

HYBRID MISMATCH ARRANGEMENTS: SPAIN IMPLEMENTS ATAD II

1. Introduction

On 10 March 2021, Royal Decree-law 4/2021, of 9 March, on hybrid mismatch arrangements (“**ATAD II Law**”)¹ was published. Royal Decree-law 4/2021 transposes the European Union’s (EU) Anti-Tax Avoidance Directive, Council Directive 2017/952 (EU) of 29 May 2017 (“**ATAD II**”).

The text ultimately passed includes amendments to the Corporate Income Tax Law² (“**CIT Law**”) and the Non-Residents Income Tax Law³ (“**NRIT Law**”), and differs in several respects from the preliminary draft issued for public consultation by the Spanish Ministry of Finance. These differences do not affect the material aspects of the legislation ultimately passed.

2. The ATAD II Law

Hybrid mismatches are mechanisms that 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 taxation deferral.

In accordance with the ATAD II Law’s recitals, the provisions of ATAD II that have been transposed apply to hybrid mismatches that occur both between Spain and other Member States, and between Spain and third countries. Both ATAD II and the ATAD II Law 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 and the hybrid situation persists.

The ATAD II Law’s provisions on hybrid mismatches will exclusively apply, as provided in ATAD II, when these mismatches arise between the taxpayer and an associated enterprise⁴ or when the mismatch takes place within the framework of a structured arrangement⁵.

¹ *Real Decreto-ley 4/2021, de 9 de marzo, en relación con las asimetrías híbridas.*

² *Law 27/2014, of 27 November, on Spanish Corporate Income Tax (Ley 27/2014, de 27 de noviembre, del Impuesto sobre Sociedades).*

³ *Royal Legislative Decree 5/2004, of 5 March, approving the consolidated text of the Non-Residents 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).*

⁴ The definition regarding related parties has been expanded by the ATAD II Law to cover acting-together and significant influence in management situations.

⁵ A structured arrangement is defined as a particular structure or arrangement, which has been designed to produce a hybrid mismatch outcome.

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By including a new Article 15 bis⁶ in the CIT Law and two new paragraphs, 6 and 7, in Article 18 of the NRIT Law⁷, the ATAD II Law establishes that expenses are not tax-deductible and that income must be taken into account in cases where the following circumstances arise:

- **Deduction without inclusion:** it consists of the deduction of an expense in the taxpayer's jurisdiction without the corresponding inclusion for tax purposes of the relevant income in the payee's jurisdiction as a result of the existence of a different characterisation of the instrument (transaction), the payment or the legal nature of the taxpayers involved. Additionally, a provision to deal with reverse hybrid situations is also introduced.
- **Double deduction:** cases where the same expense is deductible in two jurisdictions, as a result of the characterisation of such expense or the taxpayer, unless a double inclusion of income is included.
- **Hybrid permanent establishment:** these are cases of deduction without inclusion, or double deduction without double inclusion, arising from differences in the recognition of income and expenditure, the characterisation of the instrument (transaction), 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 located.
- **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, or a certain income is not attributed to any permanent establishment 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 jurisdiction⁸.
- **Imported mismatches:** where the hybrid mismatch takes place in relation to a third entity located in another jurisdiction, but which gives rise to a deductible expenditure in Spain. The rule established for imported mismatches provides that a 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 transaction or series of transactions in respect of such hybrid mismatch.

⁶ The amendments also provide for the deletion of paragraph j) in Article 15 and some technical amendments to Article 16 of the CIT Law.

⁷ These amendments are introduced in order to maintain consistency between the CIT Law and the NRIT Law.

⁸ An additional provision has been added in order to clarify that the CIT Law exemption for income obtained through a permanent establishment (Article 22) will not apply to income attributable to any permanent establishment which is not recognised as such under the laws of the other jurisdiction.

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- **Dual withholding tax:** when an entity seeks relief for tax withheld at source on a payment derived from a transferred financial instrument to more than one of the parties involved, then such relief will be limited in proportion to the net taxable income attributable to that entity.
- **Dual resident taxpayer:** when this situation leads to an expenditure being tax-deductible in two jurisdictions at the same time, to the extent that it does not involve the double inclusion of income.

The reverse hybrid mismatches included in Article 9 bis of ATAD II have not been transposed as this is not required under the Spanish tax framework, given that the current Spanish tax regulations already prevent this from occurring.

Finally, it is worth noting that the final version of the ATAD II Law provides, with respect to the preliminary draft proposed by the Spanish Ministry of Finance, that the aforementioned provisions will not be applied (i) when the hybrid mismatch derives from the beneficiary's tax exemption; (ii) when the hybrid mismatch occurs within the scope of a transaction that is based on a financial instrument or contract subject to a special tax regime; or (iii) when it derives from a difference in valuations, including those derived from the application of the transfer pricing regulation.

3. Conclusion

The ATAD II Law is consistent with ATAD II. The rules provided for follow the guidelines set by the OECD on Base Erosion and Profit Shifting (BEPS) and comply with the objective of neutralising the aforementioned hybrid mismatches.

These regulations will enter into effect on 11 March 2021 for tax periods that began on 1 January 2020 and that have not concluded before its entry into effect.

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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 12 March 2021 and Pérez-Llorca does not undertake any commitment whatsoever to update or review its content.

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