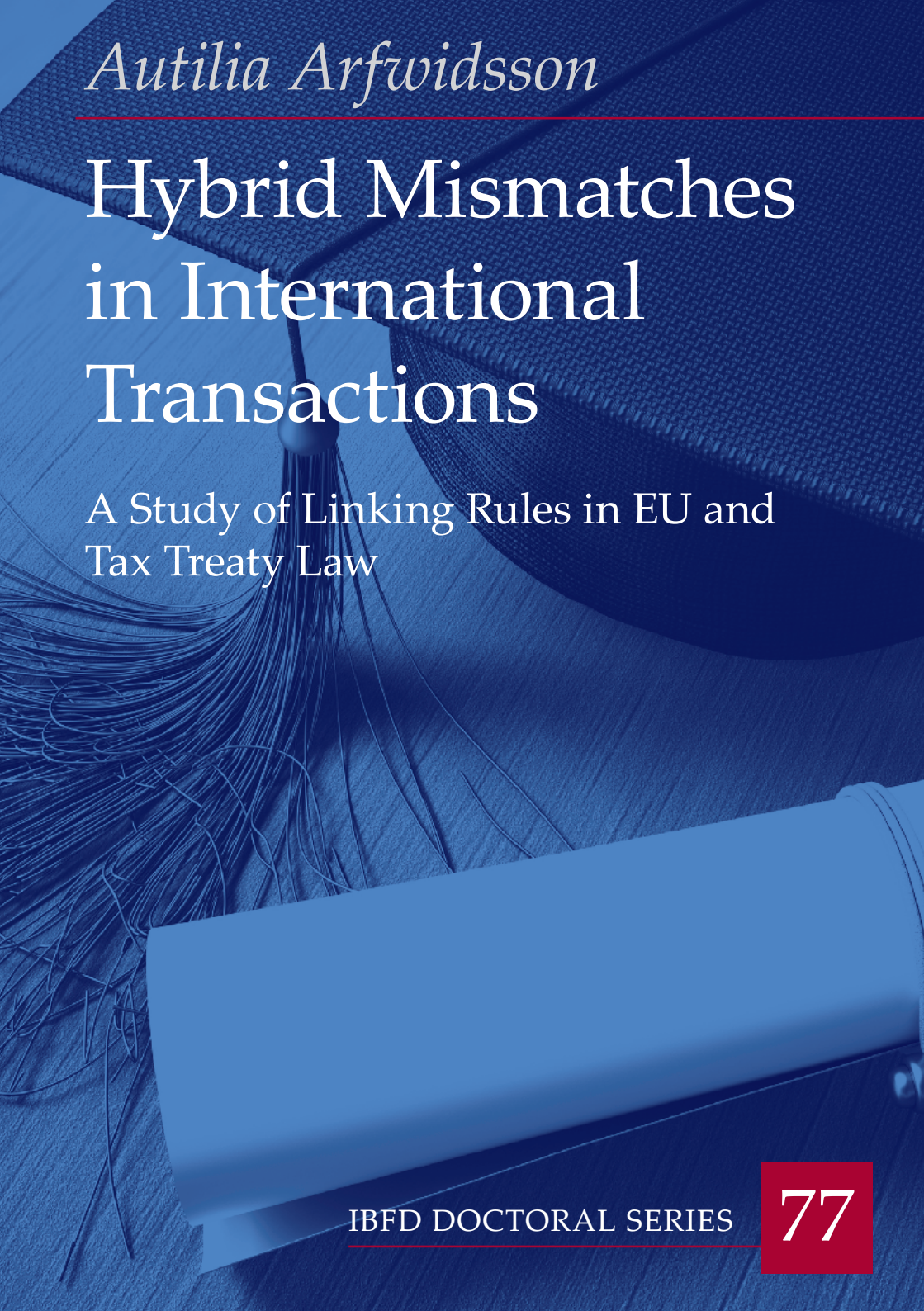
Autilia Arfwidsson

Hybrid Mismatches in International Transactions

A Study of Linking Rules in EU and Tax Treaty Law



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Hybrid Mismatches in International Transactions

