

SECOND SUPPLEMENT TO THE GIBRALTAR GAZETTE

No. 4656 GIBRALTAR Thursday 30th January 2020

LEGAL NOTICE NO 57 OF 2020.

INTERPRETATION AND GENERAL CLAUSES ACT

INCOME TAX (AMENDMENT No. 2) REGULATIONS 2020

In exercise of the powers conferred upon it by section 23(g)(ii) of the Interpretation and General Clauses Act, and in order to transpose into the law of Gibraltar, Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries, the Government has made the following Regulations—

Title.

1. These Regulations may be cited as the Income Tax (Amendment No. 2) Regulations 2020.

Commencement.

2.(1) These Regulations come into operation on 1 January 2020.

(2) The amendments made by these Regulations apply in relation to accounting periods commencing on or after 1 January 2020.

Scope.

3. These Regulations amend the Income Tax Act 2010 for the purpose of giving effect in the law of Gibraltar to Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.

Amendment of Income Tax Act 2010.

4. Schedule 4 to the Income Tax Act 2010 (Anti Avoidance) is amended as follows.

5. In paragraph 8A (definitions for Parts V to VII)—

(a) after the definition of “borrowing costs” insert—

““consolidated group for financial accounting purposes” means a group consisting of all entities which are fully included in consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State”; and

(b) after the definition of “standalone entity” insert—

““structured arrangement” means 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.”.

6. In paragraph 8A after “unless the context otherwise requires” insert “(and subject to paragraph 22)”.

7. In paragraph 18 (interest limitation rule)—

(a) for the last sentence of subparagraph (2) substitute—

“(2) For the purposes of this paragraph, the taxpayer shall be given the right to use consolidated financial statements prepared under accounting standards other than the International Financial Reporting Standards or the national financial reporting system of a Member State.”; and

(b) for subparagraph (7)(a)(ii) substitute—

“(ii) all assets and liabilities are valued using the same method as in the consolidated financial statements drawn up in accordance with the International Financial Reporting Standards or the national financial reporting system of a Member State;”.

8. For Part VII (hybrid mismatch) substitute—

“PART VII

HYBRID MISMATCH

Hybrid mismatch.

21.(1) For the purpose of this Part “hybrid mismatch” means a situation involving a taxpayer or, with respect to paragraph 25, an entity where—

(a) a payment under a financial instrument gives rise to a deduction without inclusion outcome and—

(i) such payment is not included within a reasonable period of time; and

(ii) the mismatch outcome is attributable to differences in the characterisation of the instrument or the payment made under it;

- (b) 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;
 - (c) 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 permanent establishment or between two or more permanent establishments 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 permanent establishment;
 - (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 payee jurisdiction;
 - (f) 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; or
 - (g) a double deduction outcome occurs.
- (2) For the purposes of subparagraph (1)(a), a payment under a financial instrument shall be treated as included in income within a reasonable period of time where—
- (a) the payment is included by the jurisdiction of the payee in a tax period that commences within 12 months of the end of the payer's tax period; or
 - (b) it is reasonable to expect that the payment will be included by the jurisdiction of the payee in a future tax period and the terms of payment are those that would be expected to be agreed between independent enterprises.
- (3) For the purposes of this paragraph—
- (a) a payment representing the underlying return on a transferred financial instrument shall not give rise to a hybrid mismatch under subparagraph (1)(a) where the payment is made by a financial trader under an on-market hybrid transfer provided the payer jurisdiction requires the financial trader to include as income all amounts received in relation to the transferred financial instrument;

