Hybrid mismatches: penalty protection documentation

Tax & Legal Alert
19 January 2024

Office

Milan
Via Vittor Pisani 31, 20124
T: +39 02 676441

Ancona
Via I° Maggio 150/a, 60131
T: +39 071 2916378

Bologna
Via Innocenzo Malvasia 6, 40131
T: +39 051 4392711

Florence
Viale Niccolò Machiavelli 29, 50125
T: +39 055 261961

Genoa
P.zza della Vittoria 15/12, 16121
T: +39 010 5702225

Naples
Via F. Caracciolo 17, 80122
T: +39 081 662617

Padua
Piazza Salvemini 2, 35131
T: +39 049 8239611

Perugia
Via Campo di Marte 19, 06124
T: +39 075 5734518

Pescara
P.zza Duca D'Aosta 31, 65121
T: +39 085 4210479

Rome
Via Curtatone 3, 00185
T: +39 06 809631

Turin
C.so Vittorio Emanuele II 48, 10123
T: +39 011 883166

Verona
Via Leone Pancaldo 68, 37138
T: +39 045 8114111

As part of an ongoing tax reform, recent legislation in Italy[1] has introduced the possibility for taxpayers to obtain protection from administrative penalties for false tax returns, by compiling documentary evidence that they have carried out analyses to verify the correct application of the legislation countering hybrid mismatches. Even though it will be necessary to await a ministerial decree to learn the content and form of the set of documentation, the new legislation - which also provides for a transitional regime for fiscal years prior to FY2023 - presents an undeniable opportunity for taxpayers subject to anti-hybrid regulations.

Legislation against hybrid mismatches

The legislation countering hybrid mismatches - introduced in Italy as the so-called "ATAD Decree" (Legislative Decree no. 142/2018), which tackles hybrids arising from misalignments between the Italian tax system and one or more foreign tax systems - has been applied since FY2020 (for calendar-year taxpayers).

Parties affected by the legislation

The anti-hybrid legislation applies, if they have cross-border operations, to all entities resident for tax purposes in Italy and to all non-resident entities that have a permanent establishment in Italy, regardless of the sector in which they operate (financial or industrial).

[1] Article 61 of Legislative Decree no. 209/2023 (the so-called “Internationalisation Decree”), which implements part of the tax reform introduced by Law no. 111/2023.

Hybrid mismatches

Hybrid mismatches arise where there is exploitation of asymmetric tax treatment, under the laws of two or more tax systems, of entities, permanent establishments, legal transactions and components of income. The types of hybrid mismatches are:

— **deduction/non-inclusion ("D/NI")** arrangements, which occur when a payment results in a deduction for a taxpayer operating in a certain tax jurisdiction, but the corresponding amount is not included in the taxable income of the recipient taxpayer operating in a different jurisdiction;

— **double deduction ("DD")** mismatches, which occur when the same item of income is deducted in two different jurisdictions.

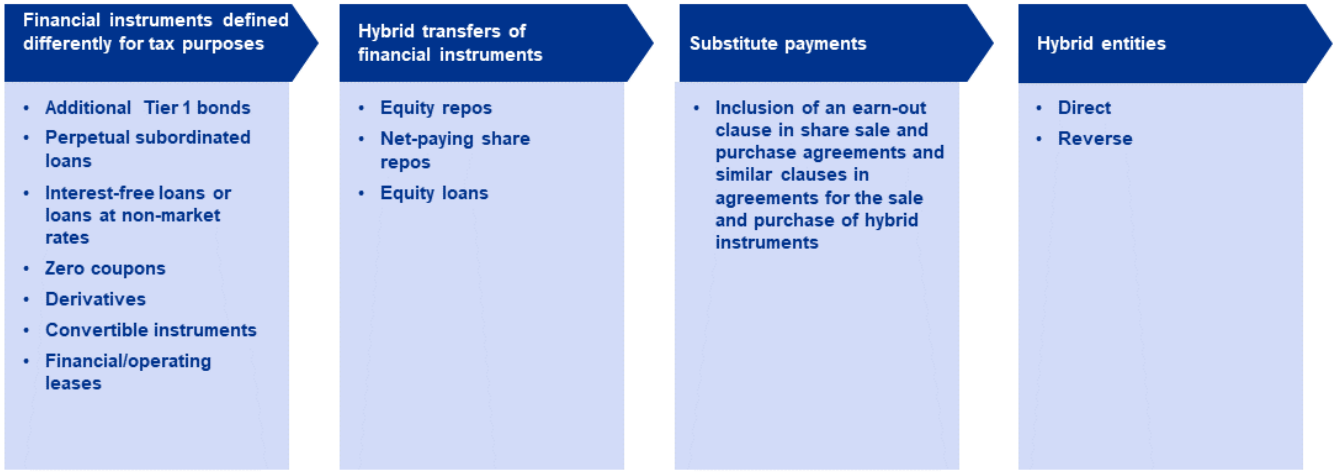
For the purposes of the hybrid mismatch rules, the transactions must be cross-border (purely domestic transactions are irrelevant). They must also be between **associated enterprises** or be the result of a **structured arrangement**.

