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HYBRID MISMATCHES – BELGIAN CASE

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AUDIT APPROACH

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AUDIT APPROACH

- Belgium has a specific withholding tax exemption for bonds. In an intragroup context, this exemption often seems to be used in tax planning structures.
- This file was selected as the result of a specific action on the withholding tax exemption for bonds issued in a group context.
- Initial information was gathered from various sources:
 - Publicly available accounts in Belgium (www.nbb.be)
 - Publicly available accounts in France (<https://www.pappers.fr/>) and Luxembourg (*"registre de commerce et des sociétés"* - www.lbr.lu/mjrsc). Accounts in Ireland are behind a paywall (<https://core.cro.ie/>)
 - <https://www.sec.gov/edgar/search> for information on US (stocklisted) Groups
 - Withholding Tax Returns (internal database)
 - Old Belgian Tax Rulings (internal database)
 - Previous audits (internal database)
 - Old exchange of information request from French authorities (in 2019) (internal database)



AUDIT APPROACH

- After the first analysis of available information, a request of information was sent to the Belgian taxpayer. In theory, he has 1 month to respond. In practice, it often takes longer:
 - Audit initiated in January 2024. Luxembourg Tax returns for FY2022 were however only filed in May 2024. This significantly delayed the second request of information.
 - Belgian Taxpayer is selective in providing information for foreign entities. Exchange of information with Luxembourg Authorities was initiated in May 2024. Additional information was provided by the Luxembourg Authorities in December 2024.
 - New (third) request for information was issued to Belgian taxpayers a few days after receiving the information from Luxembourg (Dec 2024). Tax manager did however resign, year-end closing, rather elaborate request for information... Response time extend from 1 month to 3 months....
 - Request to US IRS was launched for US LLC mid 2024, still no response...
 - Probably another exchange of information will be necessary at some stage... difficult balance between building the strongest possible file on the one hand, and statute of limitations/ reversing the burden of proof on the other hand...



AUDIT APPROACH

- Board minutes have been obtained for LuxCos for 2018 and 2019, and seem to confirm potential hybrid mismatch risk. Clear reference is made to hybrid mismatch structures, some of which were stopped in 2018, but some of which seem to continue in 2019...
- Based on own assessment, three potential transactions have been identified as potentially creating a hybrid mismatch:
 - Financing of acquisition via Irish branch;
 - Historic hybrid mismatches via tax losses;
 - Derivatives (Net Investment Hedge)



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BACKGROUND TO THE CASE

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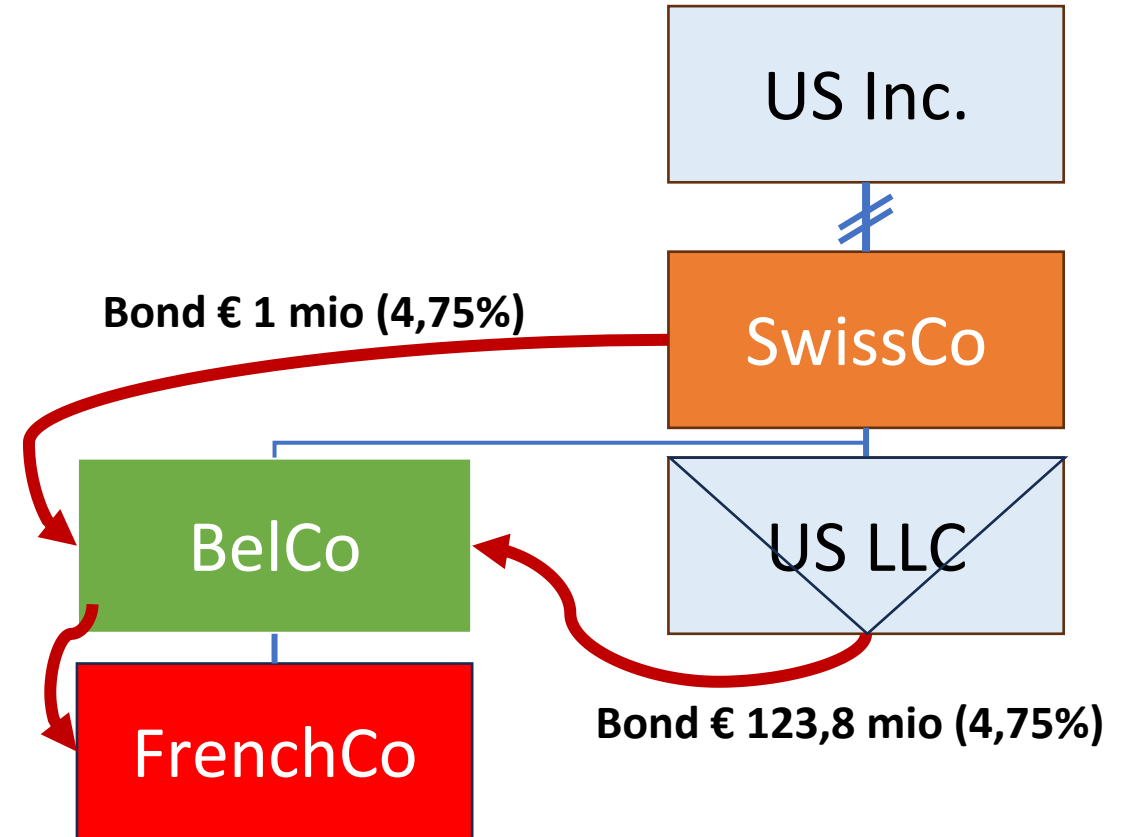
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2014

- New bond issuance by Belgian Company (“BelCo”).
- Subscribed by existing shareholders.
- (partial) Compensation with previous bonds issued to the same parties. (these bonds expired per 31.12.2013)
- IC Loan FrenchCo granted by BelCo is also new as of 1 Jan 2014 (although this seemed to be the conversion of an existing current account that was in place as of 2009...)
- In essence proceeds of the bond are lentled via the BelCo to FrenchCo