Why this book?
Hybrid mismatches, where differences in income characterization across jurisdictions lead to double non-taxation, can be exploited by multinational enterprises to reduce their overall tax burden. Common hybrid mismatch rules addressing this issue have recently been introduced within the European Union and the OECD. The adoption of these rules is unprecedented and poses a novelty for many states' national tax systems. Beyond being technically complex, the operation of these rules necessitates interactions with other anti-avoidance rules, tax treaty provisions, EU law, OECD guidelines and national rules in foreign jurisdictions.

This book makes a significant contribution through its extensive structural examination of hybrid mismatches and their rules, covering both EU and tax treaty law. The examination primarily focuses on the hybrid mismatch rules in EU secondary law and their interactions with other aspects of EU and tax treaty law in preventing such mismatches. The analysis is conducted within the context of the rules' underlying objectives.

The study highlights five formal objectives of the rules: preventing tax avoidance, neutrality, equity, administrability and legal certainty. However, a critical examination reveals that these objectives often lack substance or resemble political slogans. Several structural premises contributing to the occurrence of hybrid mismatches are identified, including the general trend of reducing or eliminating withholding taxes within EU and tax treaty law. While the hybrid mismatch rules play a crucial role in preventing mismatches, their complex design and technical limitations render them vulnerable to circumvention. Another issue is that they often risk resulting in unresolved double taxation when interacting with other parts of EU and tax treaty law. Ultimately, the rules are primarily focused on preventing tax avoidance but tend to overlook other objectives. The study particularly advocates for improved administrability and legal certainty.

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Autilia Arfwidsson

This book is based on the thesis submitted for a doctoral degree at Uppsala University

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Abstract

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Preface

This study concerns hybrid mismatches in international transactions. As I conclude this journey, I would like to express my appreciation to those who have played pivotal roles in forming this research project and its trajectory.

I would like to begin by expressing my deepest gratitude to my main supervisor, Associate Professor Martin Berglund, for his invaluable guidance, patient support and scholarly insights. Similarly, I am indebted to my secondary supervisor, Professor Claes Norberg. Their commitment to academic excellence and unwavering encouragement have played a profound role in shaping the direction and quality of this research.

During my time as a doctoral student, I had the honour of being invited by Professor Duncan Kennedy to work as a Visiting Researcher at Harvard Law School. His deep knowledge and challenging questions allowed me to grow profoundly as a researcher. I am also indebted to Professor Maria Grahn-Farley, who introduced me to the world of critical legal studies and whose guidance allowed me to explore new academic horizons.

My deep appreciation extends to everyone who has taken the time to read and discuss my drafts. I would specifically like to mention Professor David Kleist, who acted as an opponent during my final seminar. His expertise and valuable feedback enriched my research and were crucial in refining the arguments presented in this study. I am equally thankful to everyone who participated and provided comments on my half-term seminar paper, particularly to Associate Professor Jan Bjuvberg, who reviewed my manuscript.

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My research was completed on 29 November 2023. Please note that material beyond that date has not been included in this work.

Stockholm, 29 November 2023

Autilia Arfwidsson

List of Abbreviations

ATAD	Anti-Tax Avoidance Directive
BEPS	Base erosion and profit shifting
CEN	Capital export neutrality
CFC	Controlled foreign company
CIN	Capital import neutrality
CJEU/ECJ	Court of Justice of the European Union
DD	Double deduction
D/NI	Deduction without inclusion
EBITDA	Earnings before interest, taxes, depreciation and amortization
GAAR	General anti-avoidance rule
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
MLI	Multilateral instrument
NI/NI	Double non-inclusion
TFEU	Treaty on the Functioning of the European Union
TEU	Treaty on European Union
IRD	Interest and Royalties Directive
PSD	Parent-Subsidiary Directive

