Tax Pills

# Italy’s Revenue Agency issues further clarifications on the tax treatment of hybrid mismatches

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The Italian Tax Authority has drawn up and published the final **Circular n. 2/2022** regarding the hybrid mismatch rules. Particularly, the document takes into account the contributions sent by professionals and operators as part of the public consultation that was initially launched last October and, at the same time, provides valuable clarifications on the correct implementation of the European Union (EU) Anti-Tax Avoidance Directive (ATAD) and on the rules envisaged by Decree 142/2018 which implemented the EU Directive in domestic law. Indeed, after the clarifications already provided on controlled foreign companies with the Circular n. 18/E of 27 December 2021, the new document of practice sheds light on the fulfillment of the discipline fixed by articles 6 to 11 of the Decree transposing the Atad Directive.

**Hybrid mismatches** - Hybrid mismatch arrangements are used in aggressive tax planning to 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 details, an hybrid mismatch means a situation involving a taxpayer or an entity where a payment under a financial instrument gives rise to a deduction without inclusion outcome and, such payment, is not included within a reasonable period of time. Furthermore, the mismatch outcome is attributable to differences in the characterization of the instrument or the payment made under it.

**To countermeasure and neutralize the hybrids** – The Circular letter clarify how to identify hybrid mismatches and how to treat them. Basically, hybrid permanent establishment mismatches occur where differences between the rules in the jurisdictions of permanent establishment and of residence for allocating income and expenditure between different parts of the same entity give rise to a mismatch in tax outcomes and include those cases where a mismatch outcome arises due to the fact that a permanent establishment is disregarded under the laws of the branch jurisdiction.

Those mismatch outcomes may lead to a double deduction, DD, or a deduction without inclusion, DWI, and should therefore be eliminated by resorting to ad hoc forms of reaction to hybrid misalignments. Among the other aspects dealt with by the Circular letter, there are also the measures useful to neutralize the so-called “Double dips of withholding tax credits” that take form when transactions are used to double dip on whatever domestic tax relief (typically a tax credit) the jurisdiction of residence provides for taxes withheld on payments at source. Such double-dip tax credit structures do not rely on mismatch in the treatment of payments made under the repo but the double dip is still a product of the hybrid nature of the arrangement in that two jurisdictions provide for double taxation relief on the same payment. Indeed, it’s works as a generator of undue tax credits. On this front, a hierarchy is envisaged in the application of primary and secondary reactions aimed at avoiding double taxation phenomena.

Finally, it is clarified that the anti-hybrid provisions have the nature of “system rules” and not “anti-abuse rules” and, therefore, cannot be subject to disapplication following a disapplicative ruling.

Stefano Latini

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