IC Loan (5%)
€138.298.969 mio

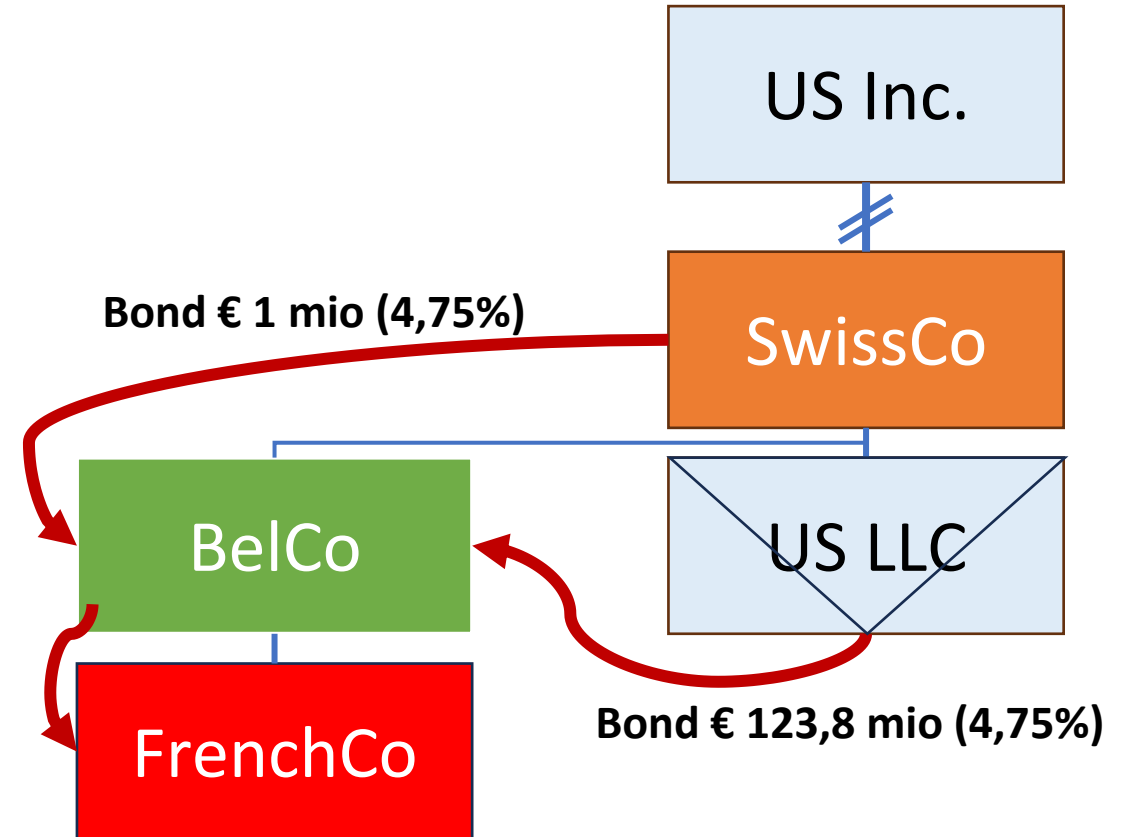




2014

- Clear hybrid mismatch (US LLC held by non-US shareholder)
- Tax play
 - **Avoid issues with tax deductibility in France?**
 - Part of the interests (margin+ interest on 15 mio that is equity financed by BelCo) is offset with carried forward losses at level of BelCo
 - Without a bond (and the related internal withholding tax exemption), a 30% withholding tax would apply in Belgium.

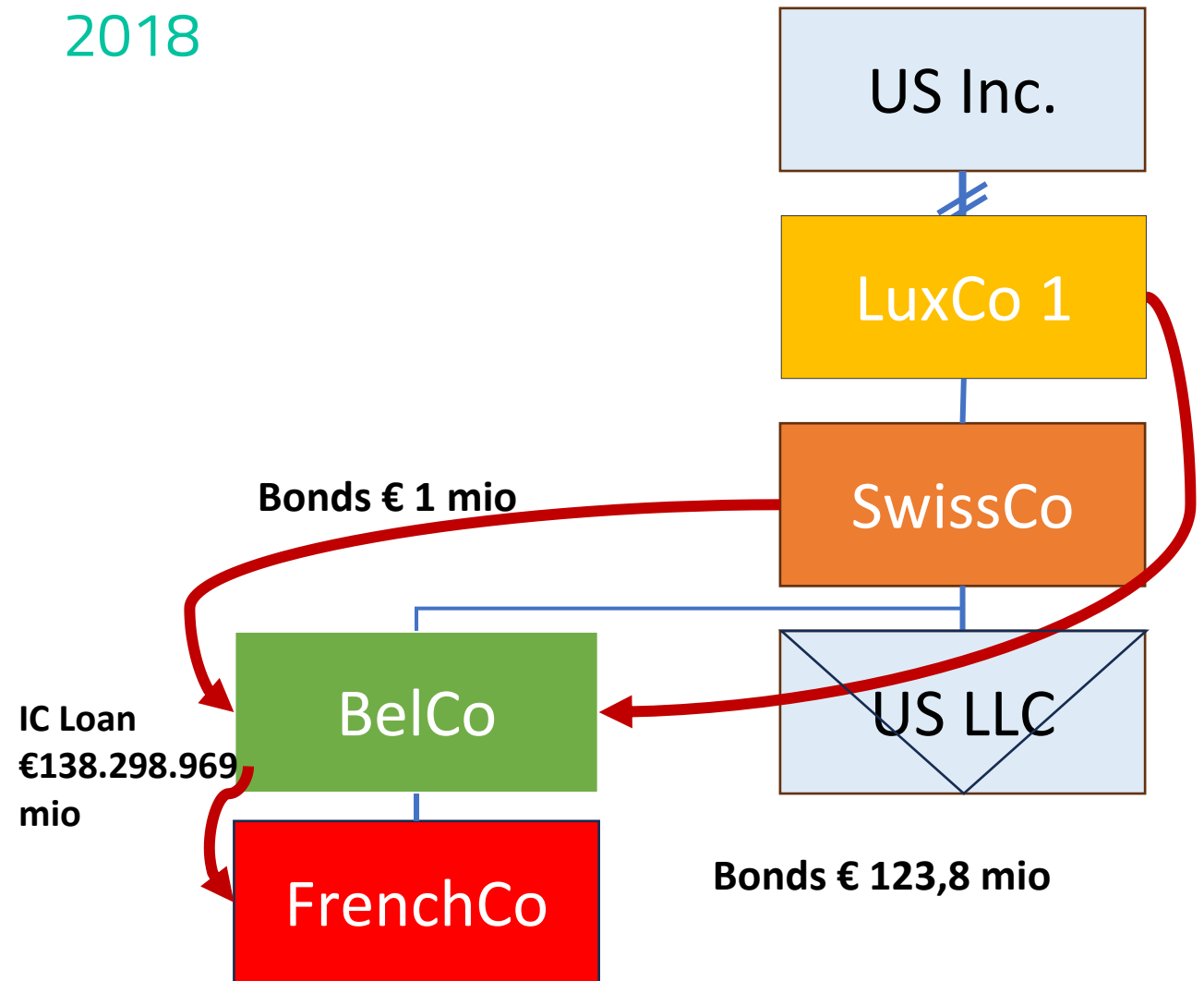
IC Loan (5%)
€138.298.969 mio





- 14.12.2018 - Transfer agreement is signed to transfer bonds from US LLC to LuxCo 1 as of 1.1.2019
- LuxCo 1 pays the consideration for the bonds on a Luxembourg bankaccount of the US LLC on 17.12.2018.
- Coupon for 2018 is only paid out on 31.1.2019 and will be passed through by LuxCo 1 to US LLC.

