Anti-Hybrid Rules of Treasury Regulations §§1.267A-1 through 1.267A-7

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(April 30, 2020)

Section 267A of the Internal Revenue Code denies a deduction for any disqualified related party amount paid or accrued pursuant to a hybrid transaction or by, or to, a hybrid entity.

To determine whether a payment is wholly or partly disallowed by section 267A, a detailed analysis is required. This outline takes you through the six not-so-easy questions that must be considered and how to proceed based on the answers to those questions.

I. Question 1: Is the payment considered interest or royalties?

If yes, continue to Question 2.

If not, payment is not disallowed by section 267A.

A. Interest is defined in Treasury Regulations §1.267A-5(a)(12) (generally, an amount paid, received, or accrued as compensation for the use or forbearance of money under the terms of an instrument or contractual arrangement, including a series of transactions, that is treated as a debt instrument for purposes of section 1275(a) and §1.1275-1(d), and not treated as stock under §1.385-3, or an amount that is treated as interest for tax purposes).

B. Royalty is defined in §1.267A-5(a)(16) (generally, amounts paid or accrued as consideration for the use of, or the right to use any copyright, patent, trademark, design or model, plan, secret formula or process, similar property (including goodwill); or any information concerning industrial, commercial or scientific experience).

II. Question 2: Is the payor making the payment a "specified party?"

If yes, then the payment is a "specified payment." See § 1.267A-1(b). Continue to Question 3.

If not, payment is not disallowed by section 267A.

A specified party is (a) a U.S. tax resident, (b) a controlled foreign corporation ('CFC") that has at least one U.S. tax resident as a US shareholder, or (c) a U.S. taxable branch. §1.267A-5(a)(17). For this purpose, "controlled foreign corporation" is defined in section 957, "tax resident" is defined in §1.267A-5(a)(23), and "U.S. taxable branch" is defined in §1.267A-5(a)(25).

III. Question 3: Do the specified person's specified payments fall below the $50,000 de minimis threshold of §1.267A-1(c)?

If yes, payment is not disallowed by section 267A.

If not, continue to Question 4.

The disallowance rule of section 267A does not apply to a specified party for a taxable year in which the sum of the specified party's specified payments that would otherwise be disallowed by §1.267A-1(b) is less than $50,000. §1.267A-1(c). For purposes of this de minimis rule, specified parties that are related (see §1.267A– 5(a)(14)) are treated as a single specified party. §1.267A-1(c).

IV. Question 4: Is the specified payment a disqualified hybrid amount, as described in §1.267A-2 (hybrid and branch arrangements)?

If yes, payment is disallowed by §1.267A-1(b), subject to applicability dates in §1.267A-7.

***If not, continue to question 5*.**

A. Disqualified hybrid amount generally. Disqualified hybrid amounts generally consist of

- Payments pursuant to hybrid transactions (see A.1 below);
- Certain disregarded payments (see A.2 below);
- Certain deemed branch payments (see A.3 below);
- Certain payments to reverse hybrids (see A.4 below); and
- Certain branch mismatch payments (see A.5 below).

A relatedness or structured arrangement requirement must also be met (see A.6 below). Disqualified hybrid amounts do not include amounts included or includible in income for US tax purposes described in §1.267A-3(b) (see B below). In making the determination whether an amount is a disqualified hybrid amount, the rules of §1.267A-5(b) must be taken into account (see C below).

1. Payments pursuant to hybrid transactions

i. *General rule*. A specified payment made pursuant to a hybrid transaction is a disqualified payment to the extent that

- The specified recipient (see §1.267A-5(a)(19)) of the payment has a "no-inclusion," i.e., the specified party does not include the payment in income (see A.7 below for rules regarding when income is considered included) and
- The lack of inclusion is a result of the payment being made pursuant to a hybrid transaction, i.e., the specified recipient's no-inclusion is a result of the specified payment being made pursuant to the hybrid transaction to the extent that the no-inclusion would not occur were the specified recipient's tax law to treat the payment as interest or a royalty, as applicable. §1.267A-2(a)(1).

ii. *Hybrid transaction definition and special rules*

a. A hybrid transaction generally is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for U.S. tax purposes but are not so treated for purposes of the tax law of a specified recipient of the payment. §1.267A-2(a)(2)(i). If the taxable year in which a specified recipient takes the payment into account in income under its tax law (or, based on all the facts and circumstances, is reasonably expected to take the payment into account in income under its tax law) ends more than 36 months after the end of the taxable year in which the specified party would be allowed a deduction for the payment under U.S. tax law, then the payment is considered to be a hybrid transaction. §1.267A-2(a)(2)(ii)(A). The definition excludes disregarded payments, see §1.267A-2(a)(2)(ii)(C); disregarded payments are addressed by §1.267A-2(b).

b. There are special rules for

- Royalties treated as payments in exchange for property under foreign law, see §1.267A-2(a)(2)(ii)(B);
- Payments pursuant to securities lending transactions, sale-repurchase transactions, or similar transactions, see §1.267A-2(a)(3) and §1.267A–6(c)(2) for an example; and
- Payments pursuant to interest-free loans and similar arrangements, see §1.267A-2(a)(4), including a delayed applicability date in §1.267A-7(b)(1).

iii. *Examples.* See Examples 1 and 2 in §1.267A-6.

2. Disregarded payments

i. *General rule*. The excess (if any) of the sum of a specified party's disregarded payments for a taxable year over its dual inclusion income for the taxable year is a disqualified hybrid amount. §1.267A-2(b)(1).

ii. *Definition of disregarded payment*. A disregarded payment generally is a specified payment to the extent that, under the tax law of a tax resident or taxable branch to which the payment is made, the payment is not regarded (for example, because under such tax law it is a payment involving a single taxpayer or members of a group) and, were the payment to be regarded (and treated as interest or a royalty, as applicable) under such tax law, the tax resident or taxable branch would include the payment in income. §1.267A-2(b)(2)(i).