- (b) a hybrid mismatch shall only arise under subparagraph (1)(e), (f) or (g) to the extent that the payer jurisdiction allows the deduction to be set off against an amount that is not dual-inclusion income;
 - (c) a mismatch outcome shall not be treated as a hybrid mismatch unless it arises between associated enterprises, between a taxpayer and an associated enterprise, between the head office and permanent establishment, between two or more permanent establishments of the same entity or under a structured arrangement.
- (4) For the purposes of this paragraph and paragraphs 23 to 28—
- (a) “mismatch outcome” means a double deduction or a deduction without inclusion;
 - (b) “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); and in the case of a payment by a hybrid entity or permanent establishment the payer jurisdiction is the jurisdiction where the hybrid entity or permanent establishment is established or situated;
 - (c) “deduction without inclusion” means the deduction of a payment or deemed payment between the head office and permanent establishment or between two or more permanent establishments 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; and 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;
 - (d) “deduction” means the amount that is treated as deductible from the taxable income under the laws of the payer or investor jurisdiction (and the term “deductible” shall be construed accordingly);
 - (e) “inclusion” means the amount that is taken into account in the taxable income under the laws of the payee jurisdiction; and—
 - (i) a payment under a financial instrument shall not be treated as included to the extent that the payment qualifies for any tax relief solely due to the way that payment is characterised under the laws of the payee jurisdiction; and
 - (ii) the term “included” shall be construed accordingly;

- (f) “tax relief” means a tax exemption, reduction in the tax rate or any tax credit or refund (other than a credit for taxes withheld at source);
- (g) “dual inclusion income” means any item of income that is included under the laws of both jurisdictions where the mismatch outcome has arisen;
- (h) “person” means an individual or entity;
- (i) “hybrid entity” means any entity or arrangement that is regarded as a taxable entity 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;
- (j) “financial instrument” means any instrument to the extent that it gives rise to a financing or equity return that is taxed under the rules for taxing debt, equity or derivatives under the laws of either the payee or payer jurisdictions and includes a hybrid transfer;
- (k) “financial trader” is a person or entity engaged in the business of regularly buying and selling financial instruments on its own account for the purposes of making a profit;
- (l) “hybrid transfer” means any arrangement to transfer a financial instrument where the underlying return on the transferred financial instrument is treated for tax purposes as derived simultaneously by more than one of the parties to that arrangement;
- (m) “on-market hybrid transfer” means any hybrid transfer that is entered into by a financial trader in the ordinary course of business, and not as part of a structured arrangement;
- (n) “disregarded permanent establishment” means any arrangement that is treated as giving rise to a permanent establishment under the laws of the head office jurisdiction and is not treated as giving rise to a permanent establishment under the laws of the other jurisdiction.

Associated enterprise.

22.(1) For the purposes of this Part the definition of “associated enterprise” in paragraph 8A is modified as follows.

(2) Where the mismatch outcome arises under paragraph 21(1)(b), (c), (d), (e) or (g) or where an adjustment is required under paragraph 25, the rate of 25% is replaced by the rate of 50%.

(3) A person who acts together with another person in respect of the voting rights or capital ownership of an entity shall be treated as holding a participation in all of the voting rights or capital ownership of that entity that are held by the other person.

- (4) An associated enterprise also means—
- (a) an entity that is part of the same consolidated group for financial accounting purposes as the taxpayer,
 - (b) an enterprise in which the taxpayer has a significant influence in the management, or
 - (c) an enterprise that has a significant influence in the management of the taxpayer.

Denial of deductions.

23.(1) To the extent that a hybrid mismatch results in a double deduction—

- (a) the deduction shall be denied in Gibraltar where it is the investor jurisdiction; and
- (b) where the deduction is not denied in the investor jurisdiction, the deduction shall be denied in Gibraltar where it is the payer jurisdiction.

(2) Notwithstanding subparagraph (1), any such deduction is eligible to be set off against dual inclusion income whether arising in a current or subsequent tax period.

24.(1) To the extent that a hybrid mismatch results in a deduction without inclusion—

- (a) the deduction shall be denied in Gibraltar where it is the payer jurisdiction; and
- (b) where the deduction is not denied in the payer jurisdiction, the amount of the payment that would otherwise give rise to a mismatch outcome shall be included in income in Gibraltar (for the purposes of the calculation of tax in accordance with section 11 of this Act) where Gibraltar is the payee jurisdiction.

