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*On 21 February 2017, the Economic and Financial Affairs Council of the European Union (ECOFIN) reached agreement on multiple amendments to the Anti-Tax Avoidance Directive (ATAD) to provide for minimum standards for hybrid mismatches involving third countries (i.e. non-EU countries) (ATAD 2).*

The original ATAD agreed to in June 2016 provides for a broad scope of minimum standards against tax avoidance, but as far as it concerns hybrid mismatches it was limited to hybrid instruments and hybrid entity mismatches between solely EU Member States.

The now agreed amendments to the ATAD expands these minimum standards to hybrid mismatches involving third countries. Furthermore, the scope is expanded to hybrid permanent establishment (PE) mismatches, hybrid transfers, imported mismatches, reverse

hybrid mismatches and dual resident mismatches that were not yet addressed by the ATAD. ATAD 2 requires Member States to either deny deduction of payments, expenses or losses or include payments as taxable income, in case of such hybrid mismatches.

The ATAD 2 would only apply in the case of a hybrid mismatch between associated enterprises, between the head office and a PE, between two or more PEs of the same entity or under a structured arrangement. ATAD 2 covers a number of (hybrid) mismatches, especially financial instrument mismatches; hybrid entity mismatches; reverse hybrid mismatches; permanent establishment mismatches; tax residency mismatches and imported mismatches.



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## Types of hybrid mismatches in scope of ATAD 2

ATAD 2 addresses the following hybrid mismatch arrangements:

- Hybrid entity mismatches: situations where an entity is qualified as non-transparent under the laws of one jurisdiction and qualified as transparent by another jurisdiction.
- Hybrid financial instrument mismatches: situations where the tax treatment of a financial instrument differs between two jurisdictions.
- Reverse hybrid mismatches: situations where an entity is incorporated or established in a Member State that qualifies the entity as transparent and held by an associated nonresident entity that is located in a jurisdiction that qualifies the entity as non-transparent.
- Hybrid transfers: situations where the laws of two jurisdictions differ on whether the transferor or the transferee of a financial instrument has the ownership of the payments on the underlying asset.
- Hybrid permanent establishment mismatches: situations where the business activities in a jurisdiction are treated as being carried on through a PE by one jurisdiction while those activities are not treated as being carried on through a PE in the other jurisdiction.
- Dual resident mismatches: situations which occur where the payer is a dual resident and makes a payment that is deductible under the law of both jurisdictions and the double deduction outcome results in a hybrid mismatch.
- Imported mismatches: situations where the effect of a hybrid mismatch between parties in third countries is shifted into the jurisdiction of a Member State through the use of a non-hybrid instrument thereby undermining the effectiveness of the rules that neutralize hybrid mismatches. This includes a deductible payment in a Member State under a non-hybrid instrument that is used to fund expenditure involving a hybrid mismatch.

## Impact on Luxembourg structures

ATAD 2 may have significant impact on cross border structures with respect to Luxembourg. Special attention needs to be paid to cross border structures involving US investors in which e.g. Luxembourg corporations or corporations in other jurisdictions have been treated e.g. as either partnerships or disregarded entities or foreign partnerships or disregarded entities which are treated for US tax purposes as corporations. The qualification of the entities as well as certain financial instruments such as (Convertible) Preferred Equity Certificates used in these structures may directly fall within the scope of ATAD 2. Also, the hybrid permanent establish-

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ment mismatches deserve special attention as often Luxembourg companies have permanent establishments abroad which are not always recognized in those countries.

## Impact on Dutch structures

From a Dutch perspective, a relevant provision concerns the reverse hybrid mismatch rule. The proposed solutions provided for by ATAD 2 are likely to have a substantial impact on current Dutch CV/BV structures, being an example of a reverse hybrid mismatch. Such structures may be covered by the scope of ATAD 2, because there is a hybrid (entity) mismatch involving a non-EU country (the US) due to a mismatch in the classification of the Dutch CV.

## Timing

ECOFIN will adopt the ATAD 2 once the European Parliament has given its opinion. The ATAD 2 needs to be implemented in the EU Member States' national laws and regulations by 31 December 2019 and will have to apply as of 1 January 2020, except for the provision on reverse hybrid mismatches for which implementation can be postponed to 31 December 2021 and will have to apply as of 1 January 2022.

If your corporate structure includes a hybrid mismatch, we highly recommend to analyze the potential impact of the proposed ATAD 2 measures and to take appropriate action. HVK Stevens would be pleased to assist you with this.

Should you have any questions, feel free to contact:



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