- A payment that gives rise to a deduction or similar offset allowed to the tax resident or taxable branch (or group of entities that includes the tax resident or taxable branch) under a foreign consolidation, fiscal unity, group relief, loss sharing, or any similar regime is a disregarded payment. §1.267A-2(b)(2)(ii)(A).
- A specified payment of a U.S. taxable branch is not a disregarded payment to the extent that under the tax law of the tax resident to which the payment is made the payment is otherwise taken into account. A disregarded payment does not include a deemed branch payment, a specified payment pursuant to a repo transaction or similar transaction described in §1.267A-2(a)(3), or a specified payment pursuant to an interest-free loan or similar transaction described in §1.267A-2(a)(4) (payments pursuant to interest-free loans and similar arrangements, see A.1.ii.b above). §1.267A-2(b)(2)(ii)(B).

iii. *Definition of dual inclusion income*. Dual inclusion income is the excess, if any, of

- The sum of the specified party's items of income or gain for U.S. tax purposes that are included in the specified party's income (by treating the items of income or gain as the specified payment; and, in the case of a specified party that is a CFC, by treating U.S. tax law as the CFC's tax law), to the extent the items of income or gain are included in the income of the tax resident or taxable branch to which the disregarded payments are made, as determined under §1.267A-3(a) (see A.7 below), by treating the items of income or gain as the specified payment; over
- The sum of the specified party's items of deduction or loss for U.S. tax purposes (other than deductions for disregarded payments), to the extent the items of deduction or loss are allowable (or have been or will be allowable during a taxable year that ends no more than 36 months after the end of the specified

party's taxable year) under the tax law of the tax resident or taxable branch to which the disregarded payments are made. §1.267A-2(b)(3)(i).

Special rules apply for purposes of dividends subject to an exemption or similar system, §1.267A-2(b)(3)(ii), and to payments made indirectly to a tax resident or taxable branch, §1.267A-2(b)(4).

iv. *Examples.* See Examples 3 and 4 in §1.267A-6.

3. Deemed branch payments

i. *General rule*. If a specified payment is a deemed branch payment, then the payment is a disqualified hybrid amount if the tax law of the home office (a tax resident that has a branch, see §1.267A-5(a)(9)) provides an exclusion or exemption for income attributable to the branch.

ii. *Definition of deemed branch payment*. A deemed branch payment is a notional payment that arises from applying Article 7 (Business Profits) of certain U.S. income tax treaties, which takes into account only the profits derived from the assets used, risks assumed and activities performed by the permanent establishment to determine the business profits that may be taxed where the permanent establishment is situated. More specifically, a deemed branch payment is, with respect to a U.S. taxable branch that is a U.S. permanent establishment of a person eligible for the benefits of an income tax treaty between the United States and the treaty country, any amount of interest or royalties allowable as a deduction in computing the business profits of the U.S. permanent establishment, to the extent the amount is deemed paid to the home office (or other branch of the home office), is not regarded (or otherwise taken into account) under the home office's tax law (or the other branch's tax law), and, were the payment to be regarded (and treated as interest or a royalty, as applicable) under the home office's tax law (or other branch's tax law), the home office (or other branch) would include the payment in income, as determined under §1.267A-3(a) (see A.7 below). §1.267A-2(c)(2).

iii. *Example.* See Example 4 in §1.267A-6.

4. Payments to reverse hybrids

i. *General rule*. If a specified payment is made to a reverse hybrid, the payment generally is a disqualified hybrid amount to the extent that

- An investor, the tax law of which treats the reverse hybrid as not fiscally transparent, has a "no-inclusion," i.e., does not include the payment in income, as determined under §1.267A-3(a) (see A.7 below); and
- The investor's no-inclusion is a result of the payment being made to the reverse hybrid. For purposes of this test, the investor's no-inclusion is a result of the specified payment being made to the reverse hybrid to the extent that the no-inclusion would not occur were the investor's tax law to treat the reverse hybrid as fiscally transparent (and treat the payment as interest or a royalty, as applicable). §1.267A-2(d)(1).

ii. *Reverse hybrid*. A reverse hybrid is an entity that is fiscally transparent (see §1.267A-5(a)(8)) under the tax law of the country in which it is created, organized, or

otherwise established but not fiscally transparent under the tax law of an investor of the entity. A reverse hybrid can be foreign or domestic. §1.267A-2(d)(2).

iii. *Indirect payments to a reverse hybrid.* A specified payment made to an entity an interest of which is directly or indirectly owned by a reverse hybrid is considered made to the reverse hybrid to the extent that, under the tax law of an investor of the reverse hybrid, the entity to which the payment is made is fiscally transparent (and all intermediate entities, if any, are also fiscally transparent). Indirect ownership is determined under the rules of section 958(a) without regard to whether an intermediate entity is foreign or domestic, or under substantially similar rules under a tax resident's or taxable branch's tax law. §1.267A-2(d)(3).

iv. *Exception for inclusion by taxable branch in establishment country*. A specified payment made to a reverse hybrid is not a disqualified hybrid amount to the extent that a taxable branch located in the country in which the reverse hybrid is created, organized, or otherwise established (and the activities of which are carried on by one or more investors of the reverse hybrid) includes the payment in income, as determined under §1.267A-3(a). §1.267A-2(d)(4).

v. *Example.* See Example 5 in §1.267A-6.