(2) Subparagraph (1) does not apply in relation to hybrid mismatches resulting from a payment of interest under a financial instrument to an associated enterprise where—

- (a) the financial instrument has conversion, bail-in or write down features;
- (b) the financial instrument has been issued with the sole purpose of satisfying loss absorbing capacity requirements applicable to the banking sector and the financial instrument is recognised as such in the taxpayer's loss absorbing capacity requirements;
- (c) the financial instrument has been issued—

- (i) in connection with financial instruments with conversion, bail-in or write down features at the level of a parent undertaking,
- (ii) at a level necessary to satisfy applicable loss absorbing capacity requirements,
- (iii) not as part of a structured arrangement; and

(d) the overall net deduction for the consolidated group under the arrangement does not exceed the amount that it would have been had the taxpayer issued such financial instrument directly to the market.

(3) The exclusion in subparagraph (2) applies in relation to accounting periods ending on or before 31 December 2022.

(4) Subparagraph (1)(a) does not apply in relation to hybrid mismatches as defined in paragraph 21(1)(b), (c), (d) or (f).

25.(1) A deduction shall be denied in Gibraltar for any payment by a taxpayer to the extent that such payment directly or indirectly funds deductible expenditure giving rise to a hybrid mismatch through a transaction or series of transactions between associated enterprises or entered into as part of a structured arrangement.

(2) But subparagraph (1) does not apply to the extent that one of the jurisdictions involved in the transaction or series of transactions has made an equivalent adjustment in respect of such hybrid mismatch.

26.(1) To the extent that a hybrid mismatch involves disregarded permanent establishment income which is not subject to tax in Gibraltar in the case of a taxpayer resident in Gibraltar for tax purposes, the taxpayer must include (for the purposes of the calculation of tax in accordance with section 11 of this Act) the income that would otherwise be attributed to the disregarded permanent establishment.

(2) Subparagraph (1) applies unless income is exempted under a double taxation treaty that applies in relation to Gibraltar.

27. To the extent that a hybrid transfer is designed to produce a relief for tax withheld at source on a payment derived from a transferred financial instrument to more than one of the parties involved, where Gibraltar is the Member State of the taxpayer, the benefit of such relief is limited in proportion to the net taxable income regarding such payment.

Tax residency mismatches.

28.(1) To the extent that a deduction for payment, expenses or losses of a taxpayer who is resident for tax purposes in two or more jurisdictions is deductible from the

tax base in both jurisdictions, Gibraltar as the Member State of the taxpayer shall deny the deduction to the extent that the other jurisdiction allows the duplicate deduction to be set off against income that is not dual-inclusion income.

(2) If the other jurisdiction is a Member State, Gibraltar as the Member State where the taxpayer is not deemed to be a resident according to the double taxation treaty concerned shall deny the deduction.”

Dated: 30th January 2020.

F R PICARDO,
Chief Minister,
For the Government.

EXPLANATORY MEMORANDUM

These Regulations amend the Income Tax Act 2010 for the purpose of implementing Council Directive (EU) 2017/952 of 29 May 2017 (“the 2017 Directive”) amending Directive (EU) 2016/1164 (“the 2016 Directive”) as regards hybrid mismatches with third countries.

As part of the measures proposed by the Organisation for Economic Cooperation and Development (OECD) in the context of the initiative against Base Erosion and Profit Shifting (BEPS), the 2016 Directive contained rules against tax avoidance including, in particular, a framework to tackle hybrid mismatches.

The 2017 Directive expands the provisions relating to hybrid mismatches so that they cover hybrid mismatches involving third countries (as well as hybrid mismatches that arise in the interaction between the corporate tax systems of Member States), hybrid mismatches involving permanent establishments, hybrid transfers, imported mismatches and a fuller range of double deduction outcomes; it also makes other miscellaneous amendments to the 2016 Directive regime.