or more associated investors regard the hybrid entity as a taxable person then the hybrid entity shall be regarded as a resident of the Member State in which it is established and taxed on its income to the extent that the income is not otherwise taxed under the laws of the Member State or any other territory.

1.3 Structure of this Feedback Statement

There are a number of technical aspects to be considered in implementing the reverse hybrid mismatch rule and these are considered in detail in Sections 3, 4, 5 and 6 of this Feedback Statement.

Article 9a (2) provides an exclusion to the reverse hybrid mismatch rule for collective investment vehicles. Section 2 of this Feedback Statement considers the meaning of the term “collective investment vehicle”.

1.4 Consultation period

The consultation period will run to **Tuesday 3rd August**. Any submissions received after this date may not be considered and early engagement is encouraged. Any queries or requests for clarification can be directed to ctreview@finance.gov.ie in advance of the consultation deadline.

1.5 How to respond

The preferred means of response is by email to ctreview@finance.gov.ie. If it is not possible to reply by email, or if you wish to make a submission both electronically and in hard copy, submissions may also be sent by post to:

ATAD Implementation
Reverse Hybrid Mismatches Feedback
Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2, D02 R583

Please include contact details if you are responding by post.

Please also indicate whether you are contributing to the consultation process as a professional adviser, representative body, business representative or member of the public.

Submissions received by e-mail will be acknowledged within 2 working days. If you do not receive an acknowledgement within this time, please contact the Department to confirm receipt.

1.6 Freedom of Information

Responses to this consultation are subject to the provisions of the Freedom of Information Act 2014. Parties should also note that responses to the consultation may be published on the Department of Finance's website.

1.7 Next steps

The Department of Finance will carefully consider the responses to this Feedback Statement and may invite key stakeholders to meet with them and with Revenue officials, by video conference or in person as appropriate under public health guidelines, in advance of the introduction of the reverse hybrid mismatch rule in Finance Bill 2021 with an effective date of 1 January 2022.

2 Collective investment vehicle

Article 9a(2) provides that the reverse hybrid mismatch rule, contained in Article 9a(1), shall not apply to a "collective investment vehicle".

"Collective investment vehicle" is defined for the purposes of this article as, an investment fund or vehicle that –

A. is subject to investor-protection regulation in the country in which it is established,
B. is widely held, and
C. holds a diversified portfolio of securities.

2.1 Condition A – investor-protection regulation

In Ireland, authorised investment vehicles are regulated by the Central Bank of Ireland as either Undertakings for the Collective Investment in Transferable Securities (UCITS), subject to the UCITS European Directives (Council Directive 2009/65/EC, Commission Directive 2010/43/EC and Commission Directive 2010/44/EC), or Alternative Investment Funds (AIFs), subject to the Alternative Investment Fund Managers Directive (Directive 2011/61/EU).

Both Directives set out EU standard levels of protection for investors so that all authorised investment vehicles established in Ireland are subject to investor-protection regulation in the State and therefore satisfy condition A.

For the purposes of tax, an Irish authorised investment vehicle is referred to as an "investment undertaking" and this term is defined in various parts of the Taxes Consolidation Act ("TCA") 1997 depending on the relevant tax provision. Accordingly, it is possible to use an existing tax definition for an Irish authorised investment vehicle when transposing the reverse hybrid mismatch rule.

The term "collective investment vehicle" could be transposed into Irish law as follows:

For the purposes of this chapter a 'collective investment vehicle' means –

(a) an investment undertaking within the meaning of section 739B,
(b) a common contractual fund within the meaning of section 739I, or
(c) an investment limited partnership within the meaning of section 739J

that –

(i) is widely held, and
(ii) holds a diversified portfolio of securities.

Question 1
Comments are invited on the suggested transposition of the term "collective investment vehicle". Is the meaning of "collective investment vehicle" as suggested appropriate in this context?

2.2 Condition B – widely held

To date, the terms "widely held" and "diversified portfolio of securities" are undefined for the purposes of Irish tax law. As such, their meaning requires further consideration for the purposes of implementing the reverse hybrid mismatch rule.

In simple terms, "widely held" is the opposite to "closely held" which typically is where a person or persons owns (or controls) an entity.

The concept of a "collector investor" is already defined for tax purposes in section 739B TCA 1997 in relation to an authorised investment company. Within that context, the definition consists of a number of limbs including being an investor who invests in property with monies contributed by 50 or more persons, none of whom has at any time contributed more than 5 per cent of such monies. It is suggested, however, that the term, as drafted, goes beyond what is intended by ATAD2 to be "widely held" and may be at odds with the meaning applied to the concept by other Member States. Accordingly, it is considered that an EU law based definition would be preferable, where available.