Internationally, the greatest tax asymmetries, and the most aggressive tax planning schemes, have hinged around the following: **financial instruments** (hybrid financial instruments, hybrid transfers of financial instruments, and substitute payments), **hybrid entities** and **permanent establishments**.

So-called "**imported hybrids**" also fall within the scope of anti-hybrid legislation. These arise when a distortion resulting from a hybrid mismatch arrangement in a third country that lacks anti-hybrid legislation and that allows the taxpayer to deduct a cost incurred to 'finance' the misalignment is reflected in a jurisdiction that applies anti-hybrid rules[2].

Potentially relevant cases

Although the recent legislation does not give any specific examples or identify cases that fall within its scope, it is possible, based on international experience and the OECD Guidelines, to outline some typical cases for each of the above categories.



As can be readily observed, these are scenarios encountered in the operations of both financial entities (such as banks and insurance companies) and commercial entities. With regard to the latter, for example, the Italian Revenue Agency has ruled that the cost paid for goods by an Italian distributor, belonging to a multinational group, to its Swiss parent company, was non-deductible due to a hybrid mismatch benefiting the Swiss company (this case represented an imported hybrid mismatch)[3]. More specifically, the Italian Revenue Agency held that:

— the imported mismatch payment was represented by the cost of the payment made by the Italian distributor to the Swiss parent company;

— the hybrid deduction was represented by the D/NI arising from the amortisation deducted by the Swiss parent in relation to goodwill recognised by it for Swiss tax purposes at the time of its exit from the Swiss principal company regime;

— the link between the imported mismatch payment and the hybrid deduction was shown by the fact that the income received by the Swiss company, corresponding to the payment made by the Italian company to purchase the goods, was offset for Swiss tax purposes by the Swiss company's deducted amortisation of goodwill.

[2] See Circular no. 2/E of 26 January 2022.
[3] Tax Ruling no. 288/2023.

The new penalty protection

The new penalty protection legislation will apply in the event of a dispute about hybrid mismatches, in which the Italian Revenue Agency claims additional taxes and penalties or refuses to recognise the use of certain tax credits. In such cases a penalty will not be imposed if - during the inspection, audit or other investigative activity - the taxpayer is able to provide the tax authority with a set of documentation demonstrating that it has carried out a specific analysis of potential hybrid mismatches. The requirements for this documentation will be detailed in a decree to be issued by the Minister of Economy and Finance. This documentation must enable the tax authority to verify that the rules designed to neutralise hybrid mismatches have been applied. Like other regulations that currently give penalty protection (e.g. transfer pricing and patent box rules), the ministerial decree will probably require taxpayers to time-stamp the documentation and notify the tax authority of the existence of the documentation by checking a designated box in their income tax return.

A transitional regime has also been established for fiscal years prior to FY2023. The penalty protection will also apply to those previous years, provided that the set of documentation bears a date that is certified before the deadline for filing the tax return for FY2023 (i.e. 30 September 2024 for calendar-year taxpayers) or, if the decree to be issued by the Minister of Economy and Finance has not been issued by then, no later than six months after its date of approval.

Contacts

KPMG in Italy, Tax & Legal

Eugenio Graziani
Partner
egraziani@kpmg.it

Giuseppe Moretti
Partner
giuseppemoretti@kpmg.it

Gianluca Stancati
Partner
gstancati@kpmg.it

Valeria Russo
Associate Partner
valeriarusso@kpmg.it

kpmg.com/it

kpmg.com/it/socialmedia