IOTA Case Study Workshop

# Tackling BEPS hybrid mismatch structures through the application of anti-abuse rules

## Case Studies

7 – 8 May 2025
Budapest, Hungary

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# CASE STUDY 1- SWEDEN

## Case Submitter:

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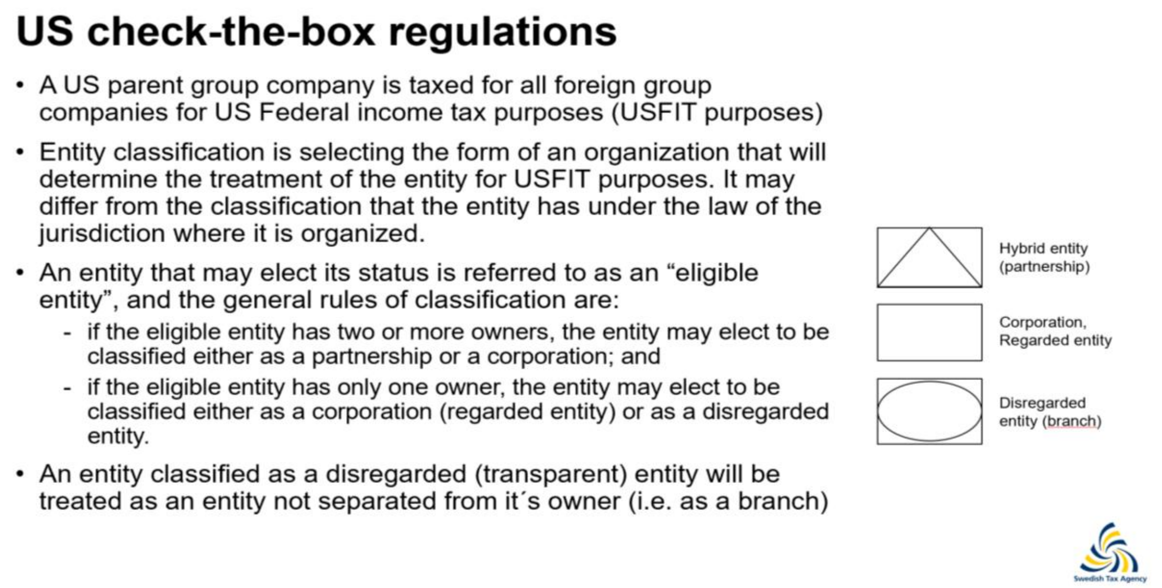
## Introductory Points:




**<u>GILTI (Global Intangible Low Tax Income)</u>**

- A US shareholder is taxed for GILTI of a controlled foreign corporation (CFC).
- The computations for GILTI of a CFC are made at the level of the US shareholders and is taxed by being included in the income of the US shareholders on a pro rata basis.
- GILTI is defined (in general terms) as the US shareholder’s portion of the income of a CFC that exceeds the shareholder’s portion of a deemed 10 % return on the CFC’s tangible property.

- Income and loss is calculated for each CFC, the results for all such CFCs are then aggregated.
- US corporate shareholders are permitted to claim a partial deduction of 50 % for the amount of GILTI included in income.
- The deduction will result in an effective tax rate of 10,5 % on GILTI.

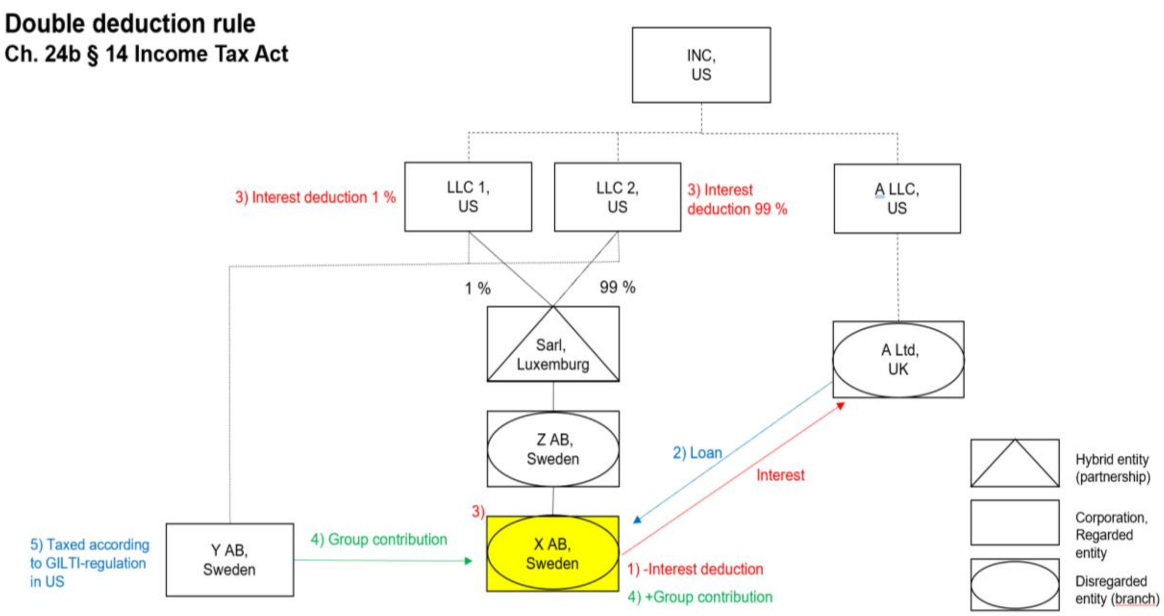
**<u>Double deduction rule – Swedish Income Tax Act</u>**