Chapter 1

Introduction

1.1. Introducing the topic

The freedom of contract is a fundamental legal principle. Although the principle covers various aspects of the exchange of goods and services, the main academic legal interest has traditionally been formed by the freedoms of classification and content.[1] The former refers to regulations concerning certain classes or types of contract, such as a sale or loan contract. The latter relates to the conformity of contract terms and conditions with applicable regulations. In relation to content, parties are essentially free to agree on aspects such as quality, quantity and price, as well as the terms and conditions of their respective performance.[2] Consequently, the potential ways to structure a contract are in principle infinite – even contracts of a specific category or type may vary significantly.

For tax purposes, the classification of a contract and the payments made under it are important because they affect the taxation of the resulting income. The infinite structural possibilities of contracts means that the question of classification can be complex. A classical issue in international taxation is how to decide whether a contract reflects debt or equity, since this impacts the taxation and deduction rights of income stemming from the contract.[3] Presently, there is no globally accepted approach on how the distinction between equity and debt should be made, and no generally recognized international policy objectives. The classification and treatment of payments executed under a contract depend upon the domestic laws of the concerned jurisdiction(s) and other relevant dimensions of international tax law, namely tax treaties and EU law (for EU companies).[4]

1. See Jürgen Basedow, 'Freedom of Contract in the European Union', *European Review of Private Law*, 16/6 (2008), 905-906; Ole Lando and Hugh Beale, eds., Principles of European Contract Law Parts I and II (2000), 99.
2. See Basedow, 'Freedom of Contract in the European Union', 906.
3. See Eva Eberhartinger and Martin Six, 'Taxation of Cross-Border Hybrid Finance: A Legal Analysis', *Intertax*, 37/1 (2009), 4.
4. The approach of studying the international tax law regime through three dimensions (domestic, double tax treaties and supranational law) has been described elsewhere; see, for example, Jakob Bundgaard, *Hybrid Financial Instruments in International Tax Law* (2016), 17-18. According to Brauner, a distinction can be made between an international tax "system" and a tax "regime", where the latter is possible to discuss even though there is no sovereign international tax system; see Yariv Brauner, 'An International Tax Regime

In cross-border transactions, discrepancies between the legislations of different countries can lead to conflicting classifications of contracts and payments made under them. When at least two countries classify the same contract or payment differently, the result can be double taxation or double non-taxation of the income in question. This risk is prominent when a contract has features of both equity and debt. Other situations can also lead to asymmetric classification of cross-border transactions. For example, two jurisdictions may disagree on whether a transaction should be seen as a sale or as a loan based on diverging views on who is the beneficial owner of the underlying asset. The latter situation can, inter alia, arise under international leasing or share lending arrangements.[5]

Historically, there has been a distinct focus on addressing double taxation in international tax law. This is often accomplished through the establishment of double tax treaties. Within the European Union, prevention of double taxation has also been achieved through rulings by the Court of Justice of the European Union (ECJ) and, more recently, through the adoption of directives.[6]

In the wake of the financial crisis in 2008, increased international efforts have been undertaken to prevent so-called "aggressive tax planning", resulting in double non-taxation.[7] To avoid such outcomes, a joint international tax coordination project has been initiated by the European Union and the OECD. This coordination project has, among other things, resulted in the development of common rules aiming to neutralize so-called hybrid mismatches resulting in double non-taxation. These regulations are usually referred to as hybrid mismatch rules.

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in Crystallization', *Tax Law Rev*, 56 (2003), 261-262 footnote 13. A similar distinction is made by Berglund, who also means that in line with this view, international taxation should be considered a "transnational" area of law; see Martin Berglund, *Avräkningsmetoden: En skatterättslig studie om undvikande av internationell dubbelbeskattning* (2013), 61.

5. For instance, see Example 1.25 (international leasing), 242-243, and Example 1.30 (share sale agreement), 261-265, in OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report* (2015) (cit. BEPS Action 2).