2018





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IRISH BRANCH

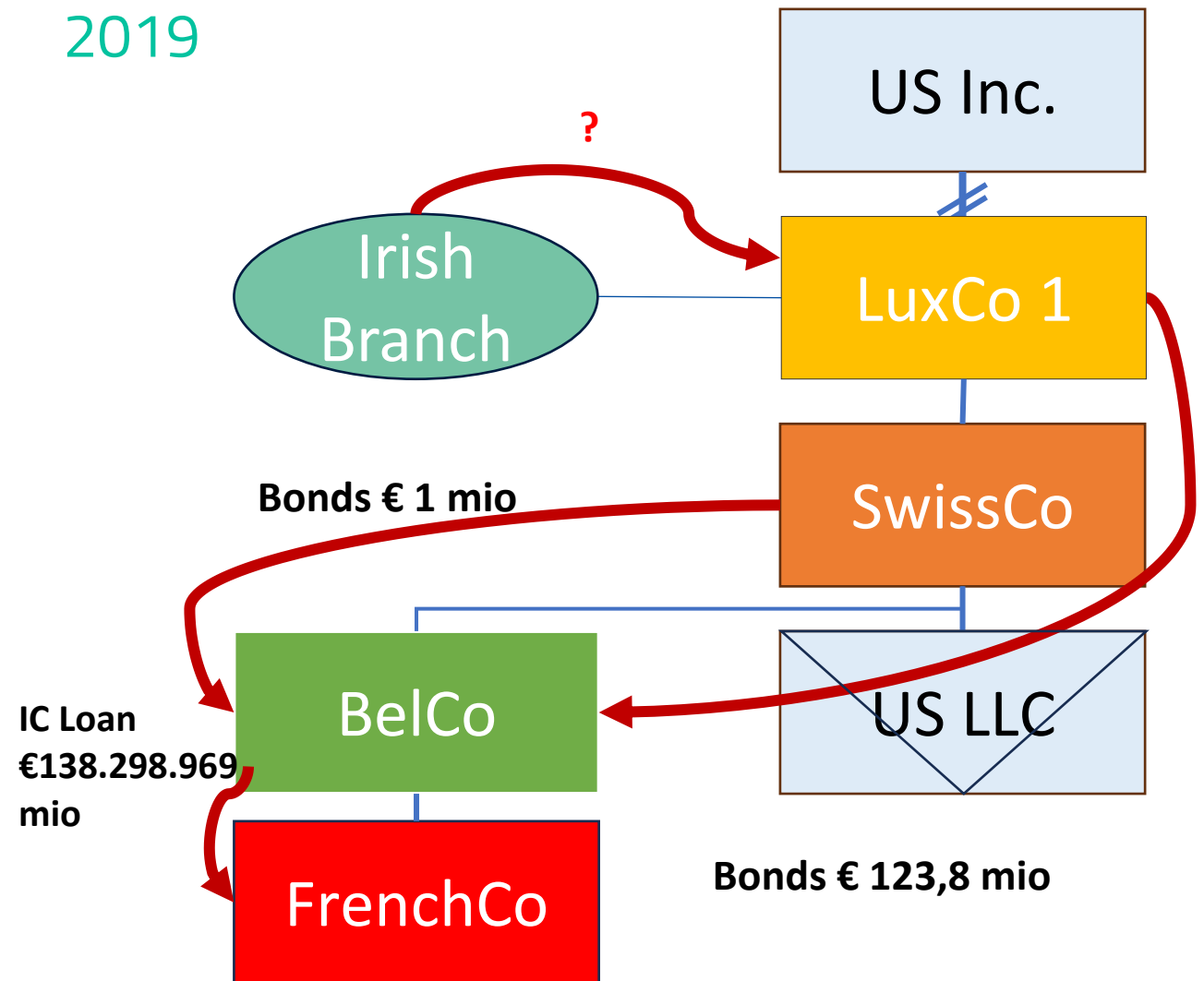
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- Minutes 29/11/2018 – LuxCo 1: *“It is proposed that the Company withdraws cash from the cashpool to fund the purchase”*
- Acquisition financed via Irish cash pool? Which is managed by a branch of LuxCo 1.
- Important to note that Ireland did not adopt the Authorised OECD Approach until 1.1.2020.

2019





BRANCH RESULT – ANNEX LUXCO 1 TAX RETURN

Balance sheet as per 31 December 2019

(expressed in EUR)

Assets

	Consolidated	Branches	Head-office Luxembourg
Participations	835,252,408	-	835,252,408
Loans to affiliated undertakings	123,800,000	-	123,800,000
Tangible assets	52,687	52,687	-
Amounts owed by affiliated undertakings	607,528,193	601,627,417	5,900,776
Trade receivables	3,335,019	3,335,019	-
Other debts receivable	53,012	53,012	-
Cash at bank	592,650,646	592,650,646	-
	<u>2,162,671,965</u>	<u>1,197,718,781</u>	<u>964,953,184</u>



BRANCH RESULT – ANNEX LUXCO 1 TAX RETURN

Liabilities

Share capital	100,000	-	100,000
Share premium	501,576,024	1,326,791	500,249,233
Share premium net repayment	(399,011,566)	-	(399,011,566)
Legal reserve	10,000	-	10,000
Profit or loss brought forward	61,840,617	1,736,982	60,103,635
Profit or loss for the financial year	694,500,799	859,836	693,640,963
Intercompany account head-office/branches	-	101,272,786	(101,272,786)
Total capital	859,015,874	105,196,395	753,819,479
Trade creditors	19,305	19,305	-
Amounts owed to affiliated undertakings	1,294,753,384	1,091,272,614	203,480,770
Tax debts	841,897	829,733	12,164
Other debts payable	502,109	400,734	101,375
Other debts payable	7,539,396	-	7,539,396
	2,162,671,965	1,197,718,781	964,953,184



BRANCH RESULT – ANNEX LUXCO 1 TAX RETURN

Profit and loss account for the year 2019 (expressed in EUR)

Income

	Consolidated	Branches	Head-office Luxembourg
Net turn over	18,736,509	18,736,509	-
Interest on debts receivable	6,232,685	352,185	5,880,500
Exchange gains	21,447	21,447	-
Other financial income	1,124,523	-	1,124,523
Value adjustment on financial fixed assets (reversal)	116,885,911	-	116,885,911
Income from financial fixed assets (dividends)	597,756,581	-	597,756,581
Other operating income	490,548	490,548	-
	<u>741,248,204</u>	<u>19,600,689</u>	<u>721,647,515</u>



BRANCH RESULT – ANNEX LUXCO TAX RETURN

Profit and loss account for the year 2020 (expressed in EUR)