- **OECD BEPS Action 2: Report "Neutralising the Effects of Hybrid Mismatch Arrangements**
  Recommendation 6, Deductible hybrid payments rule
- **ATAD** - Council Directive (EU) 2017/952 amending Directive (EU) 2016/1164, article 9.1 b
- **Ch. 24 b § 14 Income Tax Act**

A company is not allowed to make a deduction for expenses for the Swedish taxation

- if a company in another jurisdiction is allowed to make a deduction for the same expenses,
- to the part the deduction of expenses is made against income in another company at the Swedish taxation, for example against received group contribution, and
- deduction is not denied in the other jurisdiction.

<u>Exception</u>: The denial of deduction does not apply if the deduction corresponds to income that is accounting for tax in both jurisdictions (dual inclusion income). It applies for both income of the company making the deduction and the company with the income. Therefore CFC-taxation is also taken into account.




## Background - Description of the Case:

**The Swedish company, X AB, is part of a US group**

1) X AB deducts interest expenses of EUR 150 million referring to an intra-group loan from a company in UK, A Ltd
2) X AB is treated as a disregarded (transparent) entity for USFIT purposes by it´s owners in US. X AB is an independent tax payer in Sweden and is thereby a hybrid company.

3) As a result of treating X AB as a disregarded entity the owners receive a deduction for the same interest expenses for the USFIT in relation to its ownership.

4) X AB received a group contribution of EUR 130 million from Y AB. X AB:s deduction of the interest expenses is thereby made against income in another company.

⇒ A hybrid mismatch according to Chapter 24 b, paragraph 14 in the Income Tax Act.

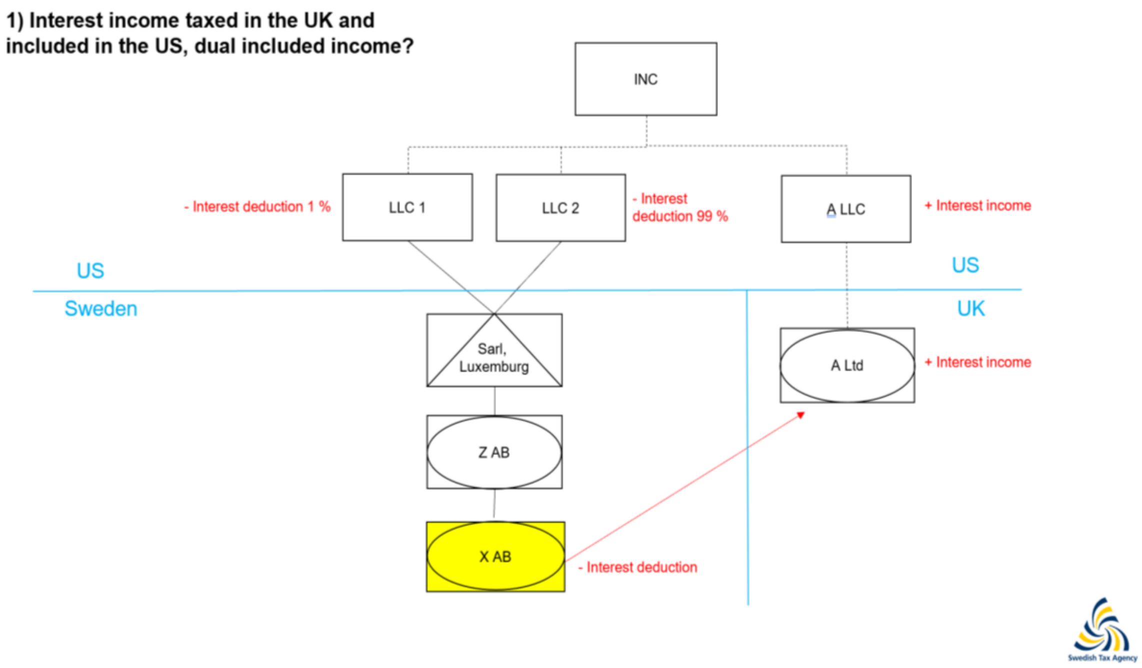
5) Y AB is treated as a regarded entity by the same owners and is taxed according to the GILTI-regulation in US