5. Branch mismatch payments

i. *General rule*. If a specified payment is a branch mismatch payment, the payment generally is a disqualified hybrid amount to the extent that

- A home office, the tax law of which treats the payment as income attributable to a branch of the home office, has a "no-inclusion," i.e., does not include the payment in income, as determined under §1.267A-3(a) (see A.7 below); and
- The home office's no-inclusion is a result of the payment being a branch mismatch payment. For purposes of this rule, the home office's no-inclusion is a result of the specified payment being a branch mismatch payment to the extent that the no-inclusion would not occur were the home office's tax law to treat the payment as income that is not attributable a branch of the home office (and treat the payment as interest or a royalty, as applicable). §1.267A-2(e)(1).

ii. *Definition of branch mismatch payment*. A branch mismatch payment is a specified payment that

- Under a home office's tax law, the payment is treated as income attributable to a branch of the home office; and
- Either the branch is not a taxable branch or, under the branch's tax law, the payment is not treated as income attributable to the branch. §1.267A-2(e)(2).

iii. *Example.* See Example 6 in §1.267A-6.

6. Relatedness or arrangement requirement. Except in the case of deemed branch payments (which involve a single entity), a payment is a disqualified hybrid amount only if a relatedness or structured arrangement requirement is met. A specified recipient, a tax resident or

taxable branch to which a specified payment is made, an investor, or a home office is taken into account for purposes of the disqualified hybrid amount rules only if the specified recipient, the tax resident or taxable branch, the investor, or the home office is related (as defined in §1.267A-5(a)(14)) to the specified party or is a party to a structured arrangement (as defined in §1.267A-5(a)(20)) pursuant to which the specified payment is made. §1.267A-2(f).

7. Determining when there has been an inclusion or no-inclusion.

i. *Generally*. As noted above, in many instances one needs to determine whether a person included or did not include an amount in income to determine whether a test has been met. Section 1.267A-3(a) sets forth a general income inclusion rule: a tax resident or taxable branch includes in income a specified payment to the extent that, under the tax law of the tax resident or taxable branch,

- It takes (or has taken) the payment into account in its income or tax base at the full marginal rate imposed on ordinary income (or, if different, the full marginal rate imposed on interest or a royalty, as applicable); and
- The payment is not reduced or offset by an exemption, exclusion, deduction, credit (other than for withholding tax imposed on the payment), or other similar relief particular to such type of payment. §1.267A-3(a)(1).
    - Reductions or offsets include a participation exemption, a dividends received deduction, a deduction or exclusion with respect to a particular category of income (such as income attributable to a branch, or royalties under a patent box regime), a credit for underlying taxes paid by a corporation from which a dividend is received, and a recovery of basis with respect to stock or a recovery of principal with respect to indebtedness. §1.267A-3(a)(1)(ii).
    - In contrast, a specified payment is not considered reduced or offset by a deduction or other similar relief particular to the type of payment if it is offset by a generally applicable deduction or other tax attribute, such as a deduction for depreciation or a net operating loss. §1.267A-3(a)(1)(ii). A deduction may be treated as being generally applicable even if it arises from a transaction related to the specified payment (for example, if the deduction and payment are in connection with a back-to-back financing arrangement). §1.267A-3(a)(1)(ii).

ii. *Payments to be made in the future*. For future payments to be treated as includible, the tax resident or taxable branch must reasonably expect to take the payment into account during a taxable year that ends no more than 36 months after the end of the specified party's taxable year. §1.267A-3(a)(1)(i).

iii. *Effect of defensive or secondary rules under the tax resident's or taxable branch's tax law*. Whether a tax resident or taxable branch includes in income a specified payment is determined without regard to any defensive or secondary rule contained in hybrid mismatch rules, if any, under the tax law of the tax resident or taxable branch. §1.267A-3(a)(2).

- Example of a defensive or secondary rule: hybrid mismatch rules that requires a tax resident or taxable branch to include an amount in income if a deduction for the amount is not disallowed under the payer's tax law. See §1.267A-3(a)(2).

- Example of a measure that is not a defensive or secondary rule: a rule pursuant to which a participation exemption or similar relief particular to a dividend is inapplicable as to a dividend for which the payer is allowed a deduction or other tax benefit under its tax law. See §1.267A-3(a)(2).

iv. *Effect of reverse hybrids*. Whether a tax resident or taxable branch that is an investor of a reverse hybrid (a "Reverse Hybrid Investor") includes in income a specified payment made to the reverse hybrid is determined without regard to a distribution (or the right to a distribution) from the reverse hybrid. Generally, the portion of the specified payment that is considered to relate to a distribution is the lesser of

- The specified payment multiplied by a fraction, the numerator of which is the amount of the distribution and the denominator of which is the aggregate amount of distributions from the reverse hybrid during the taxable year; and
- The amount of the distribution multiplied by a fraction, the numerator of which is the specified payment and the denominator of which is the sum of all specified payments made to the reverse hybrid during the taxable year. §1.267A-3(a)(3).

A special rule applies if the reverse hybrid distributes all of its income during a taxable year. In that case, a portion of a specified payment made to the reverse hybrid during the taxable year is considered to relate to each of the current year distributions from the reverse hybrid. Thus, to the extent that an investor includes in income a current year distribution, the investor is treated as including in income a corresponding portion of a specified payment made to the reverse hybrid during the year. See §1.267A-3(a)(3).

v. *Inclusions with respect to certain payments pursuant to hybrid transactions*. A special rule applies to a specified payment that is interest and that is made pursuant to a hybrid transaction, to the extent that, under the tax law of a specified recipient of the payment, the payment is a recovery of basis with respect to stock or a recovery of principal with respect to indebtedness.

