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Intra-European Organisation of Tax Administrations

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- ALBANIA

Case Submitter:

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Background - Description of the Case:

This is not a real case due to the fact that we are a small country and we haven't been faced yet with a real case and we have quite low expertise in this area.

An MNE with a parent company in Country X and a subsidiary in Country Y uses a hybrid instrument to fund the subsidiary's operations. The instrument is structured so that it is treated as debt in Country X (allowing the parent to deduct the interest paid) and as equity in Country Y (where the payment is not deductible for tax purposes). This results in the MNE effectively avoiding tax in Country Y, as no income is recognized, while benefiting from a tax deduction in Country X. For example:

- Country X: The parent company borrows money from the subsidiary and treats the interest payment as a deductible expense, reducing its taxable income.
- Country Y: The subsidiary in Country Y treats the payment as a dividend (which is not deductible in Country Y) and does not recognize the interest payment as taxable income.

In this scenario, the MNE benefits from both a deduction in Country X without an equivalent inclusion of income in Country Y. This creates an opportunity for double non-taxation or reduced tax payment on what is effectively the same income.

Questions (relating to the case):

1. What do you thing should Country X do?
2. What do you think is required for the financing arrangement?

3. Do you thing that is data matching required for this case?

Proposed Solution:

To address this type of hybrid mismatch, the OECD's anti-hybrid rules under BEPS Action 2 were applied. The key elements of these rules are as follows:

1. Primary Adjustment (Disallowance of Deductions): Under these rules, Country X (where the interest deduction is claimed) must disallow the deduction if the payment made is not included as income in Country Y (where the subsidiary is located). The anti-abuse rule works to prevent a situation where the MNE achieves a tax benefit (a deduction) without any corresponding inclusion of income in the other jurisdiction.

Specifically, the tax authorities in Country X would disallow the deduction for the interest payment if Country Y does not treat the payment as income, effectively neutralizing the mismatch. This ensures that the tax benefit is not allowed unless income is also recognized in the jurisdiction of the recipient.

2. Recharacterization of the Hybrid Instrument: The anti-hybrid rules may also require that the financing arrangement be recharacterized to reflect its true economic substance. If the instrument is being treated as debt in one jurisdiction and equity in another, the rules may require the tax authorities to treat the instrument consistently across both jurisdictions. In this case, the hybrid instrument might be recharacterized as equity in Country X, removing the tax-deductible interest expense, or as debt in Country Y, requiring it to be treated as taxable income.

3. Matching Mechanism: The OECD rules also introduce a matching mechanism. Under this system, if an income inclusion in the subsidiary's jurisdiction (Country Y) is required, the hybrid mismatch rules mandate that Country X (where the deduction is claimed) must ensure that the payment is not claimed as a deduction if it is not recognized as income by Country Y. This prevents the potential for tax avoidance through mismatched tax treatments.

The EU's Anti-Tax Avoidance Directive (ATAD), which incorporates many of the OECD's recommendations, provides a concrete example of how these anti-hybrid rules are applied in practice. The EU member states have implemented measures that require MNEs to neutralize the tax effects of hybrid mismatches within their cross-border structures. For instance, if an EU-based multinational employs hybrid instruments to exploit mismatches in tax treatment, the EU member state where the deduction is claimed (e.g., Country X) is required to disallow the deduction unless the payment is taxed in the recipient jurisdiction (e.g., Country Y). This ensures that MNEs cannot use hybrid structures to achieve double non-taxation.

CASE STUDY 2 - BULGARIA

Case Submitter:

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Background - Description of the Case:

Company A from country A is a parent company for Bulgarian Enterprise. In 2020 it makes a cash contribution to the local subsidiary for 100 mln. Euro., to be reflected in the Reserve Fund. The accounting operation taken in connection with the transaction in company A is increase in the carrying amount of the investment in Company B There is no receivable in Company A's account nor liability in Company B's account. The contribution has been declared as „irrevocable and non-refundable'. According to the management decision repayment of the grant can only be decided by the management of Company B. In 2024 a decision for a repayment of the cash has been taken.

The tax authorities in country A treat the repayment as equity.

