

Reverse Hybrid Mismatches – Irish legislation

The reverse hybrid mismatch rules apply to entities that are treated as transparent for tax purposes by the Member State in which it is incorporated or established¹, **but** which is regarded as a taxable person by the jurisdiction(s) in which one or more associated (as defined for reverse hybrid purposes) non-resident entities are located.

Where a mismatch outcome has arisen between the hybrid entity and a non-resident associated entity, the intention of the reverse hybrid rule is to create an income inclusion event in the jurisdiction where the hybrid entity is incorporated or established, such that the income is subject to tax in that jurisdiction.

Finance Act 2021, which was signed into Irish law on 21 December 2021, applies the rule to hybrid entities **only where a mismatch outcome has arisen** between the hybrid entity and a non-resident associated entity. A “mismatch outcome” includes double deductions, and deductions without inclusion in relation to permanent establishments, hybrid entities and financial instruments.

Exclusion from the rule for “collective investment schemes”

The reverse hybrid rule will not apply to “collective investment schemes”, meaning “relevant investment undertakings”² –

- (a) that are widely held, and
 - (b) which hold a diversified portfolio of assets.
1. Partnerships will qualify as “relevant investment undertakings” if they are managed by an AIFM³.
 2. A relevant investment undertaking will be **“widely held”** where there is no beneficial owner of that undertaking. A “beneficial owner” is an individual who:
 - a) ultimately is entitled to or controls, whether the entitlement or control is direct

or indirect, more than a 25% share of the capital or profits or the partnership or more than 25% of the voting rights in the partnership, or

- b) otherwise controls the partnership.
3. In determining whether the relevant investment undertaking holds a **“diversified portfolio of assets”**, there are a number of things to be considered:
 - a) the nature of the assets,
 - b) the exposure to risk and reward from different classes of assets (whether directly or indirectly),
 - c) the number of investments made by the relevant investment undertaking,
 - d) the means through which the investment objective is to be achieved, and
 - e) where the assets are derivatives, the assets to which the derivatives give exposure.

However, a relevant investment undertaking will **not** be treated as holding a diversified portfolio of assets:

- a) where more than 10% of the securities are issued by a single issuer, or
- b) where the undertaking holds land, unless the undertaking holds 3 or more properties and the market value of each of those properties is less than 40% of the total market value of the properties held.

If the relevant hybrid entity meets **all** of the criteria set out above, (i.e. it is a relevant investment undertaking, which is widely held and has a diversified portfolio of assets), it will be treated as a “collective investment scheme” and will not fall within the scope of the reverse hybrid mismatch rules. If it does not meet these criteria, an income inclusion event could be triggered where a reverse hybrid mismatch outcome arises.

¹In Ireland, only partnerships (either ILPs or other partnerships) and CCFs are treated as transparent so they are the only entities which can be treated as hybrids.

²Common Contractual Funds, Investment Limited Partnerships, or relevant partnerships (i.e. partnerships which are managed by an AIFM).

³Within the meaning of the European Union (Alternative Investment Fund Managers) Regulations 2013 (S.I. No. 257 of 2013), authorised under those Regulations

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Reverse Hybrid Mismatch Outcome

A “reverse hybrid mismatch outcome” will arise where some or all of the profits or gains of a reverse hybrid entity that are attributable to a relevant participator⁴ are subject to neither domestic nor foreign tax.

A reverse hybrid mismatch outcome will not arise where the profits or gains are attributable to a relevant participator that –

- a) is exempt from tax under the laws of its jurisdiction of establishment,
- b) is established in a territory that does not impose a foreign tax, or
- c) is established in a territory that does not impose a tax that generally applies to profits or gains derived from payments receivable in that territory by enterprises from sources outside that territory.

Impact

If the relevant entity does not meet the criteria for a “collective investment scheme”, it will not be exempt from the reverse hybrid mismatch rule and, if there is a “reverse hybrid mismatch outcome”, the impact will be that the entity is taxed as if it was a company liable to tax in Ireland. The entity will be obliged to file a corporation tax return and pay tax in Ireland in respect of the profits or gains that are attributable to the relevant participator that is not subject to domestic or foreign tax.

To avoid such an income inclusion event, the hybrid entity has the option to appropriate or cancel such portion of units of the relevant participator concerned as are required to meet the amount of tax arising on profits attributable to that participator. In that case the entity would be acquitted and discharged of such appropriation or

cancellation (as appropriate) as if the amount of tax had been paid to the participator.

Timing

The tests apply when income is passed out of the relevant hybrid entity or when profits accrue to the hybrid entity i.e., when tax would ordinarily become payable.

Practical steps

Any relevant hybrid entities, who are not collective investment schemes, should seek appropriate evidence from participators to satisfy themselves that their participators are subject to either domestic or foreign tax. It is important to note that it is assumed that a participator is not subject to tax where the remittance basis of taxation only applies in the jurisdiction in which they are located.

Key contacts



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⁴ A “relevant participator” will have 50% or more of the:

- a) ownership rights in the reverse hybrid entity;
- b) voting rights in the reverse hybrid entity; or
- c) entitlement to profits of the reverse hybrid entity.

Reverse Hybrid Decision Tree