Income

	Consolidated	Branches	Head-office Luxembourg
Net turn over	20,780,420	20,780,420	-
Interest on debts receivable	7,600,772	3,527,349	4,073,423
Exchange gains	7,519	7,519	-
Other financial income	7,367,709	-	7,367,709
Income from financial fixed assets (liquidation balance)	1,189,280	-	1,189,280
Income from financial fixed assets (dividends)	92,522,344	-	92,522,344
Other operating income	475,153	475,153	-
	129,943,197	24,790,441	105,152,756



BRANCH RESULT – ANNEX LUXCO 1 TAX RETURN

Profit and loss account for the year 2021 (expressed in EUR)

	Consolidated	Branches	Head-office Luxembourg
Income			
Net turn over	26,404,025	26,404,025	-
Interest on debts receivable	6,826,584	2,475,423	4,351,161
Exchange gains	30,374	30,374	-
Other financial income (derivatives)	532,762	-	532,762
Other operating income	689,945	689,945	-
	<u>34,483,690</u>	<u>29,599,767</u>	<u>4,883,923</u>



BRANCH RESULT – ANNEX LUXCO 1 TAX RETURN

Profit and loss account for the year 2022

(expressed in EUR)

	Consolidated	Branches	Head-office Luxembourg
Income			
Net turn over	27,721,398	27,721,398	-
Income from financial fixed assets (interest)	5,880,500	-	5,880,500
Interest on debts receivable	2,311,913	2,311,913	-
Exchange gains	10,469	10,469	-
Income from financial fixed assets (dividends)	39,963,005	-	39,963,005
Other operating income	666,924	666,924	-
	76,554,209	30,710,704	45,843,505



BRANCH RESULT – ACCOUNTS IRISH BRANCH

5. Interest receivable and similar income

	2021 €	2020 €
Interest receivable from group undertakings	2,477,854	3,507,932
	<u>2,477,854</u>	<u>3,507,932</u>

6. Interest payable and similar expenses

	2021 €	2020 €
Interest payable to credit institutions	2,658,435	3,045,594
	<u>2,658,435</u>	<u>3,045,594</u>



BRANCH RESULT – ACCOUNTS IRISH BRANCH

5. Interest receivable and similar income

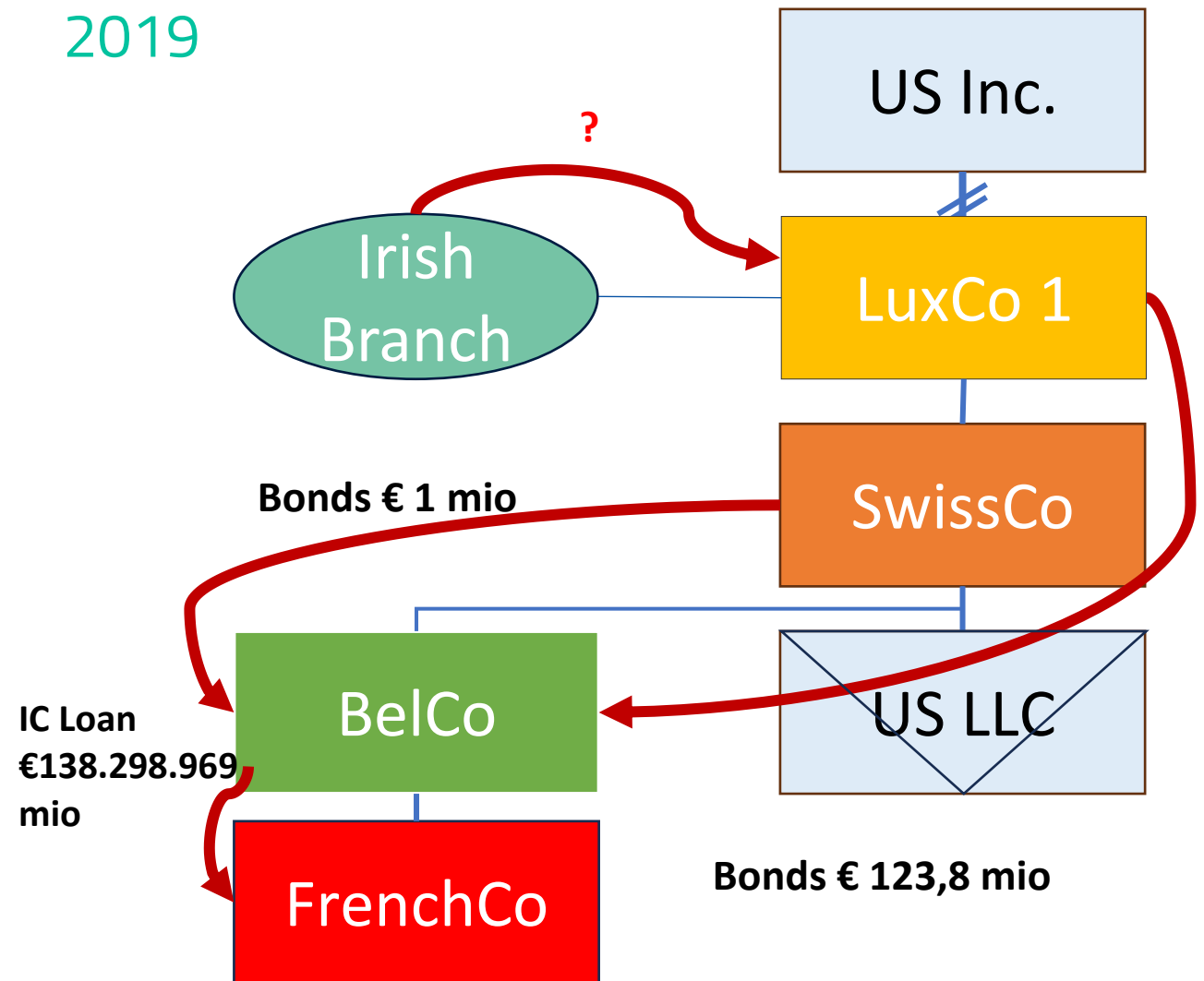
	2022 €	2021 €
Interest receivable from group undertakings	2,528,155	2,477,854
Interest receivable from credit institutions	623,768	-
	<u>3,151,923</u>	<u>2,477,854</u>

6. Interest payable and similar expenses

	2022 €	2021 €
Interest payable to group undertakings	2,765,946	-
Interest payable to credit institutions	317,430	2,658,435
	<u>3,083,376</u>	<u>2,658,435</u>

- **Hypothesis: interest on cash pool is deducted by LuxCo, but no inclusion for Irish branch (at least for 2019?).**
 - Allocation of equity to branch which is “lend” to head office? (similar to borrowing from your equity financed subsidiary?)

