

La legislación colombiana prevé diversos instrumentos mixtos capaces de comprender un elemento mixto que abarca un capital en préstamo o fondos propios, tales como acciones privilegiadas, sociedades en participación, obligaciones de convertibilidad obligada en acciones, y obligaciones susceptibles de conversión si lo desea el poseedor.

Las subcapitalizaciones están estructuradas en la práctica por medio de entidades financieras con préstamos frente a frente o acuerdos de participación con los accionistas, debido a la restricción del registro de préstamos para los fines de control de cambios a aquéllos en los que se considera al acreedor como una entidad financiera en el extranjero.

Los contratos de préstamos internacionales están estructurados con frecuencia para financiar filiales locales por medio de instrumentos de fines especiales (SPV) en el extranjero, que permiten a los accionistas adquirir bienes de equipo utilizando la exoneración del impuesto sobre los ingresos aplicables a los alquileres, y la deducción fiscal de esos alquileres por la sociedad beneficiaria.

Aparte de los instrumentos considerados en la legislación nacional, los prestadores reciben también obligaciones como indemnización y opciones de toma de participación (*equity kickers*).

Los objetivos comerciales y fiscales reglamentarios básicos que sirven de base a la emisión de instrumentos mixtos conforme a la legislación colombiana consisten en eludir los descuentos por riesgo y los impuestos nacionales sobre las distribuciones de dividendos y en poder pedir la deducción de los intereses.

Todas las formas de subcapitalización y de deuda de segunda categoría por nacionales son categorías intermedias aceptables para la legislación colombiana.

El Código de impuestos colombiano estipula que los préstamos concedidos a entidades, sucursales, filiales o sociedades que trabajan en Colombia por cuenta de sedes centrales, entidades, sucursales o sus filiales se considera que forman parte de los activos netos de las entidades nacionales para fines fiscales. Esta clasificación es compatible con las reglas sobre el control de cambios vigente, según las cuales todo envío de fondos de las sedes centrales a las sucursales nacionales se considera como una inversión por encima del capital "atribuidos". Aunque ese caso sea el único en el que las disposiciones fiscales reidentifican expresamente una transacción comercial entre entidades conexas, las autoridades fiscales colombianas tienen la posibilidad de tratar una operación simulada conforme al fondo.

Aunque los accionistas pueden financiar sus propias sociedades y estas últimas se beneficien de la deducción del impuesto sobre los intereses, el pago, directo o indirecto, de intereses procedentes de entidades, sucursales y filiales en Colombia con destino a sus sedes centrales o sociedades madres en el extranjero no es deducible para Colombia.

La principal consecuencia fiscal de la clasificación de los instrumentos mixtos desde el punto de vista de los emisores nacionales es que los instrumentos considerados como fondos propios no permiten la deducción de los intereses o los dividendos. Además, las inversiones que no han sido registradas como tales para los fines del control de cambios no permiten la transferencia de beneficios ni el reembolso del capital.

En el caso de un inversionista nacional, la clasificación de un instrumento mixto como inversión de capital implica el pago de impuestos a la tasa del 35 por ciento en caso de rechazo de la deducción de los intereses. En el caso de los inversionistas extranjeros, los pagos adicionales se elevan al 39,55 por ciento. La clasificación de un instrumento mixto para los fines fiscales o contables en el país de emisión no repercute en el trato fiscal de una inversión nacional en Colombia. Por otra parte, los convenios internacionales actualmente vigentes en Colombia no abordan la cuestión de la incompatibilidad de trato de los instrumentos en las distintas jurisdicciones.

1. General overview of the tax system and the marketplace

Since the country is still making the transition to a new market economy, the financial markets in this short period have not developed a wide range of financial products with hybrid features. Therefore, the range of hybrid instruments actively used on the market is limited.

Czech commercial law recognises several instruments whose classification towards debt or equity is not always clear and can be treated differently for accounting, tax or regulatory purposes. These instruments include:

- convertible bonds;
- zero-coupon convertible and exchangeable debt;
- silent partnerships;
- participating loans.

As you see from the list, it does not include subordinated debt, even though this is used frequently on the Czech market. Czech law is inflexible in achieving a different ranking of debtor's obligations to enable the issuance of senior and junior debt. Therefore, most Czech issuers, keen to obtain a subordinated debt, are using foreign law as the governing law for debt issuance or cross-border structures. The cross-border structures in these cases are not chosen for tax reasons, but to enable the legal creation of junior debt. Under the law of the jurisdiction of the created special purpose vehicle (SPV) (to be chosen by the debtor), SPV issues debentures which are guaranteed by a creditworthy Czech entity in such manner that these obligations of the entity will be ranked as subordinated to its other obligations.

The objectives for the use of hybrid financial instruments or hybrid entities are mostly tax or regulatory. The regulatory objectives for the issue of hybrid instruments have been, on the side of the Czech banks, their desire for raising funds which could be ranked as equity (either Tier I or Tier II) for capital adequacy purposes. Issue of other equity instruments was largely motivated by tax reasons,

* Deloitte & Touche

deductibility of the periodic return paid on these instruments, and/or avoidance of withholding tax or other tax reasons.

As described above, cross-border structures are involved in a significant number of deals. The favoured jurisdictions for organising SPVs in transactions involving hybrid financial instruments are the Netherlands, Ireland, or other offshore centres in low taxing jurisdictions.

The Czech tax system does not allow tax consolidation for holding companies. Also, no group relief or group surrendering of tax losses is available for Czech entities. Therefore, organising an SPV structure which will be consolidated into a group for accounting purposes, leaves the SPV on a stand-alone basis for tax purposes and under fulfilment of general conditions allows for the tax deduction of interest expenses of the Czech issuer.

2. General classification principles

The Czech tax system is relatively new and relies heavily on the legal features of the financial instruments and their accounting treatment. It can be stated that the legal form of the instrument is decisive for the classification of the instrument by the issuer or investor (if both are Czech taxpayers). However, receiving a tax deduction for the return paid on the instrument is possible only if the legal regulation does not state that the investor participates in the profit of the issuer. In such a case the issuer has to pay out the periodic return of the instrument from its profit after tax and the deduction for the periodic return is not available. This treatment is applicable for example for silent partnerships where the contribution of the silent partner is recognised as debt; however, the silent partner is entitled to share the profit after tax and no deduction is available for the payments to the silent partner.

If a financial instrument is issued under foreign law, then Czech law will recognise its legal classification under the foreign law. Czech companies can be organised under foreign law as well as under Czech law if the liability of the partners or shareholders is at least at the same level as under Czech law. This possibility, even though granted by the Czech commercial code, is not used in practice.

Czech tax legislation does not have any specific rules for recognition between debt and equity with the exception of thin capitalisation rules, which are based on specific ratios between equity and debt financing of the issuer. These rules limit the deduction for interest payable on the debt financing provided by related parties to the Czech entity, exceeding the above-mentioned ratios between own equity of the issuer and its debt financing. The general ratio is set at 1:4, for banks and for insurance companies the ratio is set higher at 1:6 (comparing own equity to debt financing). The tax legislation does not recognise any intermediate categories. However, if the legal regulation provides that the creditor should participate in the profit of the issuer, then the issuer will not be able to claim deduction for periodic return on such an instrument.

Classification of the financial products under the Czech accounting standards (hereinafter CAS) is strictly based on the legal characteristics of the instrument. If the creditor holds the right to get paid the principal amount (corresponding to the legal characteristics of a debt), then such an amount is recognised in the balance sheet of the Czech entity as debt. Economic characteristics, such as unusual length of repayment, do not influence the classification of the instrument under CAS.

But since the most sophisticated investors and issuers are banks and other financial groups that report under international accounting standards, the issuers can classify the financial instruments in their balance sheet based on their substantial characteristics, including the economic characteristics of instruments.

The Czech National Bank issues a special decree that stipulates the treatment of various instruments for regulatory purposes. Since the financial market is not fully developed, the Czech National Bank is prepared to issue *ad hoc* rulings for specific instruments. The capital adequacy ratio is monitored based on financial statements both under IAS and under CAS. The problems which the Czech banks were faced with in respect of maintaining the capital adequacy ratio, forced them to issue instruments which could be classified as equity for capital adequacy purposes. Most banks use subordinated debt, which is classified under the capital adequacy regulation as Tier II capital.

The treatment of a hybrid instrument with features that would allow for more than one classification is classified in a unitary manner. The unitary manner is based on the reference to its dominant characteristics. The defragmentation of the hybrid financial instruments into several separate instruments is not used. The bond with a call option of the issuer for the redemption of the bond before its set maturity is accounted for and treated for tax purposes as a single instrument, a bond.

The Czech tax authorities have not yet used such an approach even under the "substance over form" rule, which would theoretically allow the financial authorities to split the hybrid instrument into several instruments with clear characteristics. Due to the complex characteristics of the hybrid instruments, the financial authorities would encounter severe difficulties when they tried to set a price for the single features of the complex instrument.