6. It can be noted that double taxation outcomes do not necessarily stem from characterization asymmetries; it can also be an effect of states having overlapping claims to tax an item of income in cross-border situations. This aspect will be discussed further in chapter 2.

7. See Robert Dover and others, *Bringing Transparency, Coordination and Convergence to Corporate Tax Policies in the European Union Part II: Evaluation of the European Added Value of the Recommendations in the ECON Legislative Own-Initiative Draft Report* (2015), 5.

A hybrid mismatch can arise when differences in legislations of two or more countries result in different tax treatments of the same income. The term "hybrid mismatch" is mainly used in relation to double non-taxation outcomes. However, for the purposes of this study, the hybrid mismatch concept also refers to double taxation outcomes.[8]

In essence, a hybrid mismatch can be described as a difference in jurisdictions' characterizations of income stemming from the character of an entity, a contract and/or a payment (the "*hybrid*" feature), which has resulted in double taxation or double non-taxation (the "*mismatch*" outcome). For example, a hybrid mismatch in the form of double non-taxation could arise if a payment under a financial instrument is deductible in the jurisdiction of the payor but is untaxed in the jurisdiction of the payee. Within the OECD and the European Union, the hybrid mismatch rules are designed to prevent double non-taxation outcomes by making either the payer or the payee jurisdiction tax the income.

Although the term "hybrid mismatch" is a novelty, the phenomenon has arguably been present ever since the introduction of different tax legislations. Nonetheless, the introduction of hybrid mismatch rules by the OECD and the European Union is the first attempt to address this issue through international tax coordination. Within the OECD framework, the rules have been presented as a set of non-binding recommendations in one of the action plans of the Base Erosion and Profit Shifting (BEPS) project.[9] In EU legislation, the hybrid mismatch rules, intended to correspond with those of the OECD, have been implemented through the Parent Subsidiary Directive (PSD)[10] and the Anti-Tax Avoidance Directive (ATAD).[11]

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8. See section 1.6. and chapter 2.
9. See BEPS Action 2.
10. See *Council Directive 2011/96/EU of 30 November 2011 on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States (Recast)* (cit. PSD 2011). Since then, the directive has been amended to include the hybrid loan rule (2014) and a GAAR (2015); see *Council Directive 2014/86/EU of 8 July 2014 Amending Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States* (cit. PSD 2014); *Council Directive (EU) 2015/121 of 27 January 2015 Amending Directive 2011/96/EU on the Common System of Taxation Applicable in the Case of Parent Companies and Subsidiaries of Different Member States* (cit. PSD 2015), (joint cit. PSD).
11. See *Council Directive (EU) 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices That Directly Affect the Functioning of the Internal Market* (cit. ATAD 1). The directive was amended in 2017 to include additional hybrid mismatch rules; see *Council Directive (EU) 2017/952 of 29 May 2017 Amending Directive (EU) 2016/1164 as Regards Hybrid Mismatches with Third Countries* (cit. ATAD 2), (joint cit. ATAD).

For many Member States, the functioning of the rules is a novelty in their national tax systems. The hybrid mismatch rules are so-called "linking rules",[12] meaning their primary role is to prevent double non-taxation outcomes by linking the taxation of an item of income in one jurisdiction to how that particular income has been treated in another jurisdiction. The scope of these rules is not limited to payments under hybrid financial instruments but extends to various arrangements where a difference in the characterization of a payment or contract has resulted in double non-taxation. An obvious limitation of these rules is that they do not apply to mismatches in the form of double taxation. Such outcomes will generally have to be dealt with unilaterally or through double tax treaties. Apart from being technically complex, the operation of the hybrid mismatch rules requires interactions with, among other things, other national anti-avoidance rules, tax treaty provisions, EU law, OECD guidelines and national rules in foreign jurisdictions. This opens up a set of interesting research questions.