- If the amount is a repayment of principal for U.S. tax purposes and that is or has been paid (or, based on all the facts and circumstances, is reasonably expected to be paid) by the specified party pursuant to the hybrid transaction, the amount is, to the extent included in the income of the specified recipient, treated as correspondingly reducing the specified recipient's no-inclusion with respect to the specified payment. A special 36-month rule applies in determining whether the specified recipient includes the principal payment in income. See §1.267A-3(a)(4).
- Once a principal payment reduces a no-inclusion with respect to a specified payment, it is not again taken into account for purposes of this rule to another specified payment. See §1.267A-3(a)(4).
- For an example, see §1.267A-6(c)(1)(vi).

vi. *Deemed full inclusions*. A preferential rate, exemption, exclusion, deduction, credit, or similar relief particular to a type of payment that reduces or offsets 90% or more of the payment is considered to reduce or offset 100% of the payment. §1.267A-3(a)(5).

vii. *Deemed de minimis inclusions*. A preferential rate, exemption, exclusion, deduction, credit, or similar relief particular to a type of payment that reduces or offsets 10% or less of the payment is considered to reduce or offset none of the payment. §1.267A-3(a)(5).

B. Reduction in amount of disqualified hybrid amounts. Certain amounts are not treated as disqualified hybrid amounts to extent they are included or includible in income for U.S. tax purposes. See §1.267A-3(b).

1. *General rule*. A specified payment that would otherwise be a disqualified hybrid amount (a tentative disqualified hybrid amount) is reduced by

i. Amounts included in income of U.S. tax resident or U.S. taxable branch (i.e., a tentative disqualified hybrid amount is reduced to the extent that a specified recipient that is a tax resident of the United States or a U.S. taxable branch takes the tentative disqualified hybrid amount into account in determining its gross income, see §1.267A-3(b)(2));

ii. Amounts includible in income as Subpart F income (i.e., a tentative disqualified hybrid amount is reduced to the extent that the tentative disqualified hybrid amount is received by a CFC and includible under section 951(a)(1)(A) (determined without regard to properly allocable deductions of the CFC, qualified deficits under section 952(c)(1)(B), and the E&P limitation under §1.952-1(c)) in the gross income of a U.S. shareholder of the CFC or, if the U.S. shareholder is a domestic partnership, a U.S. tax resident, see §1.267A-3(b)(3));

iii. Amounts includible in income as GILTI (i.e., a tentative disqualified hybrid amount is reduced to the extent that the tentative disqualified hybrid amount increases a U.S. shareholder's pro rata share of tested income with respect to a CFC, reduces the shareholder's pro rata share of tested loss of the CFC, or both, subject to a coordination rule for Subpart F income and effectively connected income, see §1.267A-3(b)(4)); and

vi. Amounts includible in income under the QEF rules (i.e., a tentative disqualified hybrid amount is reduced to the extent that the tentative disqualified hybrid amount is received by a qualified electing fund and is includible under section 1293 in the gross income of a U.S. person that owns stock of that fund or, if the U.S. person is a domestic partnership, a U.S. tax resident, §1.267A-3(b)(5)).

2. Examples. See Examples 3 and 7 of §1.267A-6.

C. Rules generally applicable to disqualified hybrid amounts and disqualified import mismatch amounts. For purposes of the regulations under section 267A, the following special rules apply.

1. Interaction of section 267A with other provisions of the Code

i. *General rule*. A specified payment generally is subject to section 267A after the application of any other applicable provisions of the Code and regulations. §1.267A-5(b)(1)(i).

- Thus, the determination of whether a deduction for a specified payment is disallowed under section 267A is made with respect to the taxable year for which a deduction for the payment would otherwise be allowed for U.S. tax purposes.
- In addition, provisions that characterize amounts paid or accrued as something other than interest or royalties, such as §1.894-1(d)(2), govern the treatment of such amounts and therefore such amounts would not be treated as specified payments.
- Moreover, to the extent that a specified payment is not described in §1.267A-1(b) when it is subject to section 267A, the payment is not again subject to section

267A at a later time. For example, if for the taxable year in which a specified payment is paid the payment is not disallowed by §1.267A-1(b) but under section 163(j) a deduction for the payment is deferred, the payment is not again subject to section 267A in the taxable year for which section 163(j) no longer defers the deduction.

ii. *Exceptions*. There are certain exceptions, however, where Section 267A applies before another provision. In addition to the extent explicitly provided in any other applicable statutory or regulatory provision, section 267A applies before the application of sections 163(j), 461(l), 465, and 469. §1.267A-5(b)(1)(ii).

iii. *Coordination with capitalization and recovery provisions*. To the extent a specified payment is disallowed by §1.267A-1(b), a deduction for the payment is considered permanently disallowed for all purposes. The payment is not taken into account for purposes of computing costs that are required to be capitalized and recovered through depreciation, amortization, cost of goods sold, adjustment to basis, or similar forms of recovery under any applicable statutory or regulatory provision. See §1.267A-5(b)(1)(ii).

iv. *Specified payments arising in taxable years beginning before January 1, 2018*. Section 267A does not apply to a specified payment that is paid or accrued in a taxable year beginning before January 1, 2018, regardless of whether a deduction for the payment is deferred to a taxable year beginning after December 31, 2017, or whether the payment is carried over to another taxable year and under another provision of the Code (for example, section 163(j)) is considered paid or accrued in such taxable year. §1.267A-5(b)(1)(iv).

2. Foreign currency gain or loss. Foreign currency gain or loss recognized with respect to a specified payment is taken into account under section 267A only to the extent that a deduction for the specified payment is disallowed under section 267A and the foreign currency gain or loss is described in §1.988-2(b)(4) (relating to exchange gain or loss recognized by the issuer of a debt instrument with respect to accrued interest) or §1.988-2(c) (relating to items of expense or gross income or receipts which are to be paid after the date accrued). If a deduction for a specified payment is disallowed under section 267A, then a proportionate amount of foreign currency loss under section 988 with respect to the specified payment is also disallowed, and a proportionate amount of foreign currency gain under section 988 with respect to the specified payment reduces the amount of the disallowance. The proportionate amount is determined pursuant to the formula in section 1.267A-5(b)(2). See section 1.267A-5(b)(2).