2019





HYBRID MISMATCHES AND TP

- BEPS Action 2 Report: *“Differences in tax outcomes that are solely attributable to differences in the value ascribed to a payment (including through the **application of transfer pricing**) do not fall within the scope of the hybrid mismatch rule (see Example 1.15).”*
- Art. 2, §1, 16° WIB *“Er kan geen sprake zijn van een hybridemismatch die aanleiding geeft tot een aftrek in hoofde van een van de actoren samen met een niet-belasting in hoofde van een andere actor wanneer de afwezigheid van belasting voor deze laatste enkel te wijten is aan het belastingstelsel dat afwijkt van het gemeen recht dat op hem van toepassing is of aan de verschillen in de aan een betaling toegekende waarde, onder meer door de toepassing van verrekenprijzen.”*



QUESTIONS

- 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?
- Which additional information needs to be collected going forward?



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(HISTORIC) HYBRID MISMATCH?

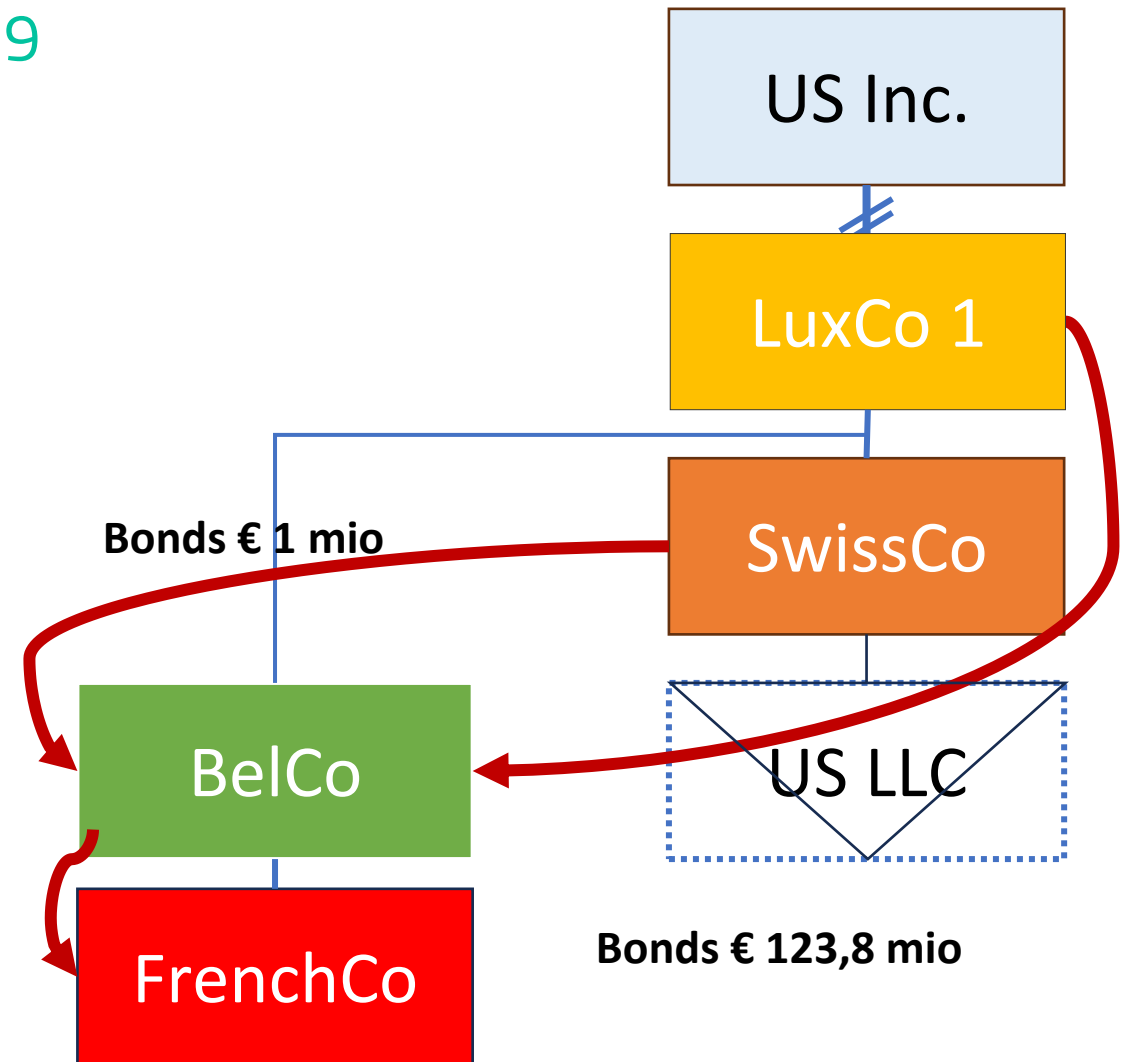


2019

- US LLC seems to have been liquidated (no longer appears in US filings (ex21 10K 2019 US Inc. SEC filings).
- Shareholders BelCo per (and prior to) 31.12.2018
 - SwissCo- 99,99% of the shares
 - US LLC – 1 share
- Shareholders BelCo per 31.12.2019
 - SwissCo – 1 share
 - LuxCo - 99,99% of shares