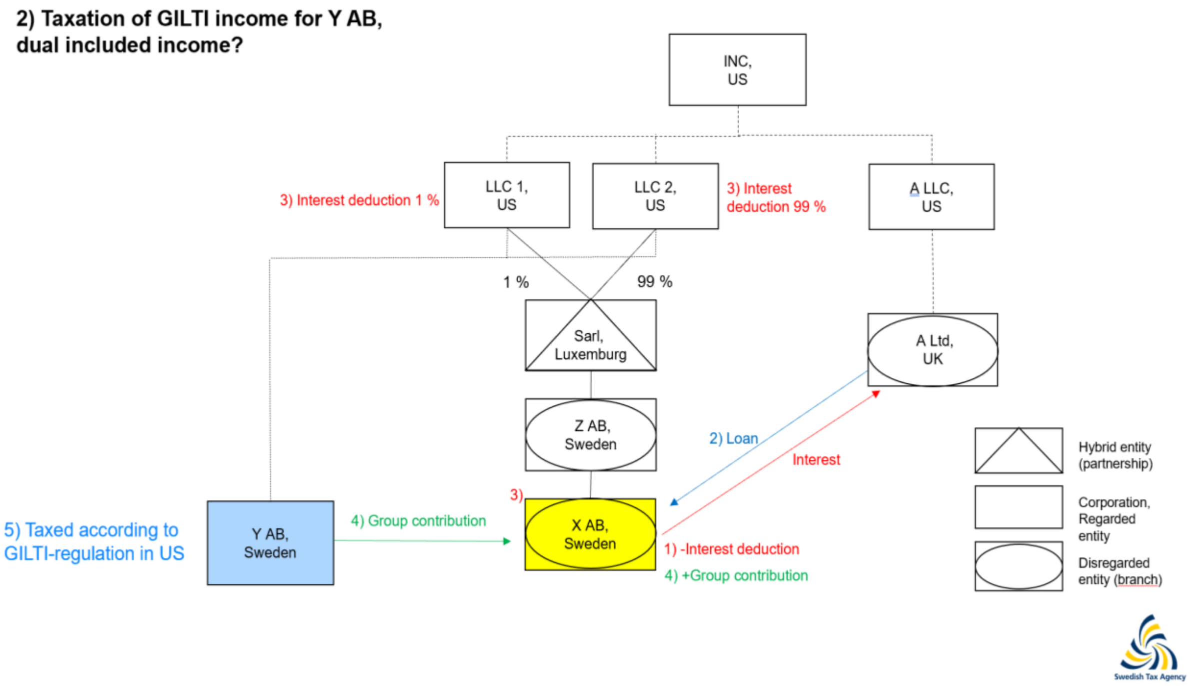
**X AB has no income of its own which can constitute a dual inclusion income**

- X AB has no income taxed for USFIT purposes
- Received group contributions are not taken into account in the US

**The company´s argument why there´s no hybrid situation:**

1. The corresponding interest income has been taxed at the receiving company in UK, and the income has been included by it´s owner in the same consolidated federal income tax return, at the same way as the company´s interest expense.
2. The company Y AB, which submits the group contribution, is taxed according to the GILTI-regime. The income therefore constitute a dual inclusion income.






## Questions (relating to the case):

1. Does the corresponding interest income between UK and US constitute dual inclusion income?
2. Does the income in the Swedish group company Y AB, which has been taxed according to the GILTI regime, constitute dual inclusion income?

