



South Block
Longboat Quay
Grand Canal Harbour
Dublin 2

+353 1 663 1700
www.taxinstitute.ie

ATAD Implementation – Reverse Hybrids Mismatches Feedback Statement

Tax Division
Department of Finance
Government Buildings
Upper Merrion Street
Dublin 2
D02 R583

By email: ctreview@finance.gov.ie

23 August 2021

ATAD Implementation Article 9a Reverse Hybrid Mismatches Feedback Statement July 2021

Dear Sir/Madam

The Institute welcomes publication of the ATAD Implementation Article 9a Reverse Hybrid Mismatches Feedback Statement¹ (the Feedback Statement) and the opportunity to engage with the Department of Finance on the implementation into Irish law of the provisions of the Council Directive (EU) 2017/952 (ATAD2)² regarding reverse hybrid mismatches.

We have set out in the attached Appendix our remarks, based on the feedback we have received from our members, on the proposed approach to the implementation of the reverse hybrid mismatch provisions contained in the Feedback Statement.

¹ Department of Finance, ATAD Implementation – Article 9a Reverse Hybrids Mismatches, Feedback Statement, July 2021.

² Council Directive (EU) 2017/952 of 29 May 2017 (ATAD2) amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

Directors: Sandra Clarke, President, Peadar Andrews, Brian Brennan, Colm Browne, Oonagh Carney, Ian Collins, Amanda-Jayne Comyn, Maura Dineen, Karen Frawley, Stephen Gahan, Aileen Keogan, Aoife Lavan, Laura Lynch, Sarah Meredith, Colm O'Callaghan, Tom Reynolds, Kieran Twomey, Shane Wallace, Martin Lambe (Chief Executive).

Immediate Past President: Frank Mitchell.



Member of the Confédération
Fiscale Européenne

The Institute is a company limited by guarantee without a share capital (CLG), registered number 53699. The Institute is also a registered charity, number 20009533. EU Transparency Register No.: 08421509356-44

The Institute would be happy to engage further with the Department on the matters raised in this submission. Please contact Anne Gunnell at agunnell@taxinstitute.ie or (01) 6631750 if you require any further information.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Sandra Clarke', with a stylized flourish at the end.

Sandra Clarke
Institute President



APPENDIX

Response to Questions in the Feedback Statement

1. Collective Investment Vehicle

1.1 Condition A – investor-protection regulation

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?

Where the fund is an umbrella fund, we believe the definition of “collective investment vehicle” outlined in the Feedback Statement should be applied at the sub-fund level.

1.2 Condition B – widely held

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”.

Using the definition of beneficial owner as set out in AMLD4³ has the advantage of ensuring that entities can use the information already available to them as a result of the compliance checks required to be completed for the purposes of anti-money laundering legislation. However, in introducing the concept of beneficial ownership into Irish tax law for this purpose, careful consideration must be given, in our view, to any potential impact it may have for the purposes of Ireland’s double taxation agreements.

The Feedback Statement proposes that “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 AMLD4, a beneficial owner is a natural person who ultimately directly or indirectly owns or controls over 25% of the share capital or the voting rights or control by any other means.⁴

A beneficial owner of an entity may be identifiable under AML legislation notwithstanding that one would expect that the entity would be considered “widely held”. For example, if an individual held a 30% interest in an entity they would be considered a beneficial owner under the AMLD4 even though there may be 70 other investors each holding a 1% interest. It would seem unreasonable in those circumstances that the entity would not be considered “widely held”.

Article 9a of ATAD2 only applies where 50% of a relevant entity is controlled by one or more associated non-resident enterprises. Therefore, we suggest it would be appropriate for an entity to be considered “widely held” except where the aggregate interests of all identified beneficial owners is greater than 50%.

1.3 Condition C – diversified portfolio of securities

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.

We believe that defining the term ‘diversified portfolio of securities’ would provide certainty to taxpayers.

³ Council Directive (EU) 2015/849 of 20 May 2015.

⁴ Council Directive (EU) 2015/849 of 20 May 2015, Article 3 (6)(a)

Diversification requirements are imposed by the Central Bank of Ireland (CBI) in determining whether a fund has a diversified portfolio of securities. However, we do not consider it would be appropriate to use the CBI's criteria for the purposes of Irish tax legislation, as we understand its criteria varies depending on the fund type and investor type.

In our view, an alternative approach which could be considered would be to define a diversified portfolio of securities as one where no more than a given percentage (for example 20%) of securities held by a relevant entity are issued by the same institution or entity.

1.4 Timing of the conditions

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?

In our view, the application of a purpose test would be appropriate in determining whether an investment undertaking meets the condition of being “widely held” or holding a “diversified portfolio of securities”.

We believe that a period of 18 – 24 months would be reasonable when applying the purpose test at the commencement or cessation of the fund.

We consider it would also be appropriate to provide a timeframe in legislation to allow for scenarios where an entity may fail to satisfy the definition of widely held on a temporary basis due, for example, to an unforeseen change in the percentage holdings of its members. We suggest that if a relevant entity fails to meet the definition of widely held for a short period (for example, 30 days), the relevant entity could continue to be treated as widely held provided that the test is satisfied at the end of that period. This approach would avoid a situation arising where an entity is obliged to register for corporation tax for a short period and then de-register due to a temporary change in its status.

2. Application of the rule

2.1 Associated 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.

The Feedback Statement proposes that the definition of “associated enterprises” in section 835AA Taxes Consolidation Act 1997 (TCA 1997) could be amended to form a definition of “associated entities” for the purpose of the reverse hybrid rules. However, Article 9a of ATAD 2 uses the term “associated non-resident entities” which is not defined.

Article 2 (4) of ATAD 2 states that:

“For the purposes of Articles 9 and 9a:

(a) Where the mismatch outcome arises under points (b), (c), (d), (e) or (g) of the first subparagraph of point (9) of this Article or where an adjustment is required under Article 9(3) or Article 9a, the definition of associated enterprise is modified so that the 25 percent requirement is replaced by a 50 percent requirement;

(b) a person who acts together with another person in respect of the voting rights or capital ownership of an entity shall be treated as holding a participation in all of the voting rights or capital ownership of that entity that are held by the other person;

(c) an associated enterprise also means an entity that is part of the same consolidated group for financial accounting purposes as the taxpayer, an enterprise in which the taxpayer has a significant influence in the management or an enterprise that has a significant influence in the management of the taxpayer.”

In our view, the application of “associated enterprises” test for the purposes of Article 9a only refers to non-resident ‘entities’. Therefore, we do not consider that it would be appropriate to use the definition of “associated enterprises” in section 835AA TCA 1997 (as currently drafted) for the purpose of the reverse hybrid rules. Instead, we consider that the associate enterprises test should apply but only by reference to non-Irish resident “entities” and not all “enterprises”.

Furthermore, the definition of “associated enterprise” in section 835AA draws on the definition of “entity” in section 835Z TCA 1997 which includes a requirement to have a legal personality under the laws of the territory in which it is established. As a partnership does not have a separate legal personality, this means a partnership would not be considered an entity for the purposes of section 835Z.

However, ATAD2 defines a hybrid entity as meaning “*any entity or arrangement*”, which would suggest that partnerships are intended to be within the scope of the

Directive. Therefore, we believe an amended definition of “associated entities” would be required to ensure the Irish legislation operates in line with the intention of the Directive.

2.2 Application of chapter

Question 8:

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

We do not consider that the proposed application of the reverse hybrid mismatch rule aligns with Article 9a of ATAD2.

Article 9a of ATAD2 provides for the application of the reverse hybrid mismatch rule where there are “*one or more associated non-resident entities holding 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 profit in the hybrid*”. In our view, the 50% ownership requirement with respect to the hybrid entity is entirely separate from the “associated entities” test discussed under Question 7.

We believe it would not be appropriate to use the “associated entities” definition outlined in paragraph 3.1 of the Feedback Statement for the purposes of the application of the reverse hybrid rule. Article 9a of ATAD2 clearly provides that the reverse hybrid mismatch rule applies where one or more associated non-resident entities hold in aggregate 50% or more of the voting rights, capital interests or rights to a share of profit of the hybrid entity rather than where the investors are associated enterprises of the relevant entity.