The term "beneficial owner" has recently been defined in the Fourth Anti-Money Laundering Directive (Council Directive (EU) 2015/849 of 20 May 2015 (AMLD4)), which has been transposed into Irish law by way of a number of legislative amendments in 2019[1] and 2020[2].

In broad terms, "beneficial owner" means any natural person who ultimately is entitled to, or controls, either directly or indirectly, more than 25 per cent of the capital (or units), profits or voting rights of the entity or otherwise controls the entity.

"Widely held", in relation to an investment undertaking, could be framed as meaning where no "beneficial owner", within the meaning of AMLD4, has been identified in relation to that undertaking.

For the purposes of anti-money laundering regulation, provision is made, under the relevant legislation, for situations where no beneficial owner can be identified in respect of an entity. Accordingly, "widely held" could be drafted in Irish law as meaning where the "beneficial owner" is identified under such provisions as they apply to the relevant undertaking.

[1] The European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2019 (S.I. 110 2019).
[2] The European Union (Modifications of Statutory Instrument No. 110 of 2019) (Registration of Beneficial Ownership of Certain Financial Vehicles) Regulations 2020 (S.I. 233 2020) and the Investment Limited Partnerships (Amendment) Act 2020.

Firstly, “beneficial owner” could be defined in Irish law as follows:

“beneficial owner”, as the context requires, has the same meaning as it has in –

(a) the European Union (Anti-Money Laundering: Beneficial Ownership of Corporate Entities) Regulations 2019 (S.I. 110 2019) (“the Principal Regulations”),

(b) the European Union (Modifications of Statutory Instrument No. 110 of 2019) (Registration of Beneficial Ownership of Certain Financial Vehicles) Regulations 2020(S.I. 233 2020) (“the Modified Regulations”),

(c) the Investment Limited Partnerships Acts 1994 and 2020, and

(d)the Investment Funds, Companies and Miscellaneous Provisions Acts 2005 and 2020.

Having defined “beneficial owner” for the purposes of Irish tax law, “widely held” could be framed as follows:

“widely held” in relation to a collective investment vehicle, means one where the beneficial owner of that collective investment vehicle, is identified, as the context requires, under –

(a) paragraph (4) of Regulation 5 of the Principal Regulations,

(b) paragraph (1) of Regulation 4 of the Modified Regulations,

(c) subsection 3 of section 27A of the Investment Limited Partnerships Acts 1994 and 2020, or

(d) subsection 3 of section 18A of the Investment Funds, Companies and Miscellaneous Provisions Acts 2005 and 2020.

Question 2

Comments are invited on the possible meaning of “widely held”.

(i) Is the use of the term “beneficial owner”, within the meaning of the relevant legislation, the purpose of which is to implement the requirements of AMLD4, appropriate in this context?

(ii) The term “beneficial owner”, as suggested, is a recently-transposed EU standard term and one which an Irish fund vehicle is required to identify under the relevant AML legislation. Accordingly, it is suggested that the use of this term for the purposes of defining “widely held” should provide certainty to all funds without being unnecessarily administratively burdensome for the taxpayer. Comments are invited regarding this analysis.

Question 3
In applying the "widely held" test, as suggested, an entity will be required to identify the natural person who, directly or indirectly, owns or controls, as the case may be, the entity. This requirement effectively means that the ownership and/or control of an entity is traced through any relevant chain in a master/feeder structure in order to identify the individual owner, or owners, who ultimately have control at the top level of that structure. Comments are invited as to whether this approach is appropriate in determining whether an entity is, or is not, ultimately "widely held".

2.3 Condition C – diversified portfolio of securities

Whether or not a fund holds a diversified portfolio of securities will depend on the meaning given to the phrase. In transposing this requirement, it may be desirable to give greater certainty to taxpayers.

Question 4
Comments are invited on whether or not it is desirable to provide for a definition of 'diversified portfolio of securities' in Irish tax law, or whether the term as used in ATAD is sufficiently clear as to not require any definition in Irish law.

Question 5
If it is desirable to provide a definition in Irish tax law, comments are invited on how that possible definition of "diversified portfolio of securities" might be framed.

2.4 Timing of the conditions

It was identified during the public consultation process in 2018 that, when a fund is being created or being wound down, it may temporarily fail either of the tests set out in condition B and C, despite the purpose of the fund being to hold a diversified portfolio of investments and be widely held.

One way in which this could be managed would be to include a purpose test (that is, the fund intends to meet condition B and C) and also a definite period within which the fund ought to meet the test. On cessation, the purpose test would be applied over the life of the fund in order to determine whether conditions B and C were met over the duration of that period.