3. Amounts considered paid or accrued by a U.S. taxable branch.

i. *General rule*. For purposes of section 267A, a U.S. taxable branch generally is considered to pay or accrue an amount of interest or royalty equal to the amount of interest or royalty allocable to effectively connected income of the U.S. taxable branch under section 873(a) or 882(c)(1), as applicable. In the case of a U.S. taxable branch that is a U.S. permanent establishment of a treaty resident eligible for benefits under an income tax treaty between the United States and the treaty country, the U.S. taxable branch is treated as paying or accruing the amount of interest or royalty allowable in computing the business profits attributable to the U.S. permanent establishment. See §1.267A-5(b)(3)(i).

ii. *U.S. taxable branch payments of interest*. Interest considered paid or accrued by a U.S. taxable branch of a foreign corporation (the "U.S. taxable branch interest payment") is treated as a payment directly to the person to which the interest is payable,

to the extent it is paid or accrued with respect to a liability described in §1.882-5(a)(1)(ii)(A) or (B) (resulting in directly allocable interest) or with respect to a U.S. booked liability, as described in §1.882-5(d)(2). If the U.S. taxable branch interest payment exceeds in the aggregate the interest paid or accrued on the U.S. taxable branch's directly allocable interest and interest paid or accrued on U.S. booked liabilities, the excess amount is treated as paid or accrued by the U.S. taxable branch on a pro-rata basis to the same persons and pursuant to the same terms that the home office paid or accrued interest, excluding any directly allocable interest or interest paid or accrued on a U.S. booked liability. See §1.267A-5(b)(3)(ii)(A).

iii. *U.S. taxable branch payments of royalties*. Royalties considered paid or accrued by a U.S. taxable branch are treated solely for purposes of section 267A as paid or accrued on a pro-rata basis by the U.S. taxable branch to the same persons and pursuant to the same terms that the home office paid or accrued such royalties. See §1.267A-5(b)(3)(ii)(B).

iv. *Permanent establishments and interbranch payments*. Except with respect to certain interbranch interest and royalty payments (see A.3.ii above), if a U.S. taxable branch is a permanent establishment in the United States, the principles of the rules described in ii and iii above apply with respect to interest and royalties allowed in computing the business profits of an entitiy eligible for treaty benefits. See §1.267A-5(b)(3)(ii)(C).

4. Effect on E&P. Whether a deduction is allowed under section 267A or not does not affect whether the amount paid or accrued that gave rise to the deduction reduces earnings and profits. An exception applies in one instance, however: For purposes of section 952(c)(1) and §1.952-1(c), a CFC's earnings and profits are not reduced by a specified payment a deduction for which is disallowed under section 267A, if a principal purpose of the transaction pursuant to which the payment is made is to reduce or limit the CFC's subpart F income. §1.267A-5(b)(4).

5. Application to structured payments

i. *General rule*. A structured payment is generally treated as interest, with the rules of section 267A applying as if the payment were an amount of interest paid or accrued. §1.267A-5(b)(5)(i). A structured payment is any substitute interest payment or amount economically equivalent to interest. §1.267A-5(b)(5)(ii).

ii. *Substitute interest payments*. A substitute interest payment described in §1.861-2(a)(7) generally is treated as a structured payment for purposes of section 267A, unless the payment relates to certain sale-repurchase agreements or a securities lending transaction that is entered into by the payor in the ordinary course of the payor's business. §1.267A-5(b)(5)(ii)(A).

iii. *Amounts economically equivalent to interest*

- *General definition*. Any expense or loss economically equivalent to interest is treated as a structured payment for purposes of section 267A if a principal purpose of structuring the transaction(s) is to reduce an amount incurred by the taxpayer that otherwise would have been treated as interest expense. §1.267A-5(b)(5)(ii)(B)(1). The fact that the taxpayer has a business purpose for obtaining the use of funds does not affect the determination of whether the manner in which the taxpayer

structures the transaction(s) is with a principal purpose of reducing the taxpayer's interest expense. In addition, the fact that the taxpayer has obtained funds at a lower pre-tax cost based on the structure of the transaction(s) does not affect the determination of whether the manner in which the taxpayer structures the transaction(s) is with a principal purpose of reducing the taxpayer's interest expense. See §1.267A-5(b)(5)(ii)(B)(1).

- An expense or loss is economically equivalent to interest to the extent that the expense or loss is deductible by the taxpayer; incurred by the taxpayer in a transaction or series of integrated or related transactions in which the taxpayer secures the use of funds for a period of time; substantially incurred in consideration of the time value of money; and not otherwise treated as interest by the section 267A regulations. See §1.267A-5(b)(5)(ii)(B)(1).
- *Principal purpose*. Whether a transaction or a series of integrated or related transactions is entered into with a principal purpose depends on all the facts and circumstances related to the transaction(s). Factors to be taken into account in determining whether one of the taxpayer's principal purposes for entering into the transaction(s) include the taxpayer's normal borrowing rate in the taxpayer's functional currency, whether the taxpayer would enter into the transaction(s) in the ordinary course of the taxpayer's trade or business, whether the parties to the transaction(s) are related persons (within the meaning of section 267(b) or 707(b)), whether there is a significant and bona fide business purpose for the structure of the transaction(s), whether the transactions are transitory, for example, due to a circular flow of cash or other property, and the substance of the transaction(s). §1.267A-5(b)(5)(ii)(B)(2).

V. Question 5: Is the specified payment a disqualified imported mismatch amount, as described in §1.267A-4 (payments offset by a hybrid deduction)?

If yes, payment is disallowed by §1.267A-1(b), subject to applicability dates in §1.267A-7.

If not, continue to question 6.