1.2. General objective and research questions

1.2.1. General objective of the study

In this study, the overall purpose is to analyse how the occurrence of hybrid mismatches stemming from international transactions is addressed within EU and tax treaty law. The outset of the examination is an assessment of the hybrid mismatch rules in EU secondary law and how they interact with other aspects of EU and tax treaty law aimed at preventing hybrid mismatches.

The analysis of the hybrid mismatch rules is conducted in light of their underlying objectives. It includes both a descriptive and a normative claim. The descriptive claim largely involves an interpretation and a systematization of the existing hybrid mismatch rules, with a focus on whether they prevent double non-taxation outcomes without giving rise to unresolved double taxation. The normative claim of the study involves an evaluation of the rules based on their underlying objectives. It should be underlined that the division between these two claims is not intended to be understood as a sharp distinction between a normative and a descriptive examination – only

12. For the use of the term linking rules, see, for example, Félix Daniel Martínez Laguna, *Hybrid Financial Instruments, Double Non-Taxation and Linking Rules* (2019), 7-8; Bruno Vanden Berghe, 'Enforceability of OECD Linking Rules in the Light of EU Law', *LSE Law Review*, 2 (2017), 73-75; Christian Kahlenberg and Agnieszka Kopec, 'Hybrid Mismatch Arrangements – A Myth or a Problem That Still Exists?', *World Tax Journal*, 8/1 (2016), 67.

that these two aspects of the study have different points of emphasis. The two claims will be specified through the research questions (section 1.2.2.) and the method (section 1.4.) of the study.

For the overall purpose to make sense to a reader not yet versed in the topic of this study, some preliminary terminological remarks are necessary. In this book, the concept of hybrid mismatches refers to double taxation and double non-taxation stemming from discrepancies in the characterization of cross-border transactions. These differences may, for example, be classification asymmetries under national law or inconsistent qualification under double tax treaties.[13] The phrase "international transactions" is used to show that the study focuses on situations where the asymmetric characterization stems from differences in the tax treatment of a *contract* and the *transactions* made under it. Mismatches stemming from so-called hybrid entities are not part of the study. The term "transactions" is also intended to signal that the study covers not only payments but also other business events, such as tax credits, notional deductions and the accrual of income.

This study is devoted to a *structural analysis* of hybrid mismatches and hybrid mismatch rules. The main study object is EU and tax treaty law. National tax laws of specific jurisdictions are not the principal focus of this work. Such an examination, however, could in itself be an interesting topic for an entire book. In the situations examined in this study, a characterization asymmetry is, instead, presumed to have occurred under national law. Against this backdrop, the examination is focused on how the hybrid mismatch rules, in conjunction with the broader EU and tax treaty law frameworks, tackle the issue of hybrid mismatches. The book can thus be described as an international tax law study.[14]

From a research point of view, the topic of the study is interesting for several reasons. First, the study relates to the fundamental issue of corporate tax planning and countries' protection of their tax bases. Second, a central part of the study involves analysing the distinction between complex concepts of international tax law, such as the terms interest, dividend, royalty and leasing. Finally, the study addresses the question of how different legislations across countries ought to be coordinated to neutralize hybrid mismatches. This requires an examination of the issue of hybrid mismatches that cuts across not only EU primary and secondary law but also includes tax treaty law.

13. The issue of characterization asymmetries will be developed further in chapter 2.
14. See section 1.4.

To fulfil the overall objective, the study deals with three research questions: (i) what are the objectives that underlie the hybrid mismatch rules? (section 1.2.2.1.); (ii) how does the EU and tax treaty law address hybrid mismatches stemming from international transactions? (section 1.2.2.2.); and (iii) do the existing hybrid mismatch rules prevent hybrid mismatches in a manner consistent with the rules' underlying objectives? (section 1.2.2.3.). These research questions are elaborated further in the following section.