This purpose test could be framed as follows:

(X) Each of the conditions [B and C] shall be regarded as having been met if –

(a) that condition is reasonably expected to be met within the period of [X] commencing on the date on which the entity is established or,

(b)that condition was met for a continuous period of [X] ending no longer than [X] prior to the commencement of the winding down of the entity, and such winding down shall take no longer than [X].

Question 6

Comments are invited on the application of a purpose test in determining whether an investment undertaking meets the condition of being “widely held” or holding a “diversified portfolio of securities” in order to fall within the definition of a “collective investment vehicle”. What time frame for [X] is reasonable when applying the purpose test at the commencement or cessation of the fund?

3 Application of the rule

3.1 Associated entities

Article 9a(1) provides that the rule shall apply where one or more associated non-resident entities regard the hybrid entity as a taxable person. Accordingly, the rule applies where the reverse hybrid mismatch arises between associated entities.

There is a requirement for the associated entity or entities to hold in aggregate a direct, or indirect, interest in 50 per cent or more of the voting rights, capital interests or rights to a share of the profit in the hybrid entity.

The term "associated enterprises" is defined for the purposes of the existing anti-hybrid rules in section 835AA of the Taxes Consolidation Act 1997. In that context, "enterprise" means an entity or an individual. Subsection 5 of that section applies a 50 per cent requirement in terms of capital interests, voting rights and rights to a share in profits of an entity when applying the definition of "associated enterprises" to the anti-hybrid rules relating to hybrid entities.

Accordingly, the existing definition of "associated enterprises" could be amended to form a definition for "associated entities".

"Associated entities" could be defined as follows:

"associated entities" has the same meaning as "associated enterprises" in section 835AA as if references to enterprises in that section were references to entities.

Question 7

Consistent with the language contained in Article 9a(1), the suggested wording would apply the rule where a reverse hybrid mismatch arises between "associated entities". Comments are invited as to this definition.

3.2 Application of chapter

As different anti-hybrid rules apply in slightly different situations, the application of each rule is clearly set out in Part 35C of the Taxes Consolidation Act 1997 to avoid confusion.

Similarly, the application of the reverse hybrid mismatch rule must be clearly set out to ensure that there is clarity on the circumstances in which the rule applies.

- Article 1(2) provides that Article 9a is to apply to all entities that are treated as transparent for tax purpose by a Member State.
- Article 9a(1) sets out that rule applies where the reverse hybrid mismatch arises between associated entities.
- Article 9a(2) provides that Article 9a(1) shall not apply to a collective investment vehicle.

Accordingly, the application of the reverse hybrid mismatch rule could be framed as follows:

This Chapter shall apply –

(a) to an entity established in the State that for the purposes of the Acts —

(i) is not chargeable to tax in respect of its profits or gains, and

(ii) the profits or gains of which are treated, or would be so treated but for an insufficiency of profits or gains, as arising or accruing to the participator, and

(b) to a mismatch outcome that arises between associated entities other than where the entity referred to in paragraph (a) is a collective investment vehicle.

Question 8

Comments are invited regarding the proposed application of the reverse hybrid mismatch rule.

4 The reverse hybrid mismatch rule

4.1 Purpose of the rule

ATAD2 is clear that the anti-hybrid rules should not affect the general features of the tax system of a Member State (Recital 9 and 24) nor should they affect the tax-exempt status of an entity (Recital 18, 19 and 20).

The objective of ATAD2 is to establish rules that are consistent with and no less effective than the rules recommended by the OECD report on Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report3 (OECD BEPS Action 2 Report)(Recital 5).

Chapter 4 of the OECD BEPS Action 2 Report contains Recommendation 4 which addresses deduction/non-inclusion outcomes that arise when a payment is made to a reverse hybrid entity. Recommendation 4.3 is clear that the rule only addresses hybrid mismatches and states that the *"Rule only applies to hybrid mismatches…..A payment results in a hybrid mismatch if a mismatch would not have arisen had the accrued income been paid directly to the investor".*

Chapter 5 sets out three specific recommendations for the tax treatment of reverse hybrid entities. Recommendation 5.2 specifically deals with limiting the tax transparency of a reverse hybrid entity for non-resident investors. It states in par. 170 that *"Recommendation 5 sets out improvements that jurisdictions could make to their domestic law that will reduce the frequency of hybrid mismatches by bringing the tax treatment of cross-border payments made to transparent entities into line with the tax policy outcomes that would generally be expected to apply to payments between domestic taxpayers."*

Accordingly, the objective of the recommendations is to bring cross-border transactions in line with domestic transactions, thus removing any hybrid element without changing the ultimate tax policy.

Having regard to the above, the purpose of the reverse hybrid mismatch rule is to only address mismatches that arise as a consequence of hybridity.

[3] Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report

Therefore, the reverse hybrid mismatch rule could be framed subject to the following:

A reverse hybrid mismatch outcome shall not arise under subsection (1) in respect of the profits or gains of the entity where the participator concerned is an entity that,

(a) 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,

(b) is established in a territory, or part of a territory, that does not impose a foreign tax, or

(c) is established in a territory that does not impose a tax that generally applies to profits or gains derived from payments receivable in that territory by enterprises from sources outside that territory.

Question 9
Comments are invited regarding framing the reverse hybrid mismatch rule, as suggested, subject to the text of ATAD2 in Recital 9 and 24 (relating to the general features of the tax system of a Member State) and Recitals 18, 19 and 20 (relating to the exempt status of an entity) and also taking account of the commentaries in the OECD BEPS Action 2 Report.

4.2 Definition of reverse hybrid mismatch outcome

The objective of Article 9a(1) is to capture income that is not otherwise taxed under the laws of the Member State or any other jurisdiction because the entity is a reverse hybrid (treated as tax transparent in the Member State in which it is established but treated by the jurisdiction in which some or all of its investors are established as a separate taxable person).

Accordingly, a reverse hybrid mismatch outcome could be set out in Irish law as follows (overleaf):

A reverse hybrid mismatch outcome shall arise where –

(a) some, or all, of the profits or gains of an entity are not, or but for this section would not be, subject to tax for the purposes of domestic tax or foreign tax, and

(b) the satisfaction of the condition described in paragraph (a) is attributable to those profits or gains being regarded by one or more participator, for the purposes of the tax law of the territory or territories in which the participator concerned is established, as arising or accruing directly to that entity.

Question 10
Comments are invited regarding the suggested definition of a reverse hybrid mismatch outcome.

4.3 The charge to tax

Article 9a provides that where a reverse hybrid mismatch outcome arises the reverse-hybrid entity shall be regarded as a resident of the Member State and taxed on its income.

The charge to tax could be transposed into Irish law as follows:

(X) A reverse hybrid mismatch outcome shall be neutralised, notwithstanding any other provision of the Tax Acts and the Capital Gains Tax Acts, by the profits and gains referred to in section XXX being charged to corporation tax on the entity concerned as if the business carried on in the State by the entity was carried on by a company resident in the State.

Question 11
Comments are invited on the mechanics of the charge to tax where the reverse hybrid mismatch rule applies.

5 Scope of application of the reverse hybrid mismatch rule

5.1 Scope of application of the chapter

Article 2(3) sets out that the provisions necessary to comply with Article 9a shall apply from 1 January 2022.

Accordingly, the scope of application of the reverse hybrid mismatch rule could be framed as follows:

Scope of application of this chapter

XXX. Notwithstanding section 835AW, this Chapter shall apply to tax periods commencing on or after 1 January 2022.

Question 12

Comments are invited regarding the scope of application of the reverse hybrid mismatch rule.

6 General matters

ATAD2 is clear that any adjustments that are required to be made under the Directive should in principal not affect the allocation of taxing rights that have been laid down under a double taxation treaty (Recital 11). That is, if the business carried on by the entity is one where the double tax treaty allocates primary taxing rights to the territory of the participator then, notwithstanding the reverse hybrid mismatch rule, Ireland should not tax the profits of that business. Of equal importance in considering how this rule is transposed is whether or not any tax that Ireland does impose ought to be available for double tax relief in the other jurisdiction.

In order to give effect to Recital 11 of ATAD2, the reverse hybrid rule could be framed with the following:

Where, in respect of a hybrid entity, a participator is resident in a territory with the government of which arrangements having the force of law by virtue of section 826(1) have been made, then any corporation tax being charged on that entity by virtue of subsection (X) shall take account of the provisions of those arrangements.

Question 13
Technical analysis is invited as to how the interaction of the reverse hybrid mismatch rule with double tax treaty provisions might be managed if/when required.

Question 14
Comments are invited regarding any technical aspects and/or other matters regarding the implementation of the reverse hybrid mismatch rule that have not been included in this Feedback Statement.

An Roinn Airgeadais
Department of Finance

Tithe an Rialtas. Sráid Mhuirfean Uacht,
Baile Átha Cliath 2, D02 R583, Éire
Government Buildings, Upper Merrion Street,
Dublin 2, D02 R583, Ireland

T:+353 1 676 7571
@IRLDeptFinance
www.gov.ie/finance