## Proposed Solution:

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# CASE STUDY 2 - AUSTRIA

## Case Submitter:

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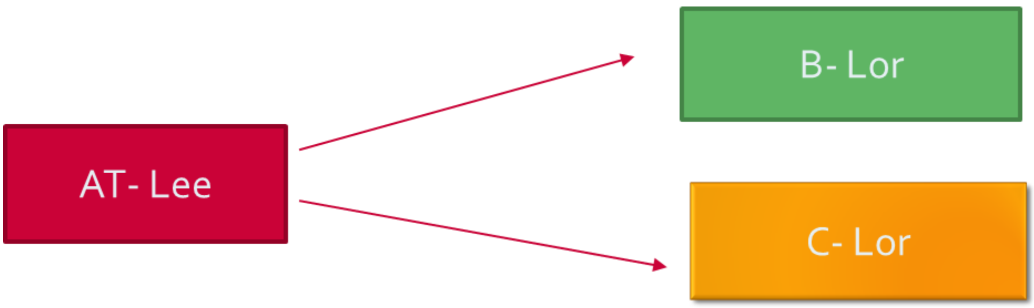
## Background - Description of the Case:

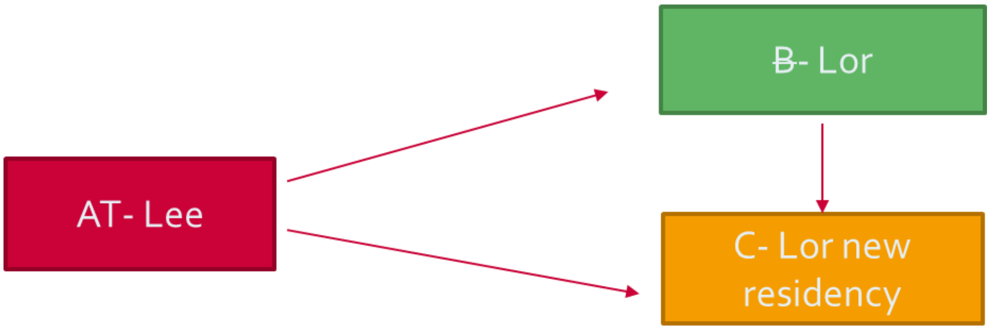
Basic situation up to 2020, real case:

The Austrian Company (Lee) pays a company name and know how royalty (IP) based on a percentage of turnover to Licensor (Lor) in country B. Lor as of 1.1.2020 changes residency to Country C. see:



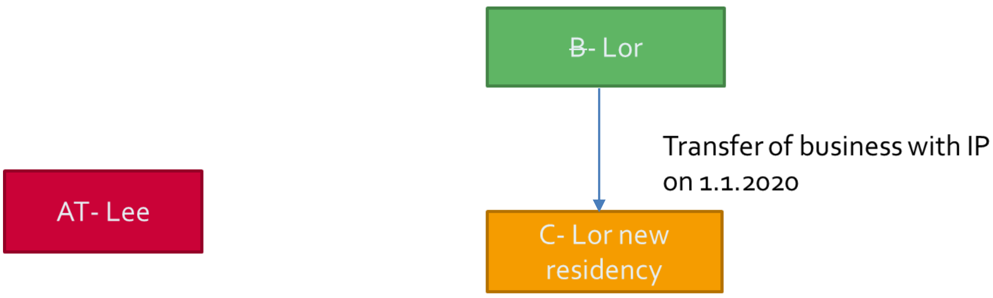

## Facts of the case step 1:

The Austrian Company (Lee) pays a company name and know how royalty (IP) based on a percentage of turnover to Licensor (Lor) in country B. Lor as of 1.1.2020 changes residency to country C. see:



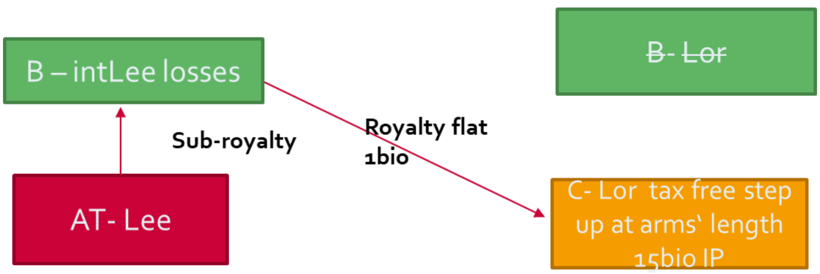

## Facts of the case step 2:

Basic situation up to 2020 real case:
As of 1.1.2020 Lor capitalizes the IP value received in country C at "market value" of 15bio but there is no exit taxation in country B.