IC Loan

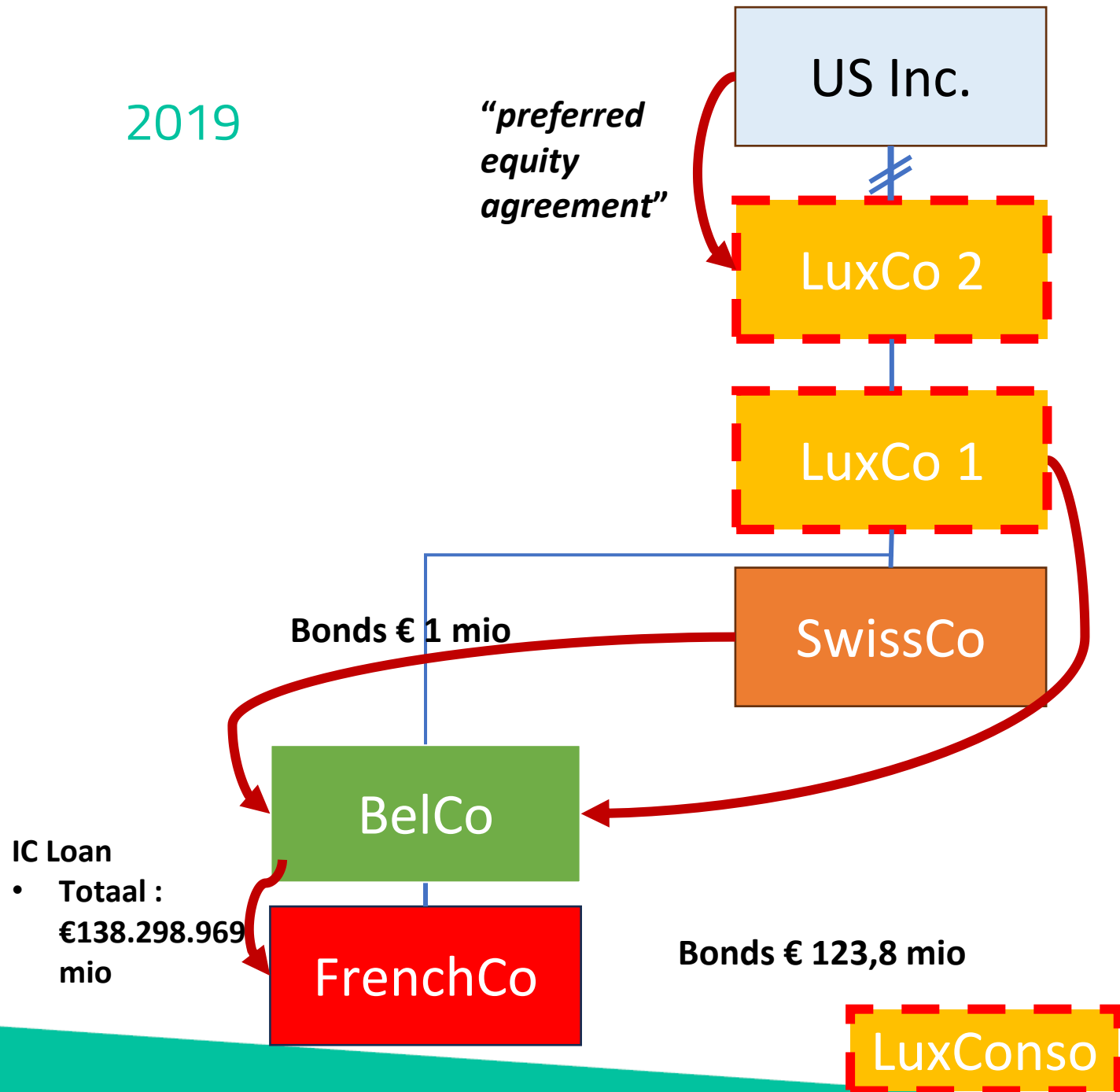
- Totaal :
€138.298.969
mio





- Luxembourg companies form a tax unity (since 2016).
- In 2019 and 2020 LuxCo 1 makes use of losses of other (Luxs) group companies.
- LuxCo 2 had entered into a “*preferred equity agreement*” with US parentCo as of 2012. (early)
Repaid at the end of 2019? Interest accrued for a number of years (but not all).
- **Hypothesis: D/Nl interest payments to the US creating current year/carried forward losses which are offset via tax unity against income from Belgian bond**

2019





USE OF LOSSES

- Tax return LuxCo 1 2019

Total of the losses carried forward incurred before the admission to the fiscal unity

C0310	At the beginning of the financial year	0,00 EUR
C0320	Allocated for the financial year	0,00 EUR
C0330	At the end of the financial year	0,00 EUR
C0350 0520	Transfer of the fiscal result of the subsidiary company to the consolidating parent company or to the consolidating subsidiary company	-95 884 382,00 EUR



USE OF LOSSES

- Tax return LuxCo 1 2020

Total of the losses carried forward incurred before the admission to the fiscal unity

C0310	At the beginning of the financial year	0,00 EUR
C0320	Allocated for the financial year	0,00 EUR
C0330	At the end of the financial year	0,00 EUR
C0350 0520	Operating profit, that is to be added to the operating profit of the consolidating parent company or of the consolidating subsidiary company	-10 890 953,00 EUR



USE OF LOSSES

- Tax return LuxCo 1 2021 / 2022 – no income taxes paid (on the contrary, losses transferred to tax unity)
 - 2021
 - In a loss position due to 1) expenses cashpool and 2) Net investment Hedge (see below)
 - “Transfer” of losses for an amount of 2,690,154 euro to LuxCo 2
 - 2022
 - In a loss position due to 1) value adjustment on shares and 2) financial debt interest (significant increase in mainly short term debt – resulting from transfers of participations)
 - “Transfer” of losses for an amount of 17,423,405 euro to LuxCo 2



USE OF LOSSES

- BEPS ACTION 5:

*263. In order to account for timing differences between jurisdictions and to prevent groups manipulating that timing in order to avoid the effect of the imported mismatch rule, **a hybrid deduction should be taken to include any net loss that has been carried-forward to a subsequent accounting period, to the extent that loss results from a hybrid deduction.** An example showing the application of the imported mismatch rule to losses which have been carried-forward from a prior period is set out in Example 8.11 and Example 8.16. In order to reduce the complexity associated with the need to identify hybrid deductions that arose prior to the publication of this report **any carry-forward loss from periods ending on or before 31 December 2016, should be excluded from the operation of this rule.***