1.2.2. Research questions

1.2.2.1. The first research question

The first question of the study addresses the objectives that underlie the hybrid mismatch rules within both the European Union and the OECD. In the work to establish common hybrid mismatch rules, various policy goals have been emphasized. For example, two general goals of the BEPS Project at large, which have also been highlighted in the context of the hybrid mismatch rules, are that the rules should achieve a "fairer" taxation and ensure that tax is paid where "value" is created. Another example of a frequently repeated goal is that the hybrid mismatch rules should "neutralize" hybrid mismatches.[15] What the general policy goals mean in relation to the hybrid mismatch rules is not obvious. The picture of these goals having a common meaning within the European Union and the OECD is also painted, at least formally. This view can undoubtedly be questioned considering the ambiguous meaning of terms such as "fairness" or "value creation".

Given this background, answering the first question means dividing it into two main aspects. The first aspect is to identify the policy objectives considered in the development of the hybrid mismatch rules and to examine how those objectives are described by both the OECD and the European Union. The second aspect is to operationalize these objectives for the purpose of the rules. These two aspects will be elaborated as follows.

The first aspect constitutes a background examination of the development of common hybrid mismatch rules, with a focus on analysing the policy goals that have been highlighted by both the European Union and the OECD. Without unduly prejudging the outcome of this examination, the various

15. See ATAD 1, sections 1 and 13 of the preamble.

policy arguments are generally divided into five main categories: *prevention of tax avoidance*, *neutrality*, *equity*, *administrability* and *legal certainty*.[16]

The second aspect builds upon the findings of the first aspect. It includes an examination of whether it is possible to operationalize the identified objectives for the purpose of the hybrid mismatch rules. In this context, the term "operationalization" refers to two distinct components. First, it involves an attempt to specify the more detailed meaning of these objectives in relation to the hybrid mismatch rules (e.g. what is meant by "neutral" taxation?). This includes a critical assessment of whether these objectives have actually influenced the formulation of the rules, or if they rather have the quality of being political slogans. Secondly, it requires an assessment of how these objectives should be prioritized in relation to each other (for instance, should prioritizing "neutral taxation" take precedence over "preventing tax avoidance" in the event of a clash between these objectives?).[17]

The purpose of the first question is to construct a foundation for the rest of the study in the following way. The second question of the study concerns the hybrid mismatch rules and how they deal with hybrid mismatches in the context of EU and tax treaty law. In this regard, the findings of the first question are important because the present hybrid mismatch rules can only be fully understood in light of their origin and underlying objectives.[18] Dissecting how these policy objectives are understood within the respective contexts of the European Union and the OECD also reveals whether there is indeed a common understanding of those objectives. The existence of any divergences in the understanding of the objectives between the two institutions could explain why there are (corresponding) differences in the design of the hybrid mismatch rules within EU law and in the BEPS Action 2 Final Report.

Another motive for operationalizing these objectives lies in their relevance for the interpretation of the hybrid mismatch rules within EU law. The majority of the hybrid mismatch rules in EU law are found in the ATAD, with the ECJ as the ultimate interpreter of the directive's provisions. When the Court interprets these rules, it must take into account their intended purpose.[19] Therefore, answering the first question provides valuable context

16. See chapter 2.
17. The method for the operationalization of the objectives is specified in chapter 2.
18. For a similar view in relation to the term permanent establishment, see Linus Jacobsson, *Permanent Establishment Though Related Persons: A Study on the Treatment of Related Persons under Article 5 of the OECD Model Tax Convention* (2018), 26.
19. The interpretative method of the ECJ will be elaborated in section 1.4.4.

and insight into how the purpose of the hybrid mismatch rules is understood in EU law. The significance of the objectives for the interpretation of the hybrid mismatch rules is obviously contextual and raises a series of interesting methodological questions. For example, the so-called "hybrid loan" rule in EU law is found in the PSD, which has distinct objectives compared to the ATAD. This and other related questions will be discussed in the method section of this study.

Moreover, the first question is necessary for answering the third question of the study, wherein the hybrid mismatch rules are evaluated in light of their underlying objectives. In other words, the operationalized objectives derived from the first question constitute the framework against which the evaluation of the hybrid mismatch rules in this study is conducted.[20]

In summary, the first question contributes to fulfilling the overall objective of the study by laying a foundation for answering the second and third research questions. It does so in two ways: first, by shedding light on the background and objectives of the hybrid mismatch rules, and second, by operationalizing these objectives.

1.2.2.2. The second research question

Building upon the background established by the first question, the second question of the study concerns the issue of hybrid mismatches and how it is handled by EU and tax treaty law. The hybrid mismatch rules are a new solution to an old problem. Even though the term "hybrid mismatch" is novel, the occurrence of asymmetric tax treatment of income across jurisdictions is not. Therefore, the second question centres around examining how the hybrid mismatch rules integrate into the already existing EU and tax treaty law framework dealing (or not dealing) with hybrid mismatches.

It can be recalled that the primary focus of this book is EU and tax treaty law. An important starting point of the second question is that it does not include a study of the national laws of specific jurisdictions. While the emergence of a hybrid mismatch is ultimately rooted in national law, this study focuses on hybrid mismatches at a structural level. A basic idea of the hybrid mismatch rules is that they should constitute a *coordinated response* to situations where there is an asymmetry in characterization under national law. In the situations examined in this study, a discrepancy in the tax treatment

20. How the evaluation of the rules is carried out is elaborated in section 1.2.3. and in chapter 7.

of income between at least two jurisdictions is, therefore, presumed to have occurred. The question then arises as to how this is addressed at the structural level. Throughout the analysis, examples of the national tax laws of different jurisdictions will still be used to illustrate specific issues.[21]

Addressing the second question involves dividing it into two sub-questions. First, how does the issue of hybrid mismatches present itself in the contexts of EU and tax treaty law? Second, how do the EU and tax treaty frameworks address hybrid mismatches? These questions are outlined in the following sections.

The first sub-question concerns the occurrence of hybrid mismatches in EU and tax treaty law. Once again, a basic presumption of this study is the presence of a cross-border transaction, characterized differently for tax purposes under the national laws of two jurisdictions. Such a difference in characterization can result in various tax outcomes, including both double taxation and double non-taxation. The first sub-question centres around how the emergence of hybrid mismatches at the national level is perceived at a structural level.

As highlighted above, the concept of hybrid mismatches was invented within the BEPS Project to describe an already existing phenomenon. It is thus relevant to examine how the term hybrid mismatch relates to the broader phenomenon of characterization asymmetries, as well as how such asymmetries are viewed not only in relation to the hybrid mismatch rules but also within other parts of EU and tax treaty law. The asymmetric tax treatment of income and its associated problems can be understood in different ways depending on the legal context. This can, in turn, affect how the issue of hybrid mismatches is handled in a specific legal context. A basic example of this is that the hybrid mismatch rules in the OECD and the European Union do not deal with mismatch outcomes in the form of double taxation, since the hybrid mismatch concept only covers double non-taxation outcomes. By contrast, in the context of tax treaty law, the approach to deal with qualification conflicts under the method articles generally covers both juridical double taxation and double non-taxation. In short, answering the first sub-question sheds light on how different parts of EU and tax treaty law together may work to either prevent – or reinforce – the occurrence of hybrid mismatches.

21. For instance, the national implementation of the hybrid mismatch rules in the Netherlands is used to illustrate problems related to the "nexus" required under the imported mismatch rule in the ATAD. Another example is that individual tax treaties are used to illustrate certain structural tax treaty issues.

Central to answering the first sub-question is, of course, the interpretation and systemization of the term "hybrid mismatch" as outlined in both the ATAD and the BEPS Action 2 Final Report. Specifying the hybrid mismatch concept illuminates how it relates to the larger phenomenon of characterization asymmetries. Additionally, it clarifies the scope of the hybrid mismatch rules.

In the context of EU secondary law, it becomes important to examine how the occurrence of asymmetric tax treatment of international transactions is viewed under the Interest and Royalty Directive (IRD)[22] and the PSD. This is because both directives are, at the outset, designed to deal with double taxation stemming from payments under "pure" debt or equity contracts. The PSD targets distributions stemming from equity, whereas the IRD targets yield deriving from debt. However, the presumption that all contracts can be described in terms of debt or equity might have unintended effects on arrangements that do not fit into this framework. For example, if contracts with features of both debt and equity are treated differently for tax purposes by two Member States, the application of the provisions of the IRD or the PSD to income stemming from such contracts may result in either double taxation or double non-taxation.[23]

From the perspective of EU primary law, the asymmetric tax treatment of cross-border transactions could be viewed as a problem if the result is a hybrid mismatch in the form of unresolved double taxation or double non-taxation. Both outcomes pose a threat to the realization of the internal market, which hinges on preventing obstacles and ensuring that competition is not distorted.

From the tax treaty law perspective, a hybrid mismatch can occur if the contracting states characterize a cross-border payment or contract differently and, as a result, apply different distributive articles under the tax treaty. This may lead to (unresolved) double taxation or double non-taxation.[24] A basic example of when a hybrid mismatch in the form of double non-taxation can arise is if the state that has been granted taxing rights according to the treaty

22. See *Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made between Associated Companies of Different Member States* (cit. IRD).
23. This aspect is further discussed in chapter 4.
24. See, for example, Christoph Marchgraber, 'Conflicts of Qualification and Interpretation: How Should Developing Countries React?', *Intertax*, 44/4 (2016), 307.

lacks national rules for taxing the payment, while the other state finds its taxing rights to be limited by the treaty.[25]

Answering the first sub-question provides a basis for *the second sub-question*, which concerns how the occurrence of hybrid mismatches is managed within EU and tax treaty law. The focus on this part of the study is the hybrid mismatch rules and how they interact with other parts of EU and tax treaty law to prevent hybrid mismatches.

The main part of the second sub-question constitutes a systematization of the existing hybrid mismatch rules and recommendations within both the European Union and the OECD. Within the European Union, hybrid mismatch rules have been adopted through the PSD and the ATAD. These rules are intended to correspond with the recommendations included in the BEPS Action 2,[26] one of 15 so-called "action plans" developed by the OECD to deal with base erosion and profit shifting. The outset of this part of the study is the hybrid mismatch rules in EU law. A continuous comparison of the scope and functioning of the rules will be made with the corresponding OECD recommendations. The study addresses situations where the asymmetric characterization derives from differences in the tax treatments of a contract and transactions made under it.[27] Against this background, the examination focuses on hybrid mismatch rules specifically targeting such situations. These rules are: (i) the so-called "hybrid loan" rule in article 4(1)(a) of the PSD and recommendation 2.1 in BEPS Action 2; (ii) the so-called "financial instrument" rule, which is regulated through article 2(9)(a) and article 9(2) of the ATAD and recommendation 1.1 in BEPS Action 2; and (iii) the so-called "imported mismatch rule" in article 9(3) of the ATAD and recommendation 8 of BEPS Action 2.[28]

Another key aspect will be to examine the interaction between the hybrid mismatch rules and other regulations. This involves an analysis of the extent to which other parts of EU and tax treaty law prevent the occurrence of hybrid mismatches, and how those measures function together with the hybrid mismatch rules in EU secondary law.

25. See Marjaana Helminen, 'Classification of Cross-Border Payments on Hybrid Instruments', *Bulletin for International Taxation*, 58/2 (2004), 61; John F Avery Jones, 'Tax Treaty Problems Relating to Source', *British Tax Review*, 3 (1998), 223; Martin Six, 'Hybrid Finance and Double Taxation Treaties', *Bulletin for International Taxation*, 63/1 (2009), 22.
26. See BEPS Action 2.
27. See section 1.2.1.
28. These rules are examined in detail in chapters 3 and 4.

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