In cross-border transactions, investors are not obliged to adopt the classification of the issuer. Since investors and issuers will be located in different tax jurisdictions, the Czech tax authorities will expect the Czech entity to classify the instrument for Czech tax purposes independently from the original classification adopted by the issuer. However, the issuer's classification should be taken into account by the investor when classifying the instrument. Also, during a tax audit, the tax authorities can request the investor to supply information about the original classification adopted by the issuer. The investor is bound in its classification by the legal form of the instrument and type of return (profit share or interest) payable by the issuer. The taxpayer is not allowed to classify the instrument based on its substance, inconsistent with the form of the instrument.

The use of the rule "substance over form" is exclusively reserved for the tax authorities who can classify the instrument based on its substance. The tax authorities are requested to take into account during tax assessment the real substance of contracts or legal acts, if the form of the act or contract is different from

its substance. The tax authorities may argue a different substance based on the economic characteristics of the instrument.

The investor is not allowed to classify a debt instrument as an equity instrument based on its characteristics. Only the Czech tax authorities are entitled to use "substance over form".

3. Issuer and consequences of classification

If the instrument is classified for tax purposes as indebtedness and according to its legal form, the issuer is required to pay interest on the instrument, and can then deduct the accrued interest for tax purposes. The deduction will be granted only if (according to legal provisions) the issuer is not required to pay the periodic return from its profit (which is interpreted by the Czech tax authorities as profit after tax).

The deduction of the debt instrument is available to the issuer on the base of its costs (including discount and contingent payments) into its books on an accrual basis. The same applies for every form of the interest costs (e.g. also for IRS). Also, interest revenue is recognised on an accrual basis without taking into account the actual payment of the interest obligation.

The payment and its form have no bearing on the deduction claim of the issuer. The issuer will be entitled to tax deduction for the discount on the bond issued below par on an accrual basis and the same deduction will be available for a zero-coupon bond. If the repayment of the bond or coupon will be through issuance of equity securities, this will have no impact on the deductibility of the interest for the issuer. However, in these cases, the "substance over form" rule should always be considered.

Gains realised upon cancellation or discharge of the hybrid financial instrument will be generally subject to tax. Losses realised on the same occasions will be treated as a tax-deductible expense of the issuer. The taxation regime applicable for debentures was different until 1 January 1998; the gains and losses achieved on maturity of bonds were exempt from tax. Also, since 1 January 1998 these losses and gains have been subject to tax and are included in the general tax base of the Czech entity. The treatment of the losses and gains on maturity is not dependent on the type of periodic return from the instrument (whether it is subject to final withholding tax or is included in the general tax base).

4. Classification and its consequences for investors

Investors (Czech tax residents) are bound in the classification of the instrument by its legal form and legal classification of the periodic return received.

The dividends or shares on profit received from abroad form a special tax base which is subject to tax at 25 per cent. These types of periodic returns are excluded from the general tax base of the entity and taxed separately. If the entity reports tax losses, these tax losses in the general tax base cannot be offset against a separate income basket.

Interest income which is not subject to final withholding tax is included in the general tax base of the entity (irrespective of whether it is from abroad or from domestic debtors).

Foreign tax credit is available for all kinds of income which is not subject to a final withholding tax. The tax credit is available up to the amount of domestic income tax payable in respect of the income for which the foreign tax credit is granted. In no case can foreign taxes be credited in excess of the domestic tax rate applicable to the income. The amount of foreign tax credit available is limited also by the tax relief and other tax credits claimed by the entity in the same period. The excess amount of foreign tax, not allowed for tax credit in one fiscal period, cannot be claimed by the entity during the following fiscal periods. The excess amount of foreign taxes can be used as deductible expense in the following fiscal period.

4.1. Recognition of revenue

Under CAS, the taxpaying entity is required to recognise the interest income on an accrual basis. Such recognition of interest income requires the entities to recognise a discount through accrual over the maturity of the instrument as an income. The dividend income is recognised under CAS on the date when the investor receives the right to claim the dividend payment from the issuer (usually coupon date for shares and other equity securities). In the case of profit share from corporate entities whose equity is not divided into shares, the revenue is recorded on the date of the decision of the general meeting at which the dividend is declared.

5. Hybrid instruments in cross-border transactions

Until now, the Czech tax system has not developed any specific anti-avoidance rules, except for a specific rule for arm's length interest paid between related parties which is stipulated to be 140 per cent of the discount rate of the Czech National Bank on the date of the conclusion of the contract. With the above-mentioned exception, there does not exist a specific anti-avoidance rule. The tax authorities can use the general doctrine which is based on the "substance