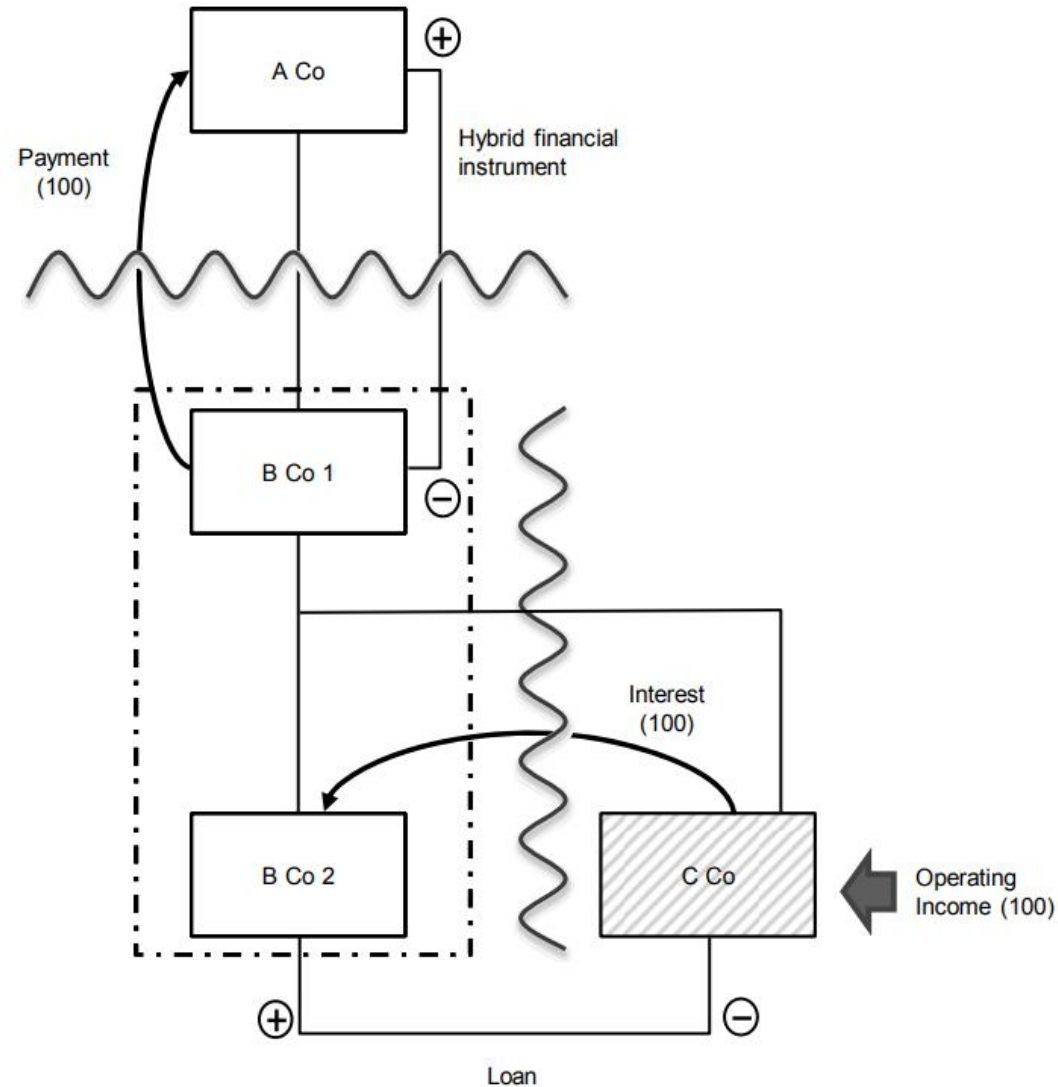


Year	Fiscal Result	Unity (standalone basis)	Transfer from other fiscal unity members	Cumulative losses carried forward	Loss primarily attributable to	Year(s) to which losses were used
2011	(9,380,354)	(11,150,389)	1,770,035	9,380,354	H	2015, 2019
2012	(19,979,510)	(22,693,156)	2,713,646	29,359,864	H	2019
2013	(7,258,902)	(33,772,456)	26,513,554	36,618,766	I	2019
2014	(27,334,477)	(31,038,464)	3,703,987	63,953,243	H	2019
2015	8,969,912	(32,607,840)	41,577,752	54,983,331	H	N/A
2016	(308,448,014)**	(35,758,544)	(163,045,619)	363,431,345	BD	2019
2017	(419,008,337)	(33,374,761)	(386,556,093)	782,439,682		N/A*
2018	(767,189,377)	(100,249,206)	(390,985,310)	1,549,629,059		N/A*
2019	97,059,572	(68,489)	(10,582,995)	1,452,569,487		N/A*
2020	98,919,385	(660,265)	86,214,878	1,353,650,102		N/A*
2021	25,654,010	(24,563)	28,752,525	1,327,996,092		N/A*
2022	(18,999,075)	235,773	(651,044)	1,346,995,167		N/A*

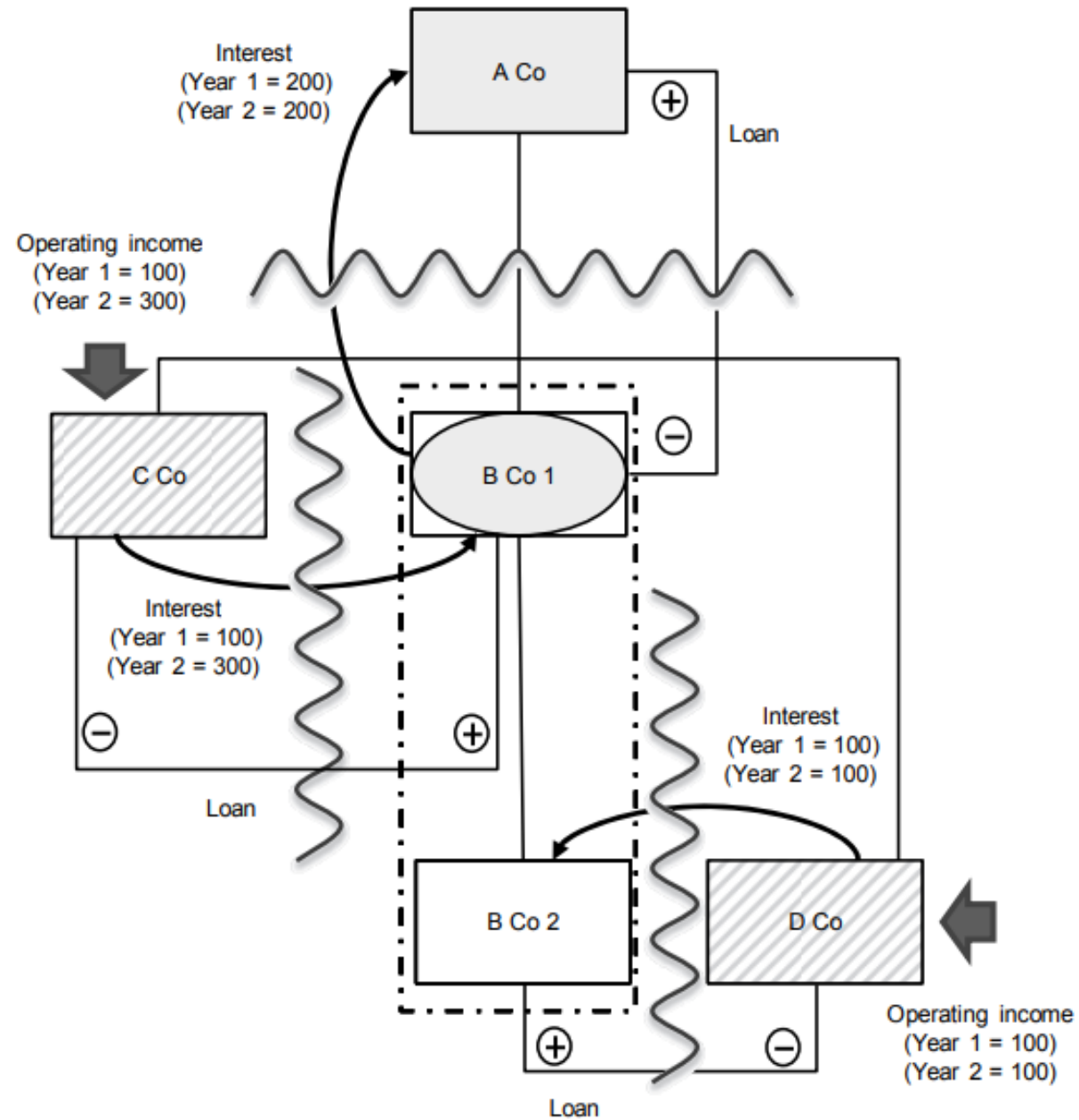
Example 8.10 (imported mismatch rule)

12. B Co 1 has surrendered a loss of 100 to B Co 2. **This loss surrender is treated in the same way as a funded taxable payment** because it is treated as set-off against an imported mismatch payment.