Questions (relating to the case):

1. Is there a hybrid mismatch in this case?
2. Do we have to start analyzing the transaction from the cash contribution or after the return of funds?
3. Should the tax authorities of Bulgaria treat the contribution as a loan?

Proposed Solution:

The case is still ongoing.

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CASE STUDY 3 - CROATIA

Case Submitter:

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Background - Description of the Case:

Company C (CCo), Company D (DCo) and Company E (ECo) are associated enterprises, and they are part of the ABC Group. ECo is owned by DCo.

ECo engages in a manufacturing business in HR and has been making huge losses for years (EUR 76 m in 2017), including 3 years under the supervision of tax authorities (2017 - 2019).

In 2014, CCo provides a loan to ECo (EUR 70 m) for the procurement of materials and tools under a Loan Agreement. Interest rate is 3m Euribor + 1,80% (floor 1.80%), which is at arm's length.

The Loan Agreement includes maturity date, but the repayment date is constantly being extended; no security is provided (i.e. no collaterals are provided).

On further examination of the facts, it is found that there is NO repayment of the principal at all, only ongoing interest payment for every year.

In 2017, the loan was transferred to DCo as a new lender (for EUR 1,00).

The taxpayer stated that the reason for this was the restructuring of the Group and the establishment of DCo as a central financing company. But Master file stated that „there is no central financing structure in place, which means that the ABC Group has neither implemented a cash pooling system nor a central finance company".

In addition, the interest calculation is still sent by CCo (the original lender).

DCo converted the loan receivables into the share capital of ECo (EUR 70 m)

Eventually, DCo was merged with ACo and ceased to exist.

Questions (relating to the case):

1. Would you consider this loan as a loan or equity?
2. Why?

Proposed Solution:

Even if the arrangement is delineated in the evidence as a loan, the commercial rationality of the transaction is questionable; it is doubtful whether ECo and a third-party lender would have been able to agree terms of a loan, given the very high level of risk for the lender.

The contractual assumption of risk wasn't consistent with the conduct of the associated enterprises. DCo assuming risk only formally but doesn't exercise control over the risk and hasn't financial capacity to assume the risk (e.g. the risk of non-payment of interest to the bank).

All features of the arrangement suggested hallmarks of equity rather than debt, and, together with the analysis of all the circumstances and evidence led to the determination that for transfer pricing purposes the loan arrangement could not be delineated as an interest-bearing loan. As a result, interest deductions have been denied.

High Administrative Court confirmed the finding of the tax authority.

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CASE STUDY 4 - POLAND

Case Submitter:

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Background - Description of the Case:

During tax avoidance counteracting, tax authorities sometimes forget about very simple double non-taxation schemes, which results in that such schemes happen to be revealed by accident.

One example of the scheme actually happened in 2017 on a Polish backyard in the matter of a Danish manager who was an Austrian resident working for a Polish company.

The taxpayer figured out hybrid mismatch on the grounds of a management package scheme using special purpose derivative, which is a particular example of a double non-taxation phenomenon on the basis of a personal income tax, when a taxpayer classifies the same income to at least two different sources of income in at least two different jurisdictions – in the aforementioned case, in Austria as a director's fee and in Poland as an other income, i.e. income from derivatives.

The primal challenging question was whether the Chief of the National Revenue Administration (the exclusive public authority responsible for a GAAR application) could apply a GAAR towards the above-mentioned tax avoidance scheme, especially in the context of article 119b Polish Tax Ordinance that ordered to use special anti-abusive tax law provisions, if there were any at that time.

In 2017 in the Double Taxation Avoidance Agreement between Austria and Poland there was no general rule dedicated to a treaty abuse counteraction – neither a PPT, nor a LOB clause. Even there was no mention about it in the preamble. The situation have changed on 1st July 2018, when the Agreement was amended, influenced by the MLI Convention. However, it did not apply to a reckoning with tax authorities in 2017.