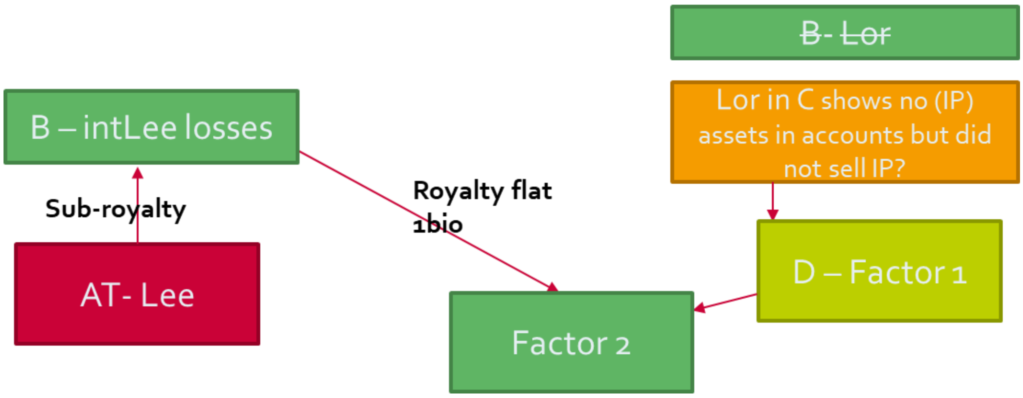

## Facts of the case step 3:

The "License and Know How" business activities are transferred from Lor to an intermediate Licensee (intLee) in country B. But the rights in the IP itself are retained by Lor and now licensed to intLee in B at a flat amount of 1bio – contract 75 years. AT-Lee now pays a turnover based sub-royalty to intLee in country B. IntLee bears the flat royalty and current cost of maintaining the IP and incurs losses.



## Facts of the case step 4:

Lor as a resident in C (or from that country's perspective) "factors" out all future receivables from license payments by intLee at the market value of 15bio (which is mor or less the same value as it capitalized the IP) to Factor 1 in D. Profits are recognized by Lor (no appropriate tax visible in accounts of Lor) and distributed tax exempt to the shareholder. Factor 1 factors the same amount out to Factor 2 in B. IntLee now pays to Factor 2 in B. Factor 2 is refinanced (pays interest) by another company in country B.




## Questions (relating to the case):

Due to the process of tax exempt recognition in country B and step up - valuation at arm's length in country C at Lor and subsequent flat license rate deduction paid by intLee to Lor (and „legal successors" of benefits) there is no tax liable on the royalty income. Our questions to you are:

1. Is the tax exempt transfer and amortization of capitalised royalties equal to a (imported) deduction/non inclusion situation of royalty payments?
2. If yes, is there any limitation/cap of „non deductibility" in general and in terms of the Lee in Austria in this case?
3. When applying local GAAR provisions can they also be combined with hybrid mismatch rules? Which means setting aside the artificial combination of transactions and looking through at a hybrid mismatch situation as economic facts and circumstances?
4. What difficulties are to be faced when establishing hybrid mismatch facts and what are your experiences with EoI?

## Proposed Solution:

# CASE STUDY 3 - NORWAY

## Case Submitter:

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## Background - Description of the Case:

- A fund (limited partnership) established in the UK and for a time operating in the UK.
    - The fund is considered transparent for tax purposes in the UK, but opaque for tax purposes according to Norwegian law.
        - No tax in the UK, and potentially no tax in Norway (double non-taxation).
    - The GP in Guernsey instructs the manager.
    - The manager of the fund is an LTD in the UK.
    - An extra GP in the UK is appointed, but no part in operations or management.
- The fund moves to Guernsey:
    - Principal place of business is moved from UK to Guernsey.
- Remaining connection to the UK:
    - The fund is listed in Companies House, and has a manager and «silent GP».
- Norwegian investors invest in the fund, and recieves dividends in 2019 and 2020. They claim that the fund is a UK fund (at the time still part of the EU) and therefore fall within the partcipation exemption.

The Norwegian Tax Act section 2-38 first section:

- Foreign sourced **dividends from EEA countries**, derived from **companies similar to Norwegian companies** and **tax residents within the EEA** are exempt from taxation (exemption method).
    - Purpose: prevent taxation both on the hand of the fund and the investor.
- Are the dividends automatically considered sourced from an EEA country if the fund is a tax

resident of an EEA country?

- According to Norwegian law, the incorporation according to the company law in UK suffice to consider the fund a tax resident in the UK.
- However, the question arises whether the incorporation of the fund in the UK, leads to the company being a tax resident there after the move to Guernsey.

