

Hybrids mismatch arrangements*

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What?

Hybrids mismatch arrangements (HMA) are arrangements which exploit differences in the tax treatment of instruments, entities or transfers on cross-border trade and investment and often lead to “double non-taxation”. They may significantly reduce overall tax for taxpayers and therefore decrease tax revenues of countries.

Who?

- **Hybrid entities** – Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country.
- **Dual residence entities**
- **Hybrid instruments** – typically instruments treated as debt in one country and as equity in another
- **Hybrid transfers** – treated as transfer of ownership of an asset for one country’s tax purposes but as collateralised loan for another

How?

Scheme	Double deduction schemes	Deduction/no inclusion scheme	Foreign tax credit generators
Implications	One arrangement = deduction in two different countries	Typically a deduction for interest expenses in one country but not inclusion in the taxable income in another	Foreign tax credit that arguably would not be available if the transaction would not take place

Problems

- **Tax revenue** – reduction of the overall tax paid by all parties involved, loss of tax revenue
- **Competition** – Business operating cross-border and having access to sophisticated tax expertise may profit from HMA, SME don’t.
- **Economic efficiency** – cross-border investment is more attractive than an equivalent domestic investment, it may potentially contribute to financial instability through increase in leverage from tax-favoured borrowing (increase of risk-taking)
- **Transparency**
- **Fairness** – available for taxpayers with income from capital rather than labour

Solutions

- **Harmonisation of domestic law** – elimination of commonly exploited differences, highly unlikely
- **General anti-avoidance rule (GAAR)**
- **Specific anti-avoidance rule (SAAR)**
- **Rules specifically addressing HMA** – in some countries (Germany, UK, US, Denmark etc.)

Recommendations

- **Introduce/revise specific rules**
- **Share relevant intelligence on HMA** (deterrence, detection and response strategies)
- **Introduce/revise disclosure initiative**

* based on OECD report from March 2012

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