Despite the fact that in Polish legal order there is a constitutional priority of international law over domestic law, hypothetical problem with a treaty override between GAAR and treaty provisions could be resolved in the light of article 31 section 1 Vienna Convention on the law of treaties, i.e. bona fide principle. Moreover, since 2003 there is a guiding principle covered by a OECD Model Convention that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favorable tax position and obtaining that more favorable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions (point 9.1-9.6 of commentary to article 1, OECD Model Convention, 2003). According to the circumstance that the DTA Agreement entered into force in Poland on 1st April 2005, and none of parties did not report any objection or reservation, there were strong grounds to apply Polish GAAR towards the aforementioned case, especially in the light of the obvious similarity of Polish GAAR with the sound of guiding principle that was placed in the OECD Model Convention from 2003.

Sticking to the point, the taxpayer between 2009 and 2018 was performing a function of the Board Member in a Polish private limited company (Alfa company). By reason of that, the taxpayer received in 2017 director's fee in amount of 2.5 million zlotys. He paid an income tax in the amount of 0.5 million zlotys, which was documented by Alfa company in the tax declaration that the company submitted to the competent tax authority.

In 2017 the taxpayer received parallelly income from a derivative disposal in the amount of 115.50 million zlotys. He did not pay any income tax from that, explaining that he is a non-resident and this income should be treated as the other income within the meaning of the article 22 section 1 of the DTA Agreement between Austria and Poland.

The income was received vis-à-vis a contract conclusion on 29th September 2014 between the taxpayer and a Luxembourgish private limited company, Beta company, that was a parent company in relation to the Alfa company. The subject of the contract was to grant the taxpayer so-called "participation units", which broadly entitled to participate in growth of the shares' value possessed in the capital group owned by the Beta company. However, it was so constructed that a risk of a dilution of equity could be prevented.

"Participation units" constituted, more or less, a conditional right to receive in the future a determined amount of money calculated as per the dedicated mathematical formula. Exercising the right was supposed to be happen under the condition that the share's value of entities being in the capital group of the Beta company would grow, which could be measured in result of the following liquidity events: going public by one of companies, companies' change of control, dividend payment, disposal or redemption of the required number of shares.

Chief of the National Revenue Administration had no doubt as for artificiality of such state of affairs, since in the period of 2014-2017 Alfa Company had been noting costs of maintenance of the aforementioned management package in financial statements as overheads. In such statements there was no mention about any strategy in terms of derivatives related to the management package, which was strange, because of its influence on financial results of the Alfa Company. Furthermore, the whole economic burden to paying out money to the taxpayer had been recharged to the Alfa Company, which was the subject of a different contract concluded between the Alfa Company and the Beta Company. At the same time, any decision about assign, delegate, charge, declare a trust or otherwise dispose of the right to receive money in virtue of possessed derivative could not be made without consent of the Beta Company. Finally, obligations of the taxpayer described in the participation units contract were not beyond his past duties. To the contrary, stipulations on the contract concerning the confidentiality clause, or the non-competition clause or the direct condition that the taxpayer would be still employed as the Board Member rather highlighted that the contract was to deepen a relationship between the capital group and the taxpayer on terms of the Board Member, not the investor.

In the preamble of the contract the official aim of the one was to motivate the taxpayer to further commitment to develop capital group of the Beta Company, and especially – the Alfa Company.

All things considered, the contract was non-genuine.

However, the crucial circumstance was that the taxpayer's tax certificate, exposed by Austrian authorities as the result of an administrative exchange of information, pointed out the taxpayer declared his income as a director's fee in the legal sense of article 16 of the DTA Agreement between Austria and Poland. The importance of such information resulted from that the article 24 section 2 of the DTA ordered, in principle, to exempt an income from a tax in Austria, if the same income was already taxed in Poland. Normally, regarding a director's fee, an Austrian resident would be taxed according to the 20% tax rate from his revenue, not the income. Therefore, hypothetical amount of the Polish income tax would be equal to 23.1 million zlotys. Equally important on the grounds of fiscal motivations of the taxpayer was a fact that identical contracts were concluded by the Beta Company only with the other Board Members, who had an indivisible influence on how capital group was to be managed and were undertaxed in Poland too. One of them received in Poland a positive tax ruling that allowed him to take advantage of the management package scheme. In the contract there was also a referring to the PIT Act's definition of the derivative, which was odd, considering the fact that contracting parties were from Austria and Luxembourg. In respect to the aforementioned, achieved by the taxpayer benefit was the predominant purpose contrary to the spirit and subject of the DTA Agreement's provisions.