**Court Case - Cadbury Schweppes (C-196/04)**

- Many countries changed their CFC-legislation pursuant to the Courts judgment.
  - Norway did too.
  - and Norway also changed the participation exemption rules:
- The 5th section of § 2-38 therfore reads:
  - «The exemtion from tax pursuant to the first section only applies if the taxpayer is an **actual establishment** carrying out **genuine economic activity** in an EEA Member State».

**Main issues of the case**

- Are the dividends received from the hybrid fund eligible for a tax exemption on the hand of the Norwegian investor?
  - Are the conditions of the first subsection fulfilled?
    - It depends on whether the dividends are considered as received from a fund in the UK or Guernsey.
  - If these conditions are satisfied: can the fund be considered as not being an actual establishment carrying out genuine economic activity in the UK, thus barred from the exemption method on that ground?
    - It depends on whether an actual establishment accords with the condition set in the first section, i.e. whether the fund being established according to the law in the UK must be considered an actual establishment.
    - It depends on whether the fund has remaining activity in the UK to substantiate genuine economic activity.

## Questions (relating to the case):

1. Provided that the Norwegian Tax Administration conclude that the dividends are received from a fund inside the EEA (UK). Does the transfer of principal place of business, and the fact that the managing GP is based on Guernsey entail that the fund is not pursuing a genuine economic activity in the UK (wholly artificial)?
2. Provided that the Norwegian Tax Administration conclude that the dividends are received from a fund outside the EEA (Guernsey). Does the funds connection to the UK render the Norwegian legislation contrary to the taxpayers right of free movement of capital? Specifically, is the funds connection to the UK, such that taxpayers can argue that the distribution of dividends is a capital movement within the EEA (free movement of capital only applies within the EEA according to the EEA Agreement)?
3. Norway does not have hybrid mismatch rules like the ATAD or BEPS Action 2 rules: Would these rules apply to the case at hand? Possibly the ATAD GAAR?

## Proposed Solution:

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# CASE STUDY 4 - BELGIUM

## Case Submitter:

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## Background - Description of the Case:

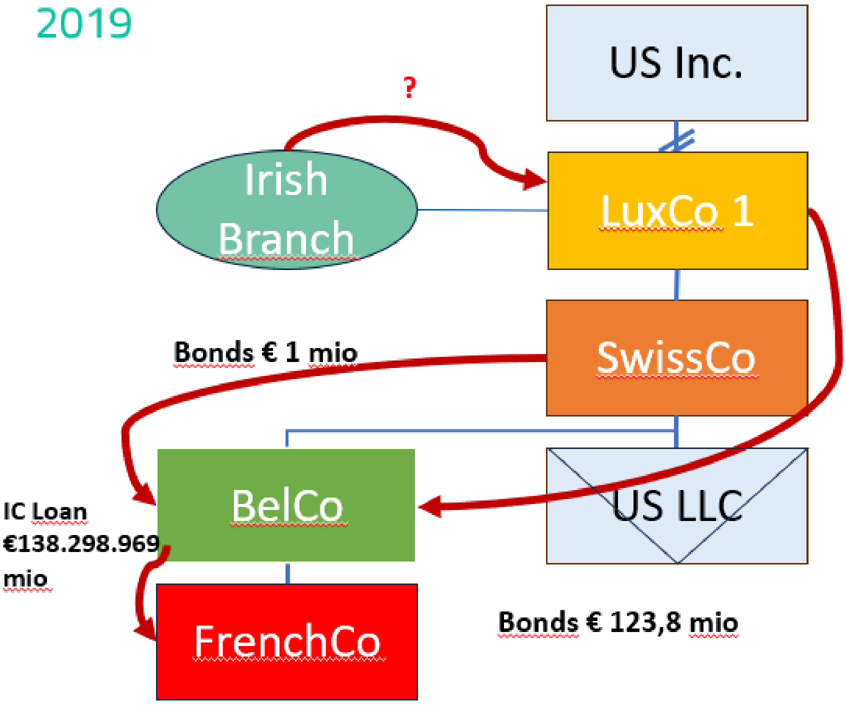
The case focusses on financing obtained by a Belgian company in 2014 ("BelCo"). Belco is part of a US Group. This financing, in the form of registered bonds, was subscribed to by a US LLC, part of the same group. The bonds were issued for a period of 10 years, with a maturity date set on 31.12.2023. Interest are paid out on the 31st January of the year subsequent to the interest period (i.e. the previous year).

