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September 3, 2026

Department of Finance Canada
90 Elgin Street
Ottawa, Ontario
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Via email: Consultation-Legislation@fin.gc.ca

RE: Hybrid Mismatch Arrangement Rules – Draft Legislation Consultation

Dear Sir or Madam:

In July 2026, the Department of Finance ("Finance") released proposed amendments to the hybrid mismatch rules that were originally announced in January (such rules, the "Second Package"). The Second Package addresses mismatches arising from the hybridity of an entity (reverse hybrid arrangements, disregarded payment arrangements, and hybrid payer arrangements) as well as imported mismatches. Finance invited interested parties to provide comments on the Second Package no later than September 4, 2026. On behalf of Tax Executives Institute, Inc. ("TEI"), I am pleased to respond to Finance's request for comments.

About TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals.[1] Today, the organization has 55 chapters across North and South America, Europe the Middle East & Africa ("EMEA"), and Asia, including four chapters in Canada. Our over 6,000 members represent 2,800 of the world's leading companies, many of which either are resident or do business in Canada. Over 15% of TEI's membership comprises tax professionals who work for Canadian businesses in a variety of industries across the country. The following comments and recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

TEI's members have extensive experience with the practical administration of hybrid mismatch rules across multiple jurisdictions. TEI's comments are informed by this practical experience and are offered to assist the Finance in crafting rules that are effective, proportionate, and administrable.

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1 TEI is organized under the Not-For-Profit Corporation Law of the State of New York and is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

TEI Comments

Executive Summary

TEI recommends Finance remove the imported hybrid mismatch rules from the Second Package, consistent with the European Commission's ("EC") recent proposals to repeal its own substantially similar provisions in their entirety. Alternatively, should Finance proceed with the imported hybrid mismatch rules, we recommend Finance amend proposed paragraph 18.4(15.94)(a) to recognize neutralization achieved through means other than deduction denial, in particular, the U.S. dual consolidated loss ("DCL") rules.

Remove the Imported Hybrid Mismatch Rules

The EU's Tax Simplification Package

Canada has the opportunity to learn from the EU's experience. On June 24, 2026, the EC proposed a Council Directive to simplify the EU's framework on direct taxation to support the growth and competitiveness of the European Union.[2] As part of the proposed directive, the EC evaluated the efficacy of its imported hybrid mismatch rules under the EU's Anti-Tax Avoidance Directives ("ATAD"). The resulting analysis concluded that the EU should remove ATAD's imported hybrid mismatch rules because their application has proven particularly complex for both taxpayers and tax administrations. The proposed repeal is complete rather than partial: the proposal, once approved, would delete the imported hybrid mismatch rules from ATAD in their entirety and generally apply from January 1, 2029.

As part of the competitiveness evaluation, the EC recognized the rules are overly complicated, primarily due to their elaborate definitions and multilayered compliance obligations. The evaluation notes the rules' complexity "not only hinders their practical implementation but also generates significant administrative burdens for both taxpayers and tax authorities, without achieving their intended results." Importantly, the EC openly acknowledged the difficulties "in deriving any positive outcome" from such rules.

Canada Should Adopt the EU's Approach to Imported Hybrid Mismatches

TEI recommends Canada remove the proposed imported hybrid mismatch arrangement rules considering the competitiveness concerns raised by the EC. The EU was one of the earliest adopters

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[2] Proposal for a Council Directive amending Directives 2003/49/EC, 2009/133/EC, 2011/96/EU, (EU) 2016/1164, (EU) 2017/1852 and (EU) 2025/50 (24 June 2026), *available at* https://taxation-customs.ec.europa.eu/document/download/c981c6cf-a3e8-4ae6-a49d-6eb0b1e047e4_en?filename=Explanatory%20Memorandum_Proposal%20for%20a%20Council%20Directive%20-%20Taxation_0.pdf.

of hybrid mismatch rules, implementing ATAD 1 in 2016 as well as a second directive addressing hybrid mismatches in 2017. EU member states were required to transpose the imported mismatch provisions into their domestic law by 2020. After more than six years of practical experience with the imported mismatch provisions across Europe, the EC concluded the imported hybrid mismatch rules are excessively complex and failed to produce any demonstrable positive outcome. While the proposed repeal remains subject to the EU legislative process, the EC's evaluation—reflecting the collective experience of 27 member states and the most comprehensive real-world assessment of imported mismatch rules undertaken to date—stands on its own evidentiary weight regardless of the timing or outcome of that process.

Canada should not ignore the EU's conclusions derived from years of experience with similar rules and therefore we urge Canada to prioritize competitiveness, administrative efficiency, and proportionality in its approach to hybrid mismatch arrangements by removing the imported hybrid mismatch rules from the Second Package.

<u>In the Alternative: Amend Proposed Paragraph 18.4(15.94)(a) – Variable B</u>

Should Finance proceed with the imported hybrid mismatch rules notwithstanding our recommendation above, TEI urges Finance to amend proposed paragraph 18.4(15.94)(a) and, at a minimum, ensure variable B properly recognizes neutralization of offshore hybrid mismatches achieved through substantially similar foreign rules.

Variable B as Drafted

Variable B may create a harsh result when it denies a deduction. Proposed subsection 18.4(15.94) determines an imported hybrid mismatch's amount in respect of an importing payment. The amount is the lesser of paragraphs (a) and (b). Paragraph (a) uses the formula A minus B, where (i) Variable A is the offshore hybrid mismatch amount; and (ii) Variable B is "the total of all amounts each of which is an amount that is not deductible in respect of" another importing payment or a payment under a foreign hybrid mismatch rule that has "an effect that is substantially similar" to subsection 18.4(15.95).

The purpose of variable B, as stated in the Explanatory Notes, is to prevent a denial of deductions in an amount beyond what is necessary to neutralize the offshore hybrid mismatch. In other words, variable B is intended to give credit for prior neutralization of the same mismatch by another country's hybrid mismatch rules.

The problem is that variable B is limited to amounts that are "not deductible," which requires a deduction denial. It does not recognize neutralization achieved through other methods employed by substantially similar foreign hybrid mismatch regimes. These include restrictions on the use of a loss, income recapture mechanisms, or certification requirements. This renders variable B overly restrictive in practice where a foreign jurisdiction neutralizes the mismatch through means other than outright denial of a deduction.

U.S. DCL Rules – Restriction vs. Denial

The United States implements a much more tailored, and consequently effective, approach to the mismatch problem. The most significant hybrid mismatch arrangement neutralization with a deduction denial is the United States DCL regime under section 1503(d) of the U.S. Internal Revenue Code and U.S. Treasury Regulation § 1.1503(d). The DCL rules address the same double deduction mismatch that Canada's hybrid mismatch rules target, namely, the potential for a single economic loss to reduce both U.S. taxable income and foreign taxable income. Such losses are referred to as a "dual consolidated" loss.

However, the DCL rules achieve neutralization through a fundamentally different mechanism. Rather than denying the deduction, the U.S. rules provide that a DCL cannot be used to offset the taxable income of any other member of the U.S. affiliated group (a "domestic use"), unless the taxpayer certifies that the loss will not be used to offset income of a foreign corporation. If the loss is subsequently made available outside the United States (a "foreign use"), a recapture mechanism requires the taxpayer to include in income an amount equal to the loss previously used domestically, plus interest. "Made available" is a broad standard, as a foreign use may arise even without any actual utilization.

This is a critical distinction. The U.S. approach neutralizes the double deduction because the loss cannot reduce both U.S. and foreign tax bases, but it does so by restricting consolidation use and imposing income recapture, not by making the amount "not deductible." The deduction remains available to the entity that incurred the loss; it simply cannot flow to an affiliated domestic corporation. That is, the DCL rules effectively prevent any double deduction from applying against non-dual inclusion income.

Because variable B requires an amount to be "not deductible," the DCL restriction does not reduce variable B, and therefore does not reduce the imported hybrid mismatch amount under paragraph 18.4(15.94)(a). Thus, Canada would deny a deduction in respect of an importing payment even where the U.S. DCL rules have already effectively neutralized the offshore hybrid mismatch. This is contrary to the stated purpose of subsection 18.4(15.94), which the Explanatory Notes describe as intended to "prevent a denial of deductions in an amount beyond what is necessary to neutralize the offshore hybrid mismatch."

Proposed Amendment to Variable B

TEI recommends Finance amend variable B of proposed paragraph 18.4(15.94)(a) to recognize neutralization of an offshore hybrid mismatch amount achieved through any mechanism under a substantially similar foreign hybrid mismatch rule and not only through deduction denial.

Specifically, we recommend expanding subparagraph 18.4(15.94)(a)(ii) to include amounts where a foreign rule (i) restricts the use of a loss, (ii) requires recapture upon foreign use, or (iii) otherwise effectively prevents the double deduction mismatch from producing a tax benefit in any jurisdiction.

An appropriate amendment could read as follows (new language **<u>bold and underlined</u>**):

> **B** is the total of all amounts each of which is an amount that is **<u>either</u>** not deductible, **<u>or if deductible, has not been applied to reduce income other than dual inclusion income</u>**, in respect of […] a payment, in computing the relevant foreign income or profits of an entity for a foreign taxation year, because of the application of a foreign hybrid mismatch rule, that has an effect that is substantially similar to that of subsection (15.95) […]

This amendment would ensure variable B properly credits neutralization achieved by the U.S. DCL rules (and any other jurisdiction's rules that employ restriction or recapture rather than outright denial), consistent with the stated policy objective of subsection 18.4(15.94).

<u>Conclusion</u>

In sum, TEI recommends Finance remove the imported hybrid mismatch rules from the Second Package in their entirety. The EU's findings, based on more than six years of practical experience, that such rules are excessively complex and produce no demonstrable positive outcome should carry substantial weight in Finance's deliberations. In the alternative, should Finance proceed with these rules, variable B of proposed paragraph 18.4(15.94)(a) must be amended to recognize neutralization achieved through means other than deduction denial, in particular the U.S. DCL rules, to avoid over-denial of deductions contrary to the stated policy intent of the provision

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TEI appreciates the opportunity to comment on the Second Package. If you have any questions or would like to TEI's comments, please do not hesitate to contact Sandy Shanks, Chair of TEI's Canadian Income Tax Committee, at sandy.shanks@conocophillips.com, or Benjamin R. Shreck of TEI's legal staff at bshreck@tei.org or +1 202 464 8353.

Respectfully submitted,

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