Questions (relating to the case):

Considering the background of the case and apart from the fact that during 2017 there was no PPT in most of DTA agreements, there could be posed following questions.

1. Are there any international legal measures other than general anti-avoidance rules that could then and can nowadays prevent from double non-taxation in the sphere of personal income tax through re-qualification of sources of income?

2. If not, then what sort of international measures can be introduced to our jurisdictions and in what way in order to combat such a double non-taxation practice?

Proposed Solution:

1) At the moment when the Chief of National Revenue Administration was taking care of the case described in the "Case study", there was no anti-abusive measure other than a GAAR. However, in the present day it is possible to combat management tax avoidance scheme owing to special provision's introduction – an article 10 section 4 placed in Personal Income Tax Act. The provision entitles a competent tax authority to reinstate the adequate source of income, if a taxpayer receives any derivative for free from an employer or an entity, where the one performs an important function. The main purpose of the aforementioned article was to make impossible to abuse incentive programs by reshaping source of income and avoiding taxation according to the higher rate 32% from a tax scale. Such a harmful tax practice follows on that income from derivatives is normally taxed in Poland according to the one and only rate 19%.

Still, it is important to notice that the aforementioned Polish tax law provision would not be effective in circumstances of cross-border transactions, either when there is no PPT, LOB or any other dedicated anti-abusive provision in a DTA Agreement, or even when there is at least one of them.

Basically, if there is an effective anti-abusive provision in a DTA Agreement, then an article 10 section 4 placed in Polish Personal Income Tax Act is no longer useful, because the competent tax authority can apply directly a provision in the Agreement. Moreover, an adequate PPT, LOB or any other general rule established in a DTA Agreement will most likely be different in its content than the aforementioned rule in the Polish tax law act, so – according to the article 91 section 2 Polish Constitution – the former one will have a precedence over the latter one.

However, if there are no anti-abusive provisions in a DTA Agreement, then we need to compare a national anti-abusive tax law provision with the guiding principle from the 2003 OECD Model Convention and, from obvious reasons, under the condition that a DTA Agreement was not concluded between contracting parties before 2003. If differences between a national anti-abusive tax law provision's wording and the guiding principle from the 2003 OECD Model Convention are too big, e.g. when there is an irrefutable premise that we have a tax avoidance scheme without giving any chance to a taxpayer to explain himself or when a tax legislator used an overdetailed wording making that way an established rule discriminatory for non-residents, then such a provision is contrary to the guiding principle and there is a risk of treaty override's accusation. Going back to the aforementioned article 10 section 4 placed in Polish Personal Income Tax Act, we have there automatic presumption of a tax avoidance scheme. In other words, it would not comply with the guiding principle that enable taxpayers to convince tax authorities about genuine non-fiscal motives. Fortunately, more and more states introduce anti-abusive provisions to their treaties, so it should not be a practical problem with treaty abuse's risk these days.

Answering the first question, in the circumstances of the described anti-abusive provision in the Polish PIT Act there was and there is no legal measure other than GAAR or PPT.

2) The distinctive fact is that neither ATAD, nor any other legal act enacted on the multilateral (e.g. UE) or bilateral level does not cover issue related to double non taxation in terms of personal income tax. Probably it's because of the fact that most states object to harmonize or even unify tax law in terms of personal income tax from the political or sovereignty reasons. However, there is also a legal reason.

In the tax law doctrine it is said that hypothetical legal foundation for personal income tax harmonization would be solely general competence norm from an article 115 of the Treaty on the Functioning of the European Union. In conformity with the article, an approximation of Member States' laws, regulations or administrative provisions is possible if they directly affect the establishment or functioning of the internal market. The problem is that most of the Member States in UE probably claim that direct taxes, and especially personal income tax, does not have particular influence on the internal market. A presumptive try to do so would be met with the accusation of the subsidiarity and proportionality general principles of the UE law. It is more probable to success, if there would be an attempt to convince European Commission on the basis of article 292 of the Treaty on the Functioning of the European Union to issue a proper recommendation addressed to all Member States – analogically to the recommendation from 6th December 2012 on aggressive tax planning. Thereby, it seems really difficult, if not possible, to introduce any international legal measure in order to combat double non-taxation practice such as described before. In that case, general anti-avoidance rules must be sufficient.

