

ANALYSIS OF THE PRELIMINARY DRAFT LAW ON HYBRID MISMATCHES INCORPORATING ATAD II

1. Introduction

The Spanish Ministry of Finance has taken the first steps towards the transposition of the European Union (EU) Anti-Tax Avoidance Directive (Council Directive 2017/952 (EU) of 29 May 2017 (“**ATAD II**”) amending Directive 2016/1164 regarding hybrid mismatches with third countries (“**ATAD II**”), through the opening of a public hearing (the “**Preliminary Draft**”).

The text under consideration includes amendments to the Corporate Income Tax Law¹ (“**CIT Law**”), and the consolidated text of the Non-Resident’s Income Tax Law² (“**NRIT Law**”) and will be subject to public comments until 23 December 2020.

2. The Preliminary Draft

In accordance with the Preliminary Draft’s recitals, the provisions of ATAD II that are being transposed are applicable to hybrid mismatches that occur both between Spain and other Member States and between Spain and third countries. Both ATAD II and the Preliminary Draft establish the application of a primary rule, understood as the solution considered appropriate to deny the tax effects of a hybrid mismatch, and a secondary rule, which will be applicable when the first one has not been applied.

The Preliminary Draft’s provisions on hybrid mismatches will exclusively apply, as provided in ATAD II, when they arise between the taxpayer and an associated enterprise or when the mismatch takes place within the framework of a structured arrangement.

The Preliminary Draft follows the approach introduced by ATAD II and proposes the creation of a new Article 15 bis in the CIT Law and a paragraph 9 in Article 18 of the NRIT Law, providing that expenses are not tax-deductible or that income must be taken into account in cases where the following circumstances arise:

¹ Law 27/2014, of 27 November, on Spanish Corporate Income Tax (*Ley 27/2014, de 27 de noviembre, del Impuesto sobre Sociedades*).

² Royal Legislative Decree 5/2004, of 5 March, approving the consolidated text of the Non-Resident’s Income Tax Law (*Real Decreto Legislativo 5/2004, de 5 de marzo, por el que se aprueba el texto reemplazado de la Ley del Impuesto sobre la Renta de no Residentes*).

- **Deduction without inclusion:** it consists of the deduction of an expenditure in the jurisdiction of the payer without the corresponding inclusion for tax purposes of the corresponding income in the jurisdiction of the payee or investor as a result of the existence of different characterisation of the instrument transaction, the payment or the legal nature of the taxpayers involved.

Neutralising that mismatch will have as its primary rule the non-deduction of the expense in Spain when it is the Member State of the payer, and as a secondary rule, the inclusion of the income in the taxable amount without its exemption, when Spain is the jurisdiction of the beneficiary or investor and the deduction of the expenditure has been allowed in the jurisdiction of the originator.

- **Hybrid permanent establishment:** these are cases of deduction without inclusion or double deduction arising from differences in the recognition of income and expenditure, or even in the recognition of the existence of a permanent establishment, between the jurisdiction in which the permanent establishment is located and the jurisdiction in which the head office is situated.
- **Disregarded permanent establishment:** this mismatch arises when the laws of a jurisdiction determine the existence of a permanent establishment but no such permanent establishment is considered under the laws of the other jurisdiction. This situation creates a "double non-inclusion" mismatch insofar as the income of the said permanent establishment is not subject to taxation in either jurisdiction.
- **Double deduction:** cases where the same expenditure is deductible in two jurisdictions. In mismatches of this nature, the deduction is refused as a primary rule. As a secondary rule, the deductibility of such expenditure by the taxpayer is denied when Spain is the country of the payee and the country of the investor has not denied such deduction.
- **Imported mismatches:** where the hybrid mismatch takes place in relation to a third entity located in another jurisdiction, but which gives rise to deductible expenditure in Spain. The rule established for imported mismatches provides that deduction for a payment made by a taxpayer shall be refused where the payment finances, directly or indirectly, deductible expenses that result in a hybrid mismatch by means of a transaction or a series of transactions between associated enterprises or agreed in the framework of a structured scheme, except where an equivalent adjustment has been made by one of the jurisdictions affected by the transactions or series of transactions in respect of such hybrid mismatch.
- **Dual resident taxpayer:** when it leads to an expenditure being tax-deductible in two jurisdictions at the same time.

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In this case, the taxpayer is denied the right to deduct the expense if such right to deduct is allowed in the other jurisdiction and is offset against income that is not dual inclusion income.

Finally, regarding the reverse hybrid mismatches included in Article 9 bis of ATAD II, they have not been transposed, given that the current Spanish tax regulations already prevent them from occurring.

3. Conclusion

The Preliminary Draft is consistent with ATAD II and not many aspects of it have been left out of the text proposed in the public hearing. The rules provided for follow the guidelines set by the OCDE on BEPS and are all in accordance with the objective of neutralising the aforementioned hybrid mismatches.

The Spanish provisions related to ATAD II will most probably be applicable to tax years beginning on, or after, 1 January 2020 and which have not concluded before the Preliminary Draft is passed and enters into force.

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The information contained in this Briefing is of a general nature and does not constitute legal advice. This Briefing was prepared on 18 December 2020 and Pérez-Llorca does not undertake any commitment whatsoever to update or review its content.

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