This technical query paper was submitted to Revenue in response to their invitation at a meeting of the TALC BEPS Implementation Subcommittee on 9 December 2021 for written submissions on areas for consideration in developing updated Revenue guidance on the Anti-Hybrid Rules

Feedback on the expanded definition of Entity in the Anti-Hybrid Rules (and by extension in the Interest Limitation Rules)

18 January 2022

1. Change in definition of 'Entity'

The definition of Entity in S.835Z has been expanded to include:

— an association of persons recognised under the laws of the territory in which it is established as having the capacity to perform legal acts, or

— any other legal arrangement of whatever nature or form, that owns or manages assets, that is subject to any of the taxes covered by this Part.

As requested, we are responding with some observations and requests for clarifications as to how this change of law applies with particular consideration of potentially unintended consequences.

General

In the first instance, in order for us to identify potential unintended consequences, it would be helpful for practitioners to comprehend Revenue's understanding as to what the change means.

For instance, the second of the two new categories seem to be limited to certain taxable trusts, but it would be helpful if Revenue could confirm this (or otherwise clarify the issue).

On the first new category, we understand that this is intended to capture partnerships though it is not clear to us if Revenue believes it covers other untaxed Entities existing under Irish law (such as discretionary trusts).

Moreover, insofar as partnerships are concerned, it is not apparent that this will result in all partnership being treated equally as it would depend on what the 'capacity to perform legal acts' means and what the relevant law governing the partnership permits. In this regard, clarity on what constitutes 'legal acts' would be welcome.

Aside from what Entities are intended to be captured, it is not clear to practitioners what the change is intended to achieve *i.e.*, its purpose. We understand that the genesis for the change was the drafting of the reverse-hybrid rules and concerns that absent the change, the reverse-hybrid rules might not work as most reverse-hybrids do not have legal personality.

However, those rules have been implemented without reference to 'Entities' but rather to 'hybrid entities, the definition of which does not make reference to having legal personality and so already covers partnerships and the like. As such, if this was the primary reason for the change, it appears to no longer be relevant based on the final reverse-hybrid legislation.

In order to comprehend the application, in the first instance we would like to understand whether Revenue is of the view that the classification of a partnership or trust as an Entity imposes a fiction as to whether that partnership or trust can own property, receive income, and make payments in its own right. Legally this is not the case, nor is it deemed to be the case under Irish tax law as a general matter. It is not apparent that such a fiction is imposed based on the legislation as it stands, in which case the change in definition of Entity would seem to act only to restrict access to reliefs under interest limitation rules (ILR), as discussed below, which would seem to be inequitable given that the partnership or trust is otherwise essentially a pass-through vehicle for all purposes.

In attempting to understand the intention and consequences, we have reviewed the various anti-hybrid rules and how the broader definition might interact with them. As noted above, if the new definition does not create a fictional ownership of property for the partnership or trust, then much of what follows is irrelevant.

However, we have explored some of these points to illustrate the consequences of such a fiction. In many cases, even where a partnership (or indeed a trust) is treated as an Entity, the specific anti-hybrid rules would not seem to have application. For example, the rules may not apply to an Irish partnership with a foreign PE but if the tax laws here and there look through the partnership for the purposes of imposing tax, then it would seem section 835AE et seq do not apply because the partnership is not in the charge to Irish or foreign tax.

However, this is not universally the case and there are some important areas where clarity is required.

Associated Enterprises: Partnership Interests

Under the expanded definition, partnerships can now – in their own right - be associated enterprises. This gives rise to a number of questions.

Firstly, how is the 'acting together' rule in S.835AA(3) to be applied?

If it is applied with reference to the investment in the partnership itself, this means that if a company had any degree of an interest in a partnership (*e.g.* a 1% interest) then it would automatically become an associated enterprise of that partnership because of the

acting together rule deeming it to have 100% of the interests. This seems counter-intuitive given that while one can make a legal argument that partners in a partnership act together with respect to the partnership property (because they are carrying on business together and legally are agents of each other), this does not logically apply to their investments in the partnership itself.

A corollary of the above interpretation would seem to be that while the 'acting together' rule applies to create association with respect to interests in the partnership itself, it does not automatically extend to the assets of the partnership (based on a plain reading of the legislation). This is contrary to the treatment applied to date.

Under the 'old' analysis, if a partnership held shares in a subsidiary company, the acting together rule was applied to the partners acting together with reference to the partnership property and this meant that one considered each of the partners in the partnership to be an associated enterprise of the underlying irrespective of the size of their stake.

However, if the partnership is now an Entity in its own right and 'acting together' applies to the investment in the partnership then, in the absence of a particular partner having 'control' in their own right (e.g. a majority of the voting power or profit rights), the partners would not appear to be treated as an associated enterprise of the subsidiary. (While S.835AA(2) covers direct and indirect interest, the 'acting together' rule in ss.3 only applies to those matters whether the partners are acting together – under this analysis, they are acting together with respect to their investment in the partnership, not the partnership property).

An alternative view – which may sit better with partnership law – is that the partners are legally acting together (as agents for one and other) with respect to the partnership property (here the subsidiary) so the old analysis remains and they are associated enterprises of the subsidiary. However, a minority partner would not be an associated enterprise of the partnership Entity even though it may be an associated enterprise of a subsidiary owned by that partnership. This seems like an odd result.

We would welcome clarification from Revenue as to how the 'acting together' rule operates post the change of law.