The provision outlined in the Feedback Statement refers to an entity “established” in the State. As the term “established” has not been defined in the Feedback Statement, is it intended that the definition set out in section 835Z (4) TCA 1997 will apply for the purposes of the reverse hybrid rules?

Section 835Z (4) TCA 1997 provides that:

"A reference in this Part -

(i) to the territory in which an entity is established, shall -

(A) in a case in which the entity is registered, incorporated or created under the laws of one territory, but has its place of effective management in another territory, be construed as a reference to the territory in which the entity has its place of effective management, and

(B) in all other cases, be construed as a reference to the territory in which the entity is registered, incorporated or created,"

If the definition of “established” as set out in section 835Z (4) above would apply to the reverse hybrid rules, then the position of an Irish Common Contractual Fund with

a non-Irish manager, a similar non-Irish entity with an Irish manager or an Irish Investment Limited Partnership with an Irish or non-Irish general partner is unclear.

Article 9a refers to a hybrid entity "incorporated or established" in a Member State. In contrast, the other hybrid rules refer to the jurisdiction in which the entity is "established or registered". If it is the intention for the purposes of the implementation of the reverse hybrid rules to capture entities established under Irish law irrespective of where they are managed, we believe this should be clearly reflected in Irish law.

3. The reverse hybrid mismatch rule

3.1 Purpose of the rule

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.

We would agree with the proposed approach of framing the reverse hybrid mismatch rule subject to the text of Recitals 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) of ATAD2 and also taking account of the commentaries in the OECD BEPS Action 2 Report.⁵

We note that the draft provision outlined in the Feedback Statement does not encompass a number of the measures that are included in existing anti-hybrid rules. For example, where the income of the entity has been subject to tax under a remittance basis regime or has been subject to a Controlled Foreign Company charge, or similar foreign company charge. In our view, the rules for identifying a mismatch for the purposes of the application of the reverse hybrids mismatch rule should reflect the rules which apply in the existing general anti-hybrid mismatch provisions.

3.2 Definition of reverse hybrid mismatch outcome

Questions 10:

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

To ensure that only actual economic hybrid mismatches are neutralised, we suggest the provisions relating to a worldwide system of taxation in section 835AB TCA 1997 which apply to the existing anti-hybrid rules should similarly apply to the proposed

⁵ OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements: Action 2: 2015 Final Report.

definition of a reverse hybrid mismatch outcome. For example, this would allow for a scenario where a mismatch may arise but the direct participator's profits are taxed (whether in the same jurisdiction or another) under worldwide or group controlled foreign company rules.

In our view, the definition of "included" in section 835Z TCA 1997 would need to be amended to accommodate its use in this context, as the current definition focuses on payments, rather than profits. An amendment to the definition of payee may also be required, to take into account instances where the profits may in fact be subject to foreign tax in the hands of the ultimate parent entity (where such an entity is not a participator), through the operation of the global intangible low-taxed income (GILTI) or an equivalent foreign company charge.

3.3 The charge to tax

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

In our view, it may not be appropriate in all instances to neutralise a reverse hybrid mismatch outcome by treating the entity as an Irish resident company carrying on a business in the State. We would suggest that such an approach could give rise to inconsistent outcomes in certain cases. For example, in the case of regulated transparent funds it would seem more appropriate to apply the tax regime applicable to regulated corporate funds rather than treating it as an Irish resident company carrying on a business in the State.

The Feedback Statement notes that "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)".

In addition, the OECD BEPS Action 2 Report⁶ refers to bringing the profits for the reverse hybrid into scope of local taxation by treating the entity as a resident taxpayer:

*"In these circumstances Recommendation 5.2 provides that the establishment jurisdiction should treat the reverse hybrid as if it were a resident taxpayer. By treating the entity as a resident taxpayer, this will eliminate the need to apply the reverse hybrid rule to such entities and the investor jurisdiction could continue to include such payments in income under Recommendation 5.1 but provide a credit for any taxes paid in the establishment jurisdiction on the income that is brought into account under such rules."*⁷

⁶ OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements: Action 2: 2015 Final Report

⁷ OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements: Action 2: 2015 Final Report; para 175

Therefore, in our view, in neutralising a reverse hybrid mismatch outcome the option of applying exemptions available to similar entities locally is not precluded by either ATAD2 or the OECD BEPS Action 2 Report.⁸ We would suggest that the intention of ATAD2 is to ensure that the profits or gains arising from a particular activity are included for tax purposes in at least one jurisdiction and we believe that this should be reflected in the implementing legislation.

If policymakers do not adopt such an approach, we believe that the imposition of the reverse hybrid charge as a tax on the profits of the vehicle rather than on the distributions of the vehicle is likely to present issues in the context of Investment Limited Partnerships (ILP) and Common Contractual Funds (CCF). To the extent that tax is levied on an ILP or a CCF it will likely be discharged out of the fund's assets to the detriment of investors generally. For such funds, it would be more appropriate, in our view, to amend the provisions of section 739E TCA 1997 to arrange collection and discharge of any tax liability on behalf of certain unit holders without prejudicing the treatment of investors generally.

We also consider that the charging provision should specify that it will only apply to the extent that the reverse hybrid outcome has not been captured in the payor territory under foreign tax rules. If the payment is reversed in the payor territory, or indeed if there is no deduction in the payor territory, then we consider that the charge to tax in Ireland should not apply.

It is possible that an entity coming within the definition of a reverse hybrid entity may have Irish tax resident investors who are subject to Irish tax on their share of the profits or gains of the entity as the income arises. To avoid the double taxation of such investors as a result of the application of the reverse hybrid rules, we consider that they should be entitled to a credit for the proportion of any taxes imposed on the entity that is attributable to their investment.

3.4 Scope of application of the reverse hybrid mismatch rule

Question 12:
Comments are invited regarding the scope of application of the reverse hybrid mismatch rule.

We believe that the proposed application of the reverse hybrid mismatch rule to tax periods commencing on or after 1 January 2022 is in accordance with ATAD2.

⁸ OECD/G20 Base Erosion and Profit Shifting Project: Neutralising the Effects of Hybrid Mismatch Arrangements: Action 2: 2015 Final Report

3.5 General Matters

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.

We consider that the provision outlined in the Feedback Statement is consistent with Recital 11 of ATAD2 which provides that “*any adjustments that are required to be made under this Directive should in principle not affect the allocation of taxing rights between jurisdictions laid down under a double taxation treaty.*”

Double taxation can arise where one jurisdiction views an entity as a person for the purposes of a double tax agreement, whereas the other jurisdiction consider the entity to be transparent. In the event that a jurisdiction imposes tax as a result of the application of the anti-hybrid rules, double taxation may arise. However, there may be no provision in the relevant double tax agreement to provide for relief or to establish who has the primary taxing rights.

As outlined in the Feedback Statement, the purpose of the reverse hybrid rules is to address a scenario where an entity is treated as tax transparent in the territory in which it is established but is treated as a taxable person by some or all its investors, such that “some, or all, of its income goes untaxed”.⁹ It is clear from this statement that it is intended that the reverse hybrid rule should be targeted at instances of non-taxation. Therefore, we believe that the reverse hybrid mismatch rule should not apply where a treaty jurisdiction has already imposed taxation on the hybrid entity or its members.

If double taxation does arise as a result of the application of the reverse hybrid mismatch rule, in our view, it would be appropriate to allow a credit to be claimed by an Irish hybrid entity for tax applied by the foreign jurisdiction in respect of the investors in the Irish entity, which it regards as transparent, but for which no credit can be claimed by those investors because the Irish entity is regarded as opaque in their jurisdiction.

We have no additional comments to make at this stage regarding any technical aspects of the implementation of the reverse hybrid mismatch rule that have not been included in this Feedback Statement. We look forward to the publication of the full legislation in the Finance Bill.

⁹ Department of Finance, ATAD Implementation – Article 9a Reverse Hybrids Mismatches, Feedback Statement, July 2021, at paragraph 1.2.