Hybrid Mismatches

S.L. 123.187

European Union Anti-Tax Avoidance

Directives Implementation Regulations

As a result of the implementation of the EU Anti-Tax Avoidance Directive (ATAD), Malta introduced specific rules addressing hybrid mismatches, aimed at preventing tax avoidance practices stemming from differences in the tax treatment of financial instruments or entities across jurisdictions.

The hybrid mismatches rules are intended to neutralise tax advantages resulting from mismatches in tax treatment of transactions or entities, such as double deductions, or deductions without corresponding income inclusions.

The most common form of hybrid mismatches include:

Hybrid entities – an entity that is treated as a separate taxable entity in one jurisdiction but as a transparent entity in another jurisdiction;

Hybrid instruments - financial instruments are treated differently in different jurisdictions, such as debt in one jurisdiction and equity in another;

Dual resident entities – entities are treated as resident for tax purposes in more than one jurisdiction;

Reverse hybrids – entities that are treated as transparent in the jurisdiction of establishment but as separate entities in the jurisdiction of the owners;

Imported mismatch – these involve the use of hybrid mismatches in one jurisdiction to create a tax benefit in another jurisdiction.

A hybrid mismatch could arise in any of the following scenarios:

- A payment under a financial instrument gives rise to a deduction without inclusion outcome and:
  - such payment (income) is not included within a reasonable period of time; and
  - the mismatch outcome is attributable to differences in the characterisation of the instrument or the payment made under it;
- A payment to a *hybrid entity* gives rise to a deduction without inclusion and that mismatch outcome is the result of differences in the allocation of payments made to the *hybrid entity* under the laws of the jurisdiction where the *hybrid entity* is established or registered and the jurisdiction of any person with a participation in that *hybrid entity;*
- A payment to an entity with one or more permanent establishments gives rise to a deduction without inclusion and that mismatch outcome is the result of differences in the allocation of payments between the head office and the permanent establishment or between two or more permanent establishments of the same entity under the laws of the jurisdiction where the entity operates;
- A payment gives rise to a deduction without inclusion as a result of a payment to a disregarded permanent establishment;
- A payment by a *hybrid entity* gives rise to a deduction without inclusion and that mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction;
- A deemed payment between the head office and permanent establishment or between two or more permanent establishments gives rise to a deduction without inclusion and that mismatch is the result of the fact that the payment is disregarded under the laws of the payee jurisdiction;
- A double deduction outcome occurs.