

Maquiladora operations and Disregarded Branch Payment Mismatch

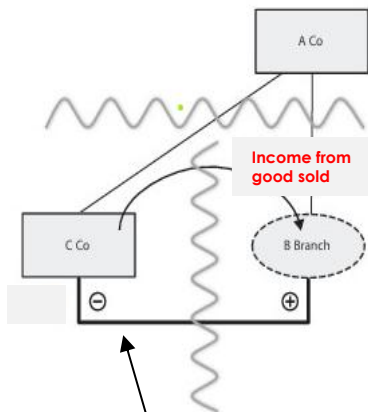
***“Tackling BEPS hybrid mismatch structures through the
application of anti-abuse rules (GAAR, PPT or the anti-
hybrid mismatch rules from the ATAD)”***

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Is there a Branch Mismatch Arrangement?

Figure 1. Disregarded branch structure



Based on the Italian Tax Law:

The reaction consists in denying the payment deduction in Italy

Recommendation 2 (BMA 2017) specifically targets:

Diverted branch payments, where the mismatch arises, not because of a conflict in the characterisation of the branch, but rather, due to difference between the laws of two jurisdictions as to the attribution of payments to the branch.

Disregarded branch structures, where the mismatch arises due to the fact that a deductible payment received by a taxpayer is treated, under the laws of the residence jurisdiction, as being made to a foreign branch (and therefore eligible for an exemption from income) while the branch jurisdiction does not recognise the existence of the branch and therefore does not subject the payment to tax.

Counterfactual test

The question of whether the mismatch is a result of the misallocation of payments between the branch and the head office can be answered by posing a counterfactual test that asks what the tax treatment of the payment would have been if it had been made directly to the head office. In the case the payment would have been taxed because A Co is not tax exempt.

It is the operation of the branch exemption **that shelters the relevant payment from taxation under the laws of the residence jurisdiction**, so that Recommendation 2 applies to deny a deduction for the payment in the payer jurisdiction if the payment is not subject to tax in the branch jurisdiction.

Italian Revenue Agency view

TAXPAYER POSITION

Country B recognises the Double Taxation Agreement (DTA) between **Country A** and **Country B**, and therefore the branch is recognised in **Country B**, there is a specific tax exemption that means there is no tax payable. Therefore, any mismatch cannot be due to the fact the branch is not recognised.

ITALIAN REVENUE AGENCY POSITION

Looking at the overall net effect of all the relevant laws that impact the branch, we can conclude that **the branch is disregarded for tax purposes**. In the case the mismatch is due to the jurisdiction not recognising the branch for tax purposes.

Accepting the argument put forward by the taxpayer, that the branch is recognised in Country B law despite it ultimately being disregarded for tax purposes, it would be contrary to the purpose of the relevant (Italian) legislation and could mean that the **disregarded branch payment rule** has no effect.