A. General Rule. An imported mismatch payment generally is a disqualified imported mismatch amount to the extent that, under the set-off rules of §1.267A-4(c) (see C below), the income attributable to the payment is directly or indirectly offset by a hybrid deduction (see B below) incurred by a foreign tax resident or foreign taxable branch that is related to the imported mismatch payer (or that is a party to a structured arrangement pursuant to which the payment is made). §1.267A-4(a)(1). In making the determination whether an amount is a disqualified imported mismatch amount, the rules of §1.267A-5(b) (see Question 4.C above) must be taken into account.

1. Imported mismatch payment. An imported mismatch payment is a specified payment to the extent that it is neither a disqualified hybrid amount nor included or includible in income in the United States. §1.267A-4(a)(2)(v). For purposes of this definition, a specified payment is included or includible in income in the United States to the extent that, if the payment were a tentative disqualified hybrid amount as described in §1.267A-3(b)(1), it would be reduced under the rules of §1.267A-3(b)(2) through (5) (see Question 4.B.1 above). §1.267A-4(a)(2)(v).

2. Foreign tax resident and foreign taxable branch. A foreign tax resident is a person that is not a tax resident of the United States, and a foreign taxable branch is a taxable branch that is not a U.S. taxable branch. §1.267A-4(a)(2)(i), (ii).

3. Imported mismatch payee and payor. An imported mismatch payee is a foreign tax resident or foreign taxable branch that includes the imported mismatch payment in income, as determined under §1.267A-3(a) (see Question 4.A.7 above), and an imported mismatch payer is the specified party with respect to the imported mismatch payment. §1.267A-4(a)(2)(iii), (iv).

4. Examples. For an illustration of these rules, see Example 8 (Imported mismatch rule— direct offset), Example 9 (Imported mismatch rule— indirect offsets and pro rata allocations), Example 10 (Imported mismatch rule—ordering rules and rule deeming certain payments to be imported mismatch payments), Example 11 (Imported mismatch rule—hybrid deduction of a CFC), and Example 12 (Imported mismatch rule—application first with respect to certain hybrid deductions, then with respect to other hybrid deductions) of §1.267A-6.

B. Hybrid deduction

1. General definition. A hybrid deduction is generally either:

i. A deduction allowed to a foreign tax resident or foreign taxable branch under its tax law for an amount paid or accrued that is interest (including an amount that would be a structured payment under the principles of §1.267A-5(b)(5)(ii)) or royalty under such tax law, to the extent that a deduction for the amount would be disallowed if such tax law contained rules substantially similar to those under §§1.267A-1 through 1.267A-3 and 1.267A-5. §1.267A-4(b)(1)(i). If the foreign tax law of the foreign tax resident or foreign taxable branch contains hybrid mismatch rules, then only certain deductions allowed to the foreign tax resident or foreign taxable branch under its tax law are hybrid deductions. See §1.267A-4(b)(2)(i)(A).

ii. A deduction allowed to a foreign tax resident or foreign taxable branch under its tax law with respect to equity (including deemed equity), such as a notional interest deduction (or similar deduction determined with respect to the foreign tax resident's or foreign taxable branch's equity). §1.267A-4(b)(1)(ii).

- A deduction allowed to a foreign tax resident or foreign taxable branch with respect to equity is a hybrid deduction only to the extent that an investor of the foreign tax resident, or the home office of the foreign taxable branch, would include the amount in income if, for purposes of the investor's or home office's tax law, the amount were interest paid by the foreign tax resident ratably (by value) with respect to the interests of the foreign tax resident, or interest paid by the foreign taxable branch to the home office. §1.267A-4(b)(1)(ii).
- The rules of §1.267A-3(a) (see Question 4.A.7 above) apply to determine the extent that an investor or home office would include an amount in income, by treating the amount as the specified payment. §1.267A-4(b)(1)(ii).
- If the foreign tax law of the foreign tax resident or foreign taxable branch contains hybrid mismatch rules, then only certain deductions allowed to the foreign tax resident or foreign taxable branch under its tax law are hybrid deductions. See §1.267A-4(b)(2)(i)(B).

2. Various special rules apply

i. *Dual inclusion income used to determine hybrid deductions arising from deemed branch payments in certain cases*. In the case of a foreign taxable branch the tax law of which permits a loss of the foreign taxable branch to be shared with a tax

resident or taxable branch, a deduction allowed to the foreign taxable branch for an amount that would be a deemed branch payment were such tax law to contain a provision substantially similar to §1.267A-2(c) (see Question 4.A.3 above) is a hybrid deduction to the extent of the excess (if any) of the sum of all such amounts over the foreign taxable branch's dual inclusion income (as determined under the principles of §1.267A-2(b)(3), see Question 4.A.2.iii above). This rule applies without regard to whether the loss is in fact so shared or whether there is a tax resident or taxable branch with which the loss can be shared and without regard to whether the tax law of the home office provides an exclusion or exemption for income attributable to the branch. See §1.267A-4(b)(2)(ii).

ii. *Certain Post-2018 Deductions*. Deductions described in §1.267A-4(b)(1)(ii) (deductions with respect to equity, see B.1.ii above) and deductions that would be disallowed if the foreign tax resident's or foreign taxable branch's tax law contained a rule substantially similar to §1.267A-2(a)(4) (payments pursuant to interest-free loans and similar arrangements, see Question 4A.1.ii.b above) are treated as hybrid deductions only if allowed for an accounting period (see §1.267A-5(a)(a)) beginning on or after December 20, 2018. See §1.267A-4(b)(2)(iii).

iii. *Certain deductions of a CFC*. A deduction is not a hybrid deduction to the extent that the amount paid or accrued giving rise to the deduction is

- A disqualified hybrid amount subject to the special rule of §1.267A-4(g) (special rule regarding extent to which a disqualified hybrid amount of a CFC prevents a hybrid deduction or a funded taxable payment, see D.5 below) or
- Included or includible in income in the United States (i.e., to the extent that, if the amount were a tentative disqualified hybrid amount described in §1.267A-3(b)(1)), it would be reduced under the rules of §1.267A-3(b)(2) through (5)). See §1.267A-4(b)(2)(iv) and Question 4.B above.

iv. *Loss carryovers*. A hybrid deduction for a particular accounting period includes a loss carryover from another accounting period, but only to the extent that a hybrid deduction incurred in an accounting period ending on or after December 20, 2018, comprises the loss carryover. §1.267A-4(b)(2)(v).