Associated Enterprises: Accounting Consolidation

As partnerships (or indeed trusts) are now Entities, they potentially come in scope of the definition of Associated Enterprise in S.835AA(2)(e):

> where—
>
> *(i) both enterprises are entities,*
>
> *(ii) one enterprise (which is other than a non-consolidating entity) is included in the same consolidated financial statements as the other enterprise, and*

(iii) the consolidated financial statements referred to in subparagraph (ii) are prepared under—
(I) international accounting standards, or
(II) Irish generally accepted accounting practice,]2

A similar point applies re paragraph (f).

For the purposes of the above, a 'non-consolidating entity' is defined as an entity which is valued in the ultimate consolidated financial statements using fair value accounting, or on the basis that it is an asset held for sale.

On a plain reading of the legislation, notwithstanding the explicit exception for non-consolidating entities, it seems clear that this definition is referring to the totality of the results of entity concerned being included in the financial statements of the other enterprise.

This distinction is important because a partner in a partnership might include, in its income statement, its share of the results of that partnership's business. If one did not interpret this provision as we have suggested and instead took the view that the inclusion of any amount of a partnership's profits gave rise to Associated Enterprise status, this would make all minority partners in a partnership Associated Enterprises of the partnership.

We do not think that this latter interpretation is correct or equitable. Therefore, for clarity, we would suggest that Revenue Guidance confirms the former interpretation *i.e.*, the reference to one enterprise being included in the financial statements of another in S.835AA(2)(e) / (f) is a reference to inclusion of all of that enterprise's results for the period concerned.

Interaction with ILR

Connected to the above, there is also an important question in relation to the interest limitation rules (ILR).

The introduction of partnerships into the definition of Entity has implications under both the Standalone Entity exception and the Single Company Worldwide Group rules. As noted above, having any percentage of an interest in the partnership would create association. Therefore, potential implications arise regarding transactions between a partnership and a company which qualifies for Single Company Worldwide Group treatment. Depending on the level at which 'acting together' is applied, it will affect which transactions need to be adjusted for (i.e., transactions with the partnership, with partners (who may be minority investors), and / or with subsidiaries of the partnership.

If one were to ignore partnerships for these purposes, then the question remains as to what the purpose of the change in law is?

We would welcome clarification from Revenue as to how the Standalone Entity exception and the Single Company Worldwide Group rules operate in these types of situations.

Inclusion

Another key issue is whether 'inclusion' – for anti-hybrid purposes – can and should be tested at the level of a partnership Entity.

The term 'included' is defined in S.835Z with reference to a payment to a 'payee', so for this to happen the partnership would need to be a 'payee'. In this regard, a payee includes an Entity—

(a) which receives that payment or is treated as receiving that payment under the laws of any territory, other than where that payment is received or treated as being received, as the case may be, in a fiduciary or representative capacity,
(b) which is a participator,
(c) to the benefit of which the payment is treated as arising or accruing under the laws of any territory, or
(d) on which a controlled foreign company charge or foreign company charge is made by reference to that payment;

It would appear that a partnership could, in the right circumstances, come under (a) or (c). If one were to suggest that the partnership were in receipt of the payment concerned only in a fiduciary capacity or without the benefit of the payment accruing to it (as a matter of general law of the relevant countries) – a contention that may not be supported legally – and so neither category applies, this raises the question as to what the change in the definition of Entity actually achieves given a partnership could never be deemed to have any profits or gains of its own or make or receive any payments on its own account?

If a partnership can be a payee, then inclusion requires an amount of profits or gains arising from the payment:

(a) that is treated as arising or accruing to the payee where the payee—
    (i) is chargeable to domestic tax or foreign tax, as the case may be, but not including any amount which is only so chargeable when it is remitted into the payee territory,
    (ii) is a pension fund, government body or other Entity that, 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,
    (iii) is established in a territory, or part of a territory, that does not impose a foreign tax, or
    (iv) 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,

    or
(b) that is subject to a controlled foreign company charge or a foreign company charge.

Certainly, for a partnership in a zero-tax country, (a)(iii) is met. An Irish partnership might be said to come within (ii) – exempt Entity. Partnerships are effectively exempt as the

Government has chosen not to tax them (but could do so if it wished – as the US does in certain cases).

If inclusion can be tested at the partnership level, then this creates some potential anomalies.

For example, the inclusion question arises with respect to the financial instrument mismatch rules. If you have a deduction on a financial instrument by an Irish company with the payment being received by, say, a Cayman partnership, under the old definition of 'Entity', the partnership was ignored (as it was not an Entity) and inclusion was tested with respect to the partners.

Applying the new definition of 'Entity' (and the rationale above), while one could still test at the level of the partners (as the taxpayer only needs to show inclusion once not in all possible levels), it seems you might be able to test for inclusion at the level of the partnership. If so, then this test will be met in this case because Cayman is a zero-tax jurisdiction so there is inclusion.

Alternatively, if Revenue's position is that the analysis is that one ignores the partnership for these purposes, then the question arises as to what the purpose of including partnerships as Entities in these rules is?

A similar question arises in respect of the payments by hybrid Entity mismatch rules in section 835AM. That is, if an Irish company were a hybrid Entity and it made a payment to a partnership, how is inclusion tested for these purposes?

We would welcome clarification from Revenue as to how the Standalone Entity exception and the Single Company Worldwide Group rules operate in these types of situations.

2. Disregarded PE mismatch

If it is intended that specific guidance be given with respect to the disregarded PE mismatch, we would welcome confirmation from Revenue that it expects this to apply in a manner consistent with Recital 18 of ATAD2, (i.e., any non-taxation must arise from a hybrid aspect and not due to the tax-exempt status of the payment of the payee or the payment in a payee jurisdiction).