At the end of 2018, the bond was transferred to a Luxembourg Company ("LuxCo 1"), with effect of 1/1/2019. Interest related to 2018 were paid in 2019 by the BelCo to LuxCo 1, but were passed on to the US LLC by the latter. As of 2020 all interest payments were beneficially owned by the LuxCo 1 (no back-to-back financing it seems).

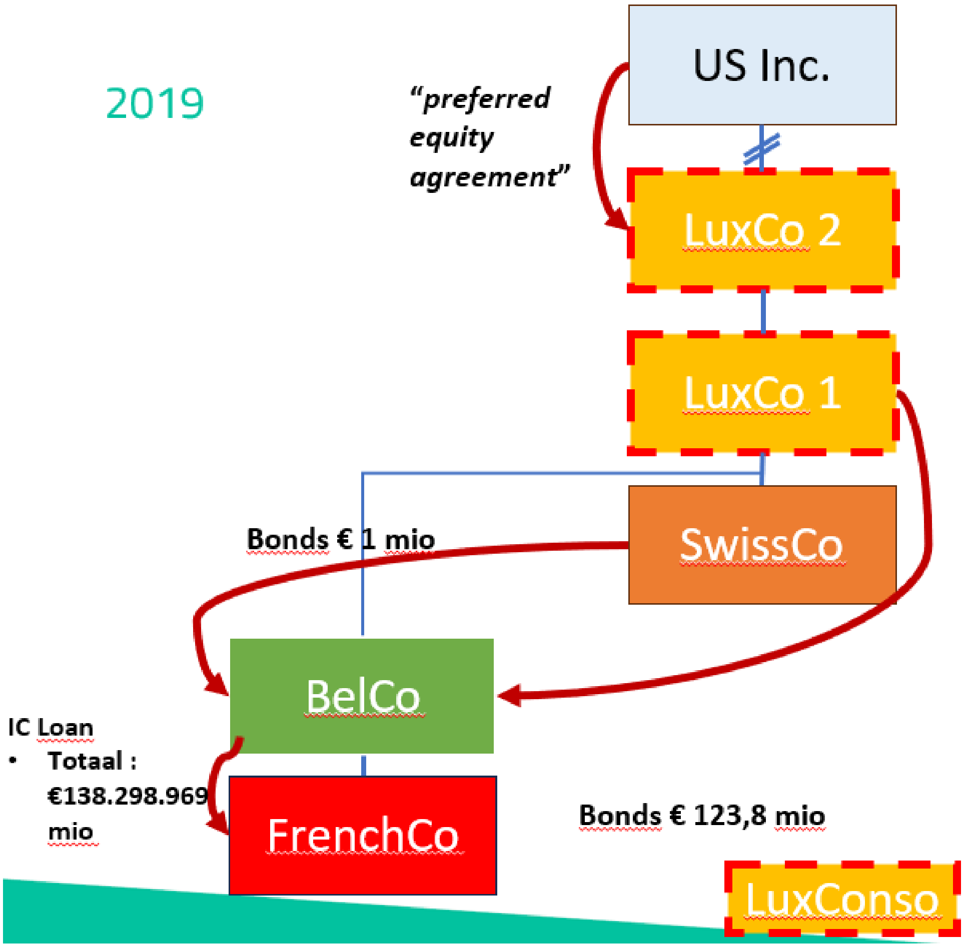
The US LCC was fully owned by a group company in Switzerland (SwissCo), and hence resulted in a hybrid mismatch (D/NI of the interest paid by BelCo). BelCo in his turn granted financing to a French subsdiary ("FrenchCo"). This financing was granted at the same time the bonds were issued. BelCo acted as a "conduit company". As such, the application of French anti-abuse rules (interest deduction requirements) seem to have been circumvented.

While the structure until 2018 was obviously a hybrid mismatch structure, the reasons for transferring the bonds to LuxCo 1 are less obvious. There is little doubt that the transfer of the bonds to LuxCo 1 is driven by tax motives. LuxCo 1 has never paid taxes in the years it has owned the bonds. It would also have been more straight forward to transfer the bonds to SwissCo. The transfer of bonds also coincides with other transactions (such as the transfer of almost all the shares in the BelCo from SwissCo to LuxCo 1).
In the context of the IOTA workshop, three aspects of the Luxembourg structure are highlighted:

- **Irish Branch**
  - According to board minutes, LuxCo 1 would finance the acquisition of the bonds via the group's cashpool, which is managed by the Irish Permanent Establishment of LuxCo 1.
  - It is important to note that Ireland did not adopt the Authorised OECD Approach untill 1.1.2020. Hence, internal dealings, such as a loan from the Irish Branch to the Luxembourg Head Office could result in an asymmetric treatment, and a Deduction/Non-Inclusion (D/NI- outcome) (e.g. deemed interest deduction at the level of the Luxembourg, without a pick up in Ireland)




- **Historic Hybrid Mismatches – Carry Forward Losses**
  - LuxCo 1 is part of a tax unity in Luxembourg since 2016.
  - For 2019 and 2020, LuxCo 1 does not pay taxes as a result of losses it has access to via the tax unity.
  - Other Luxembourg group companies (like LuxCo 2) seem to have generated losses in years prior to 2019, that seemed to be related to hybrid mismatch structures, such as preferred equity agreements with US companies.
  - To the extent that these losses are now used to offset the received interest income, this could potentially give rise to a D/NI.




- **Derivatives – Net Investment Hedges**
  - LuxCo 1 has entered in a Net Investment Hedge in 2017, with several third parties. It is a currency swap to hedge for the changes in the exchange rate between EUR/CHF (Swiss France) and USD (the functional currency of the group).
  - US group reports in US dollars, LuxCo 1 owns euro/CHF operations. According to the tax payer, this is why a hedge was concluded (to eliminate FX impact at US consolidated level).
  - It is remarkable that the Luxembourg entity has concluded a net investment hedge. Why should this entity need to take on the expenses related to the US Group?

## Questions (relating to the case):

- **Irish Branch**
  - Conceptually speaking, do you see a hybrid mismatch for an internal dealing (debt instrument), recognized by the head office, but disregarded by the permanent establishment?
  - Based on the limited facts you have access to, do you see this risk in the case at hand?

- **Historic Hybrid Mismatches – Carry Forward Losses**
  - Assuming that the carried forward losses stem from a hybrid mismatch in 2016, 2017 or 2018, does the use of the losses in 2019 or 2020 qualify as a hybrid mismatch deduction, targeted by BEPS ACTION 2?
  - How to calculate the adjustment? Is this adjustment different in the knowledge that

there is no clear link between the hybrid mismatch at the level of LuxCo 2, and the bond held by LuxCo 1?

## Proposed Solution:

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# CASE STUDY 5 - ITALY

## Case Submitter:

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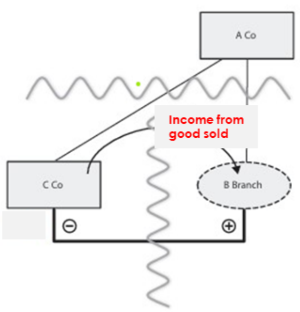
## Background - Description of the Case:

### Maquiladora Branch Model (a real case)

Figure 1. **Disregarded branch structure**




**Background**

- A Co is a company resident in Country A and own all the share in C Co
- C Co is a company resident in Country C
- A Co supplies goods to C Co (a related company) through a branch located in Country B.
- Country C permits C Co to claim a deduction for the goods acquired.
- Country A exempts income derived by C CO from taxation on the grounds that it is attributable to a foreign branch but is not, however, taxed in Country B.
- Company A has a sufficient presence in Country B to be considered a Permanent Establishment (PE), both under the Double Taxation Convention (DTC) and national law.
- However, due to a local tax benefit, the branch is exempt from taxation. Therefore, no TIN or tax return is required.

Is this a “Disregarded Branch Structures” ?

## Analysis

- Goods in question were purchased as a result of a manufacturing activity (**Maquila = Tolling**) carried out by A Co at its own industrial facility in in State B.
- Under the legislation of State A, the manufacturing facility located in State B qualifies as a **Permanent Establishment (PE),** thereby constituting a taxable presence in State B of an entity resident in State A. In accordance with this classification, State A provides a tax exemption on 95% of the profits and losses attributable to the aforementioned PE **(Branch Exemption Regime).**
- Formally, A Co is considered by the tax authorities of State B to have a PE in State B (in accordance with both the Double Taxation Convention (DTC) and local law), engaged in so-called "maquila" operations **(i.e., briefly, the assembly of goods on a processing basis, with the processed products being entirely exported from State B).**
- However, due to the presence of a specific tax incentive, such activities are not, in practice, regarded as a PE for tax purposes under the laws of State B.
- **Indeed, in State B, no Tax Identification Number (TIN) is issued, and no tax return is required to be filed by the PE.**

## Questions (relating to the case):

1) Is Mexican tax law give rise to "Disregarded Branch Structures"?

## Proposed Solution: