

ACTION 2: NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

Background Documents:

OECD Discussion Draft (Treaty issues):	March 19 th , 2014
OECD Discussion Draft (Domestic law issues):	March 19 th , 2014
BIAC Response:	May 2 nd , 2014
OECD 2014 Report:	September 16 th , 2014
OECD 2015 Report:	October 5 th , 2015

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TOPIC	BIAC COMMENTS	OECD RESPONSE
Complexity and compliance	1. Information reporting itself could create substantial complexity and an administrative/compliance burden.	The substantial compliance burden is acknowledged in the Final Report in respect of the disregarded hybrid payment rules and the deductible hybrid payment rules. In these cases, tax administrations may consider simpler implementation solutions if they produce substantially similar results.
Double taxation	2. The proposed rules, which are designed to eliminate cases of double non-taxation, might produce double taxation.	Rule-order defined in Final Report with a primary and defensive rule which should address some double taxation concerns. Chapter 9 calls for countries to coordinate domestic implementation to avoid potential double taxation.
	3. BIAC recommends that taxation under CFC rules be taken into account in all categories of transactions. To the extent that the CFC rules operate to tax income, there is no need for the hybrid rules to apply. Failure to take account of taxation by an investor country under CFC rules can lead to double taxation.	The hybrid rules are not intended to apply where it can be demonstrated to the relevant tax authorities that a payment is taxed under the CFC rules of the relevant jurisdiction at the full rate. However, the definition of what it means to subject to tax at the full rate is very narrow and an amount is only treated as included under a CFC regime if it "does not carry any entitlement to any credit or other relief" (para 38). There is therefore a risk the hybrid rules will apply in circumstances not specifically intended, creating double taxation. For example, a CFC inclusion under the US rules would not exclude a taxpayer from the hybrid rules.
	4. Close coordination with other BEPS Actions (including the work streams on CFCs, interest deductibility, and harmful tax practices) is imperative.	Interactions with the BEPS work streams on interest deductibility and CFCs noted. Final Report recommends CFC regimes are strengthened to target reverse hybrid and imported mismatch arrangements.
	5. Enactment of the proposed rules should be clearly linked to the	Comment not acknowledged.

Co-ordinated Action	adoption of strong and expeditious dispute-resolution processes, including MAP and binding arbitration for cross-border disputes.	
	6. BIAC recommends no action is taken to enact Action 2 until proposals under other Actions are developed.	Final recommendations released in package with the rest of Final Reports. However, implementation of domestic legislation at discretion of individual jurisdictions.
	7. BIAC recommends that a process be established to ensure that any action by countries to adopt hybrid rules be closely coordinated (e.g. deferral of any rule until a critical mass of countries has adopted similar limitations).	No formal process established. Changes to domestic law at the discretion of individual countries. Chapter 9 of the Final Report calls for co-ordination of implementation, including co-ordination of timings, between countries.
	8. The work on Tax-Structured Arrangements should be coordinated with the work on Action 12.	Comment not acknowledged.
	9. The proposed rules need to be compliant with EU law on the free movement of capital. Otherwise, different standards will likely apply to different regions. This may require further study.	Comment not acknowledged. Depending on if and how member states choose to adopt proposals into law, there is a risk of challenge under EU law where rules are not adopted into legislation consistently.
Withholding Tax	10. Clarification of rules with respect to interaction with withholding tax required. If the proposed rules apply, is there a denial of deduction plus the imposition of withholding tax; or a denial of deduction together with an elimination of withholding tax?	Denial of deduction plus the imposition of withholding tax. Tax credits available to recipient of income in proportion to net taxable income.
	11. BIAC recommends that the hybrid rules not apply if a payment is subject to withholding tax.	Comment not acknowledged – hybrid rule will apply to payments subject to withholding tax.
	12. BIAC requests that the OECD articulate the policy rationale for distinguishing between hybrid arrangements and other types of mismatches.	Comment not acknowledged.
	13. The proposal should not apply to transactions between	Recommended rules apply only to related party transactions and certain

Scope of rules	unrelated parties, except in the case of tax-structured transactions.	structured arrangements designed to produce a hybrid mismatch.
	14. A hybrid instrument should be limited to an instrument that represents an investment in debt or equity of a related party, except in the case of a tax-motivated “structured transaction”.	Rules apply only to instruments that are treated as debt, equity or derivative contracts under the tax laws of both the payer and payee and that are either between related parties or part of certain structured transactions.
	15. BIAC recommends that the definition of hybrid transfer for purposes of the proposed rules be limited, consistent with the definition of hybrid instrument, i.e. a limited to a transfer of an instrument that represents a debt or equity investment in an entity that is related to one of the parties to the transaction (except in the case of a tax-structured transaction).	Rules limited to transfer of instruments that are treated as debt, equity or derivative contracts under the tax laws of both the payer and payee and that are either between related parties or part of certain structured arrangements.
	16. The proposal should narrow and define in more detail what is meant by includable in “ordinary income”.	Expanded definitions of “includable in ordinary income” and “ordinary income” in Final Report but scope not narrowed.
	17. The affiliation threshold for the definition of a related party should be increased to a level of 25% or higher (in the absence of a more detailed definition that depends upon the facts).	Threshold for related parties increased to 25% in Final Report.
	18. Proposed rules apply automatically regardless of the parties’ intention in entering into the transaction, and without a qualitative assessment of whether the transaction achieves a tax result inconsistent with the policies of the countries involved.	There is no requirement for a tax avoidance intention for the rules to apply to related party transactions. Therefore there is a risk that genuine commercial arrangements could be caught by the rules. The rules only apply to unrelated parties in respect of certain structured arrangements, broadly those which are tax motivated.
	19. BIAC recommends that a carve-out be provided for hybrid regulatory capital, including intra-group hybrid regulatory capital.	The OECD has not adopted a specific proposal in respect of regulatory capital, and has instead left it to individual jurisdictions to determine themselves whether regulatory capital will be excluded.

	20. BIAC recommends that investors, as well as issuers, be excluded from the rules, except in the case of tax-structured transactions.	Investors/issuers not specifically excluded but the rules will only apply to related party transactions and certain structured arrangements.
Imported mismatches	21. The imported mismatch rule should not be included in the proposal.	Comment not acknowledged. The imported mismatch rule is included in the final recommendations.
	22. With respect to imported mismatches, a country would deny a deduction with respect to a non-hybrid transaction because other countries do not apply the proposed rules to an associated hybrid transaction. This gives rise to complexity and it would be very difficult to allocate taxing rights in such a circumstance.	Rules limited to intra-group imported mismatches and certain structured transactions. Final Report includes three tracing and priority rules to determine the extent to which a payment should be treated as set-off against a deduction under an imported mismatch arrangement. However, significant complexity remains.