

Portugal transposes EU ATAD Directives regarding hybrid mismatches into domestic tax law

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Executive summary

Portuguese Law nr. 24/2020 (Law 24/2020) was published in the *Official Gazette* on 6 July 2020 in order to transpose the Council Directive (EU) 2017/952 of 29 May 2017 (ATAD 2) and Council Directive (EU) 2016/1164 (ATAD 1) regarding hybrid mismatches.

The ATAD 1 was presented by the European Commission as part of the Anti-Tax Avoidance package in January 2016, to provide for coordinated implementation, across the European Union (EU), of a specific set of anti-tax avoidance provisions, namely, interest deduction limitation rules, controlled foreign corporation rules, hybrid mismatches rules within the EU, exit taxation rules and a general anti-abuse rule.

By means of Law nr. 32/2019, Portugal transposed rules covering the ATAD 1's elements above, except for the anti-hybrid mismatches provisions, which were now transposed into domestic law under Law 24/2020.

In this regard, Law 24/2020 introduced certain rules to the Portuguese Corporate Income Tax (CIT) Code against tax avoidance actions, in particular, with respect to hybrid mismatches that directly affect the internal market.

This Tax Alert summarizes the ATADs 1 and 2 elements transposed into the Portuguese Tax Law.

Detailed discussion

Law 24/2020 provides definitions for a number of concepts that are relevant for the anti-hybrid mismatches provisions that are introduced, such as hybrid mismatches, dual inclusion income, double deduction, deduction without inclusion, hybrid entity, and hybrid transfer, among others.

Hybrid mismatches

Hybrid mismatch means a situation involving a taxpayer or an entity under any of the following circumstances:

- a. A payment under a financial instrument gives rise to a deduction without inclusion and such payment is not included within a reasonable period of time, and the mismatch outcome is attributable to differences in the characterization of the instrument or the payment deriving thereof.
- b. A payment made to a hybrid entity gives rise to a deduction without inclusion and that mismatch outcome results from 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.
- c. A payment made to an entity with one or more permanent establishments (PEs) 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 PE or between two or more PEs of the same entity under the laws of the jurisdictions where the entity operates.
- d. A payment gives rise to a deduction without inclusion as a result of a payment to a disregarded PE.
- e. 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 beneficiary (except and to the extent that such deduction is compensated with a double inclusion income in the jurisdiction of the payor).
- f. A deemed payment between the head office and PE or between two or more PEs 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 (except and to the extent that such deduction is compensated with a double inclusion income in the jurisdiction of the payor).
- g. A double deduction outcome occurs (except and to the extent that such deduction is compensated with a double inclusion income in the jurisdiction of the payor).

Hybrid entities

Hybrid entities are those entities or mechanisms regarded as taxable entities under the laws of one jurisdiction and whose income or expenditure is treated as income or expenditure of one or more other persons under the laws of another jurisdiction (e.g., tax transparent entities).

Associated enterprises and structured arrangements

The outcome of a mismatch should only be regarded as a hybrid mismatch when arising between “associated enterprises,” a taxpayer and an associated enterprise, the head office and a PE, between two or more PEs of the same entity or resulting from a “structured arrangement.”

For this purpose, the concept of associated enterprise is generally considered met under the following situations (with some particularities further detailed in Law 24/2020):

- ▶ An entity in which the taxpayer holds directly or indirectly a participation in terms of voting rights or capital ownership of 25% or more or is entitled to receive 25% or more of the profits of that entity.
- ▶ An individual or entity which holds directly or indirectly a participation in terms of voting rights or capital ownership in that entity of 25% or more or is entitled to receive 25% or more of the profits of the that entity.
- ▶ Entities that belong to the same consolidated group for financial accounting purposes.
- ▶ An enterprise that has significant influence on the management of the Portuguese taxpayer or an enterprise in the management of which the Portuguese taxpayer has significant influence.

If no “associated enterprise” could be identified, anti-hybrid mismatch provisions may still apply if a structured arrangement is deemed to exist.