C. Set-off rules

1. General rule. A hybrid deduction directly or indirectly offsets the income attributable to an imported mismatch payment to the extent that the payment directly or indirectly funds the hybrid deduction. §1.267A-4(c)(1). In applying this rule, one follows the ordering rules of §1.267A-4(c)(2) (see C.2 below) and the funding rules of §1.267A-4(c)(3) (see C.3 below), taking into account the adjustments required by §1.267A-4(c)(4) (see C.4 below).

2. Ordering rules. The following ordering rules apply for purposes of determining the extent that a hybrid deduction directly or indirectly offsets income attributable to imported mismatch payments. §1.267A-4(c)(2).

i. First, the hybrid deduction offsets income attributable to a factually-related imported mismatch payment that directly or indirectly funds the hybrid deduction. A factually-related imported mismatch payment generally is an imported mismatch payment that is made pursuant to a transaction, agreement, or instrument entered into pursuant to the same plan or series of related transactions that includes the transaction, agreement, or instrument pursuant to which the hybrid deduction is incurred, provided that a design

of the plan or series of related transactions was for the hybrid deduction to offset income attributable to the payment (as determined under the principles of §1.267A-5(a)(20)(i), by treating the offset as the "hybrid mismatch" described in §1.267A-5(a)(20)(i)). §1.267A-4(c)(2)(i).

ii. Second, to the extent remaining, the hybrid deduction offsets income attributable to an imported mismatch payment (other than a factually-related imported mismatch payment) that directly funds the hybrid deduction. §1.267A-4(c)(2)(ii).

iii. Third, to the extent remaining, the hybrid deduction offsets income attributable to an imported mismatch payment (other than a factually-related imported mismatch payment) that indirectly funds the hybrid deduction. §1.267A-4(c)(2)(iii).

3. Funding rules

i. *General rules*. The following funding rules apply for purposes of determining the extent that an imported mismatch payment directly or indirectly funds a hybrid deduction. §1.267A-4(c)(3).

- The imported mismatch payment directly funds a hybrid deduction to the extent that the imported mismatch payee incurs the hybrid deduction. §1.267A-4(c)(3)(i).
- The imported mismatch payment indirectly funds a hybrid deduction to the extent that the imported mismatch payee is allocated the hybrid deduction, provided that the imported mismatch payee is related to the imported mismatch payer (or is a party to a structured arrangement pursuant to which the imported mismatch payment is made). §1.267A-4(c)(3)(ii).
- The imported mismatch payee is allocated a hybrid deduction to the extent that the imported mismatch payee directly or indirectly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs the hybrid deduction. §1.267A-4(c)(3)(iii).
- An imported mismatch payee indirectly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs a hybrid deduction to the extent that a chain of funded taxable payments connects the imported mismatch payee, each intermediary foreign tax resident or foreign taxable branch, and the foreign tax resident or foreign taxable branch that incurs the hybrid deduction, and provided that each intermediary foreign tax resident or foreign taxable branch is related to the imported mismatch payer (or is a party to a structured arrangement pursuant to which the imported mismatch payment is made). §1.267A-4(c)(3)(iv).
- If a deduction or loss that is not incurred by a foreign tax resident or foreign taxable branch is directly or indirectly made available to offset income of the foreign tax resident or foreign taxable branch under its tax law, then the foreign tax resident or foreign taxable branch to which the deduction or loss is made available and the foreign tax resident or foreign taxable branch that incurs the deduction or loss are treated as a single foreign tax resident or foreign taxable branch. Thus, if a deduction or loss of one foreign tax resident is made available to offset income of another foreign tax resident under a tax consolidation, fiscal unity, group relief, loss sharing, or any similar regime, then the foreign tax residents are treated as a single foreign tax resident for purposes of these funding rules. §1.267A-4(c)(3)(vi).
- An imported mismatch payee that directly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs a hybrid

deduction is allocated the hybrid deduction before the hybrid deduction (to the extent remaining) is allocated to an imported mismatch payee that indirectly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs the hybrid deduction. §1.267A-4(c)(3)(vii).

- An imported mismatch payee that, through a chain of funded taxable payments consisting of a particular number of funded taxable payments, indirectly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs a hybrid deduction is allocated the hybrid deduction before the hybrid deduction (to the extent remaining) is allocated to an imported mismatch payee that, through a chain of funded taxable payments consisting of a greater number of funded taxable payments, indirectly makes a funded taxable payment to the foreign tax resident or foreign taxable branch that incurs the hybrid deduction. §1.267A-4(c)(3)(viii).

ii. *Funded taxable payment*. For purposes of these funding rules, a funded taxable payment is an amount paid or accrued by a foreign tax resident or foreign taxable branch under its tax law (other than an amount that gives rise to a hybrid deduction) to the extent that

- The amount is deductible (but, if such tax law contains hybrid mismatch rules, determined without regard to a provision substantially similar to this section), §1.267A-4(c)(3)(v)(A);
- Another foreign tax resident or foreign taxable branch includes the amount in income, as determined under §1.267A-3(a) (see Question 4.A.7 above), by treating the amount as the specified payment, §1.267A-4(c)(3)(v)(B); and
- The amount is neither a disqualified hybrid amount (but subject to the special rule of §1.267A-4(g), see D.5 below) nor included or includible in income in the United States, §1.267A-4(c)(3)(v)(C).

D. Additional rules

1. Adjustments to ensure amounts not taken into account more than once. To the extent that the income attributable to an imported mismatch payment is directly or indirectly offset by a hybrid deduction, the imported mismatch payment, the hybrid deduction, and, if applicable, each funded taxable payment comprising the chain of funded taxable payments connecting the imported mismatch payee, each intermediary foreign tax resident or foreign taxable branch, and the foreign tax resident or foreign taxable branch that incurs the hybrid deduction is correspondingly reduced. §1.267A-4(c)(4).

2. Amounts determined on an accounting period basis. The amount of imported mismatch payments made by an imported mismatch payer to a particular imported mismatch payee is equal to the aggregate amount of all such payments made by the imported mismatch payer during the accounting period. §1.267A-4(d).

3. Amounts allocated on a pro rata basis if there would otherwise be more than one permissible manner in which to allocate the amounts. If (a) multiple imported mismatch payers make an imported mismatch payment to a single imported mismatch payee, (b) the sum of such payments exceeds the hybrid deduction incurred by the imported mismatch payee, and (c) the payments are not factually-related imported mismatch payments, then a pro rata portion of each imported mismatch payer's payment is considered to directly fund the hybrid deduction. §1.267A-4(d). For illustrations of this rule, see Examples 9 and 12 of §1.267A-6.

4. Manner in which the imported mismatch rules are applied. Section 1.267A-4(f) sets forth special rules regarding the manner in which §1.267A-4 is applied.

i. First, only the following hybrid deductions are taken into account:

- A hybrid deduction described in §1.267A-4(b)(1)(i) (see B.1.i above) to the extent that the deduction would be disallowed if the foreign tax resident's or foreign taxable branch's tax law contained a rule substantially similar to §1.267A-2(a)(4) (payments pursuant to interest-free loans and similar arrangements, see Question 4A.1.ii.b above) or the paid or accrued amount giving rise to the deduction is included in income in a third country but is not included in income in another country as a result of a hybrid or branch arrangement. §1.267A-4(f)(1)(i).
- A hybrid deduction described in §1.267A-4(b)(1)(ii) (deductions with respect to equity, see B.1.ii above). §1.267A-4(f)(1)(ii).

ii. Subsequent application of §1.267A-4 takes into account certain amounts deemed to be imported mismatch payments. After the first step, the other hybrid deductions are taken into account. See §1.267A-4(f)(2). For purposes of determining the extent to which the income attributable to an imported mismatch payment is directly or indirectly offset by a hybrid deduction, an amount paid or accrued by a foreign tax resident or foreign taxable branch that is not a specified party is deemed to be an imported mismatch payment to the extent that

- The tax law of such foreign tax resident or foreign taxable branch contains hybrid mismatch rules; and
- The amount is subject to disallowance under a provision of the hybrid mismatch rules substantially similar to this section. §1.267A-4(f)(2).

For this purpose, the foreign tax resident or foreign taxable branch and a foreign tax resident or foreign taxable branch that includes the amount in income (as determined under §1.267A-3(a), see Question 4.A.7 above, by treating the amount as the specified payment) are deemed to be an imported mismatch payer and an imported mismatch payee, respectively. §1.267A-4(f)(2).

iii. *Examples*. For illustration of these rules, see Examples 10 and 12 of §1.267A-6.

5. Special rule regarding when a disqualified hybrid amount of a CFC prevents a hybrid deduction or a funded taxable payment

i. *Limitation*. A disqualified hybrid amount of a CFC is taken into account for purposes of §1.267A-4(b)(2)(iv)(A) (certain deductions not hybrid deductions, see B.2.iii above) or §1.267A-4(c)(3)(v)(C) (funded taxable payments to the extent the amount giving rise to the deduction is a disqualified hybrid amount, see C.3.ii above) only to the extent of the excess (if any) of the disqualified hybrid amount over the sum of

- The disqualified hybrid amount to the extent that, if allowed as a deduction, it would be allocated and apportioned to residual CFC gross income (as described in §1.951A-2(c)(5)(iii)(B)) of the CFC, see §1.267A-4(g)(1);
- The disqualified hybrid amount to the extent that, if allowed as a deduction, it would be allocated and apportioned (under the rules of section 954(b)(5)) to gross income that is taken into account in determining the CFC's subpart F

income (as described in section 952 and §1.952-1), using the formula in §1.267A-4(g)(2), see §1.267A-4(g)(2); and

- The disqualified hybrid amount to the extent that, if allowed as a deduction, it would be allocated and apportioned (under the rules of §1.951A-2(c)(3)) to gross tested income of the CFC (as described in section 951A(c)(2)(A) and §1.951A-2(c)(1)), using the formula in §1.267A-4(g)(3), see §1.267A-4(g)(3).

ii. *Example*. See Example 11 of §1.267A-6.

Question 6: Is the specified payment subject to the anti-avoidance rule of §1.267A-5(b)(6)?

If yes, payment is disallowed by §1.267A-1(b) subject to applicability dates in §1.267A-7.

If not, payment is not disallowed by §1.267A-1(b).

Under this anti-avoidance rule, a specified party's deduction for a specified payment is disallowed to the extent that (i) the payment (or income attributable to the payment) is not included in the income of a tax resident or taxable branch (without regard to the deemed full inclusion rule in §1.267A-3(a)(5), see Question 4.A.7.vi above) and (ii) a principal purpose of the terms or structure of the arrangement (including the form and the tax laws of the parties to the arrangement) is to avoid the application of the section 267A regulations "in a manner that is contrary to the purposes of section 267A and the regulations in this part under section 267A."