USE OF LOSSES



Example 8.11 (imported mismatch rule)



IMPORTED MISMATCH

- Tracing and priority rules according to the OECD report. Complex set of rules to ensure that the hybrid deduction is corrected once, and only once (avoiding double taxation):
- (a) *The first rule (the “structured imported mismatch rule”) identifies whether a direct hybrid deduction is part of a structured arrangement and, if so, treats that hybrid deduction as being set-off against any imported mismatch payment that forms part of the same arrangement and that funds (directly or indirectly) the expenditure that gave rise to the hybrid deduction.*
- (b) **Direct imported mismatches #252.** *The direct imported mismatch rule applies an apportionment approach that compares the amount of the taxpayer’s hybrid deductions (including any indirect hybrid deductions) to the total amount of imported mismatch payments made to that taxpayer by group entities (as calculated under the law of the taxpayer’s jurisdiction) and treats each imported mismatch payment as being set-off against those hybrid deductions in accordance with that ratio*

$$\text{Imported mismatch payment made by payer} \times \frac{\text{Total amount of remaining hybrid deductions incurred}}{\text{Total amount of imported mismatch payments received}}$$

- (c) **Indirect imported mismatches #255.** *If the effect of the hybrid deduction has not been fully neutralised through the operation of the direct imported mismatch rule, the final step is to determine whether the surplus hybrid deduction should be allocated to another group member under the indirect imported mismatch rule.*



QUESTIONS

- 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?
- Which additional information needs to be collected?



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NET INVESTMENT HEDGE

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NET INVESTMENT HEDGE

- Underlying mechanism is less clear.
- US group reporting in US dollars, LuxCo 1 owns participations in euro and Swiss Franc (CHF) operations. This is why a hedge was concluded (to eliminate FX impact at conso level).
- “Notional” swap, hedging EUR and CHF
- It is remarkable that the Luxembourg entity has concluded a net investment hedge. It is a currency swap to hedge for the changes in the exchange rate between EUR and USD (the functional currency of the group).
- Currency swap is with third parties (in place as of 2017?).
- LuxCo 1 is not a disregarded entity for US tax purposes.

	FX Gain	Hedge Gain	Hedge Loss
2017	(4.301.797)	No further details	
2018	4.360.109		
2019	-	1.100.000,00	7.700.000,00
2020	59.000,00	7.300.000,00	1.700.000,00
2021	58.000,00	500.000,00	6.900.000,00
2022	40.000,00	-	-
TOTAL	157.000,00	8.900.000,00	16.300.000,00



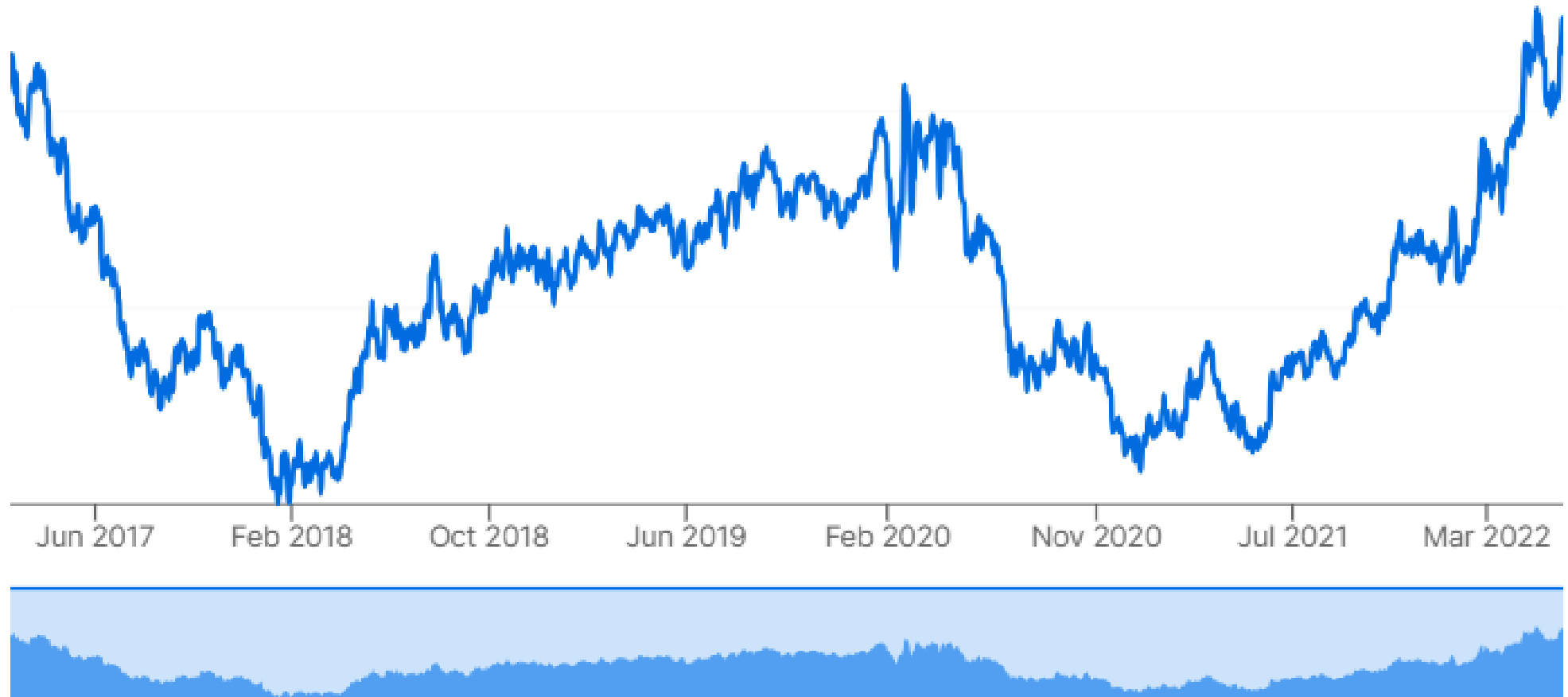
NET INVESTMENT HEDGE

- Is stopped in february 2021. Explanation: other group companies were more suited for the hedge...
- Hypothesis? Requires better understanding of agreement with third parties to rule out structured arrangement.
- Taxpayer claims that there is no framework agreement, just new swaps that are entered into on a regular basis...

	FX Gain	Hedge Gain	Hedge Loss
2017	(4.301.797)	No further details	
2018	4.360.109		
2019	-	1.100.000,00	7.700.000,00
2020	59.000,00	7.300.000,00	1.700.000,00
2021	58.000,00	500.000,00	6.900.000,00
2022	40.000,00	-	-
TOTAL	157.000,00	8.900.000,00	16.300.000,00



NET INVESTMENT HEDGE – USD TO EUR CHART





QUESTIONS

- Does anyone have experience with such derivatives, and if so, do you see a hybrid mismatch risk?
- Which additional information needs to be collected?