A structured arrangement is defined as an arrangement involving a hybrid mismatch where the mismatch outcome is priced into the terms of the arrangement or an arrangement that has been designed to produce a hybrid mismatch outcome, unless the taxpayer or an associated enterprise could not reasonably have been expected to be aware of the hybrid mismatch and did not share in the value of the tax benefit resulting from the hybrid mismatch.

Hybrid mismatches outcomes

Generally speaking, Law 24/2020 distinguishes between the following mismatch outcomes:

- ▶ Double deduction: means a deduction of the same payment, expenses or losses in the jurisdiction in which the payment has its source, the expenses are incurred or the losses are suffered (payer jurisdiction) and in another jurisdiction (investor jurisdiction). In the case of a payment by a hybrid entity or PE, the payer jurisdiction is the jurisdiction where the hybrid entity or PE is established or situated.
- ▶ Deduction without inclusion: means the deduction of a payment or deemed payment between the head office and the PE or between two or more PEs in any jurisdiction in which that payment or deemed payment is treated as made (payer jurisdiction) without a corresponding inclusion for tax purposes of that payment or deemed payment in the payee jurisdiction. The payee jurisdiction is any jurisdiction where that payment or deemed payment is received or is treated as being received under the laws of any other jurisdiction.

Rules applicable to hybrid mismatches

The deduction of expenses shall be denied in the following situations (although some exceptions may apply):

- ▶ Payments or deemed payments, expenses or losses generated in other jurisdictions resulting from a hybrid mismatch that give rise to a double deduction.
- ▶ Payments or deemed payments, expenses or losses generated in the Portuguese territory resulting from a hybrid mismatch that give rise to a double deduction, except when that deduction is denied in the investor's jurisdiction.
- ▶ Payments or deemed payments, expenses or losses generated in the Portuguese territory resulting from a hybrid mismatch that give rise to a deduction without inclusion that do not correspond to taxable income under the legislation in force the investor's jurisdiction.
- ▶ Financing, directly or indirectly, deductible expenses that give rise to a hybrid mismatch through a transaction or series of transactions between associated enterprises or entered into as part of a structured arrangement, except where the other jurisdiction involved in the transaction or series of transactions has made an equivalent adjustment in respect of such hybrid mismatch.

The following income should be included in the taxable income of the taxpayer (although some exceptions may apply):

- ▶ Income corresponding to payments made in other jurisdictions related to a hybrid mismatch that leads to a deduction without inclusion (with some exceptions notably in case the deduction of such payments is denied in the other jurisdiction).
- ▶ Income allocable to a disregarded PE when involved in a hybrid mismatch (except when the income should be exempt under a Double Tax Treaty concluded with a third country).

Reverse hybrid mismatches

Where one or more associated nonresident entities holding in aggregate a direct or indirect interest of at least 50% of the share capital, voting rights or rights to a share of profit in a hybrid entity incorporated or established in Portugal are located in a jurisdiction or jurisdictions that regard the hybrid entity as a taxable person, the hybrid entity shall be regarded as a Portuguese tax resident entity and taxed herein.

The above shall not be applicable if the income of the hybrid entity is taxed under Personal Income Tax or CIT, in the sphere of individuals or entities, or in accordance with the legislation of the other jurisdiction(s). The above shall not apply to a collective investment vehicle.

Tax residency mismatches

Expenses or losses of a taxpayer, resident for tax purposes in Portugal and in another jurisdiction, that are deductible from the taxable base in Portugal and in the other jurisdiction, should not be deductible for tax purposes in Portugal to the extent that the other jurisdiction allows the duplicate deduction to be set-off against income that is not dual-inclusion income.

When the other jurisdiction is an EU Member State, the above should only be applicable if the taxpayer is considered resident for tax purposes in that EU Member State under the applicable Double Tax Treaty.

Entry into force

The law will be applicable to fiscal years starting as from 1 January 2020 (except for reverse hybrid mismatches, which will be delayed until 1 January 2022, as well as in situations connected with the loss-absorbing capacity for the banking sector, which will be delayed until 1 January 2023).

For additional information with respect to this Alert, please contact the following:

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