However, not all things are washed up. It is vital to have a very productive and proactive cooperation between tax administrations. If there was no such a cooperation from Austrian tax authorities, probably we would not know anything about a double non-taxation practice related to the management package scheme. In other words, it would be more than welcomed to put on tax certificate not only demanded information, but also additional information that could be useful, e.g. declared in Austria source of income. Convincing other states to unify form of tax certificate, which could have such useful information obligatorily, seems to be more probable than a whole harmonization of personal income taxes system in Europe.

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CASE STUDY 5 – REPUBLIC OF NORTH MACEDONIA

Case Submitter:

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Background - Description of the Case:

The Macedonian tax legislation has only two articles related to the anti-abuse rules. The first article is outlined in the Law on the tax procedure and it covers the fictive legal transactions. The second article has been introduced at the end of FY2023, by amending the Corporate Income Tax Law, in order to comply with the EU Anti-Tax Avoidance Directive (ATAD). It refers mainly to the General Anti-Abuse Rules (GAAR) and sets forth that the rights established by the CIT Law and/or a Double Tax Agreement, which relate to reductions in the tax base, tax exemptions, exemptions from paying tax or withholding tax, reductions in the calculated tax, application of a lower tax rate or a different taxation model, the taxpayer shall not be able to use them for an arrangement or a series of arrangements whose main purpose or one of the purposes is the use of the specified tax benefits, provided that the arrangements are not authentic.

For the time being, the Macedonian tax authority has no practical experience related to hybrid mismatches. Therefore, we provide a hypothetical example on branch mismatches.

Branch mismatches

The tax system of jurisdiction X is relatively simple and straight forward. For example:

• Jurisdiction X has a worldwide system of tax whereby companies are subject to tax on a current year basis on their worldwide profits and gains i.e. all profits arising in Jurisdiction X and all profits arising to foreign branches are subject to tax in the current year.

• Jurisdiction X does not have tax consolidation. Tax consolidation is where a country allows a group of companies to prepare a single tax return. In Jurisdiction X, the requirement is to pay CIT on a company-by-company basis such that intragroup transactions are recognised in each individual company for tax purposes.

The CIT Law of Jurisdiction X has provisions designed to provide for the effective interaction between the anti-hybrid rules and Jurisdiction X's worldwide system of taxation. It combines specific rules with an overriding principle based in the anti-avoidance rule, to ensure that it only neutralises actual economic hybrid mismatches and not juridical hybrid mismatches arising because of a worldwide system of taxation.

The Article 1 paragraph (1) of Jurisdiction X's CIT Law provides that it applies where certain payments are disregarded ("disregarded payments") in an investor or payee territory when computing the taxable profits of an enterprise in that territory under a provision similar to the worldwide system of taxation.

The payments that may be "disregarded payments" for the purposes of that provision are payments between:

(a) the head office of an entity and a permanent establishment of that entity,

(b) two or more permanent establishments of an entity,

(c) an individual and a permanent establishment of that individual,

(d) two or more permanent establishments of an individual,

(e) where an enterprise is a participator in a hybrid entity, the enterprise and the hybrid entity,

(f) where an enterprise is a participator in two or more hybrid entities, two or more such hybrid entities, or

(g) where an entity is an entity on which a controlled foreign company charge or foreign company charge is made in respect of two or more hybrid entities, two or more such hybrid entities.

Paragraph (2) of Article 1 provides for situations where "disregarded payments" shall be treated as included in an investor or payee territory for the purposes of the anti-hybrid rules such that a mismatch outcome will not arise.

Example: Payments between Company A in Jurisdiction X and its foreign branch

❖ Facts:

- Company A is established and tax resident of Jurisdiction X, which develops and sells computer software.

- Company B is a foreign branch of Company A in Jurisdiction Y, which provides IT services to Company A in Jurisdiction X.

- Company B incurs 3rd party costs in respect of its IT services.

- Company A pays Company B an intra company payment in respect of the IT services.

The intra company payment is a "disregarded payment" per the provision in Article 1 paragraph (1) from the CIT Law of Jurisdiction X. It is a payment between the head office of Company A and a permanent establishment of Company A that is disregarded when computing Company A's taxable profits in Jurisdiction X.

❖ Interaction with the anti-hybrid rules:

- Company B in Jurisdiction Y, takes a tax deduction in respect of its 3rd party costs against its income from Company A (intra-company income).

- Company A in Jurisdiction X, takes a tax deduction in respect of the 3rd party costs in Jurisdiction Y, under its worldwide system of taxation, against its 3rd party income.

- There is a double deduction (in Jurisdiction Y and Jurisdiction X)

Questions (relating to the case):

Question: Is there dual inclusion income?

Proposed Solution:

When applying Article 1 paragraph (1) from the CIT Law of Jurisdiction X to a particular transaction, the Company A must have regard to paragraph (3) which sets out when this provision will not apply. It is effectively a principle-based test which obliges the Company A to look to the substance of a transaction to ascertain whether a mismatch arises either in the context of ATAD or within the meaning of the term mismatch when construed in accordance with the BEPS Action 2 report. ATAD in recital 13 sets out that: "…hybrid mismatches are the consequence of differences in the legal characterisation of payments (financial instruments) or entities and those differences surface in the interaction between legal systems of two jurisdictions…. In this context, it is useful to clarify that measures aimed to tackle hybrid mismatches in ATAD are aimed to tackle mismatch situations attributable to differences in the legal characterisation of a financial instrument or entity".

The executive summary of the BEPS Action 2 report provides that: "Hybrid mismatch arrangements exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions to achieve double non-taxation, including long-term deferral."

Therefore, before benefiting of the treatment allowed in Article 1 paragraph (2) from the CIT Law of Jurisdiction X, the Company A must be able to illustrate that the transaction has not resulted in double non-taxation (including long-term deferral).

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CASE STUDY 5 – SLOVAKIA

Case Submitter:

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Background - Description of the Case:

This is a theoretical case of a hybrid mismatch that allows for a D/NI outcome.

In this case, A Co (a company resident in Country A) owns all the shares in B Co (a company resident in Country B). A Co has granted a subordinated loan to B Co, with interest payments due on an annual basis. The loan is subordinated to the ordinary creditors of B Co, and the payments of interest and principal can be suspended if B Co fails to meet certain solvency requirements.

The hybrid mismatch of the loan arises from the differing legal classifications of the loan in Country A and Country B:
Country B treats the loan as a debt instrument.
Country A treats the loan as an equity instrument (i.e., a share), meaning the interest payments on the loan are treated as dividends under Country A law.

This creates a hybrid mismatch situation, as the same payment is treated differently under the laws of each country. This difference in treatment allows the payer (B Co) to claim a deduction for a payment while payment is not included in the payee's (A Co) taxable income, i.e., it allows for a D/NI result (deduction/non-inclusion).

Questions (relating to the case):

1. How should tax administrations address hybrid mismatches arising from the different classifications of debt and equity instruments in different jurisdictions?

2. How can tax authorities determine whether a payment should be treated as a dividend or interest in the context of hybrid mismatch rules?

3. How should multinational enterprises structure financing arrangements to avoid hybrid mismatches when the financing instrument is treated as debt in one jurisdiction and equity in another?

Proposed Solution:

Avoiding D/NI: The rules aim to prevent the situation where B Co can claim a deduction for the interest payment (as it is treated as a debt instrument under Country B's tax law), while A Co benefits from non-inclusion of the payment in taxation (as it is treated as a dividend under Country A's tax law).

The Slovak Republic has implemented rules in its legislation to address hybrid mismatches. By adopting these rules, the Slovak Republic can eliminate the mismatch by denying the interest deduction to B Co, thus preventing a "double benefit" (i.e., a deduction in Country B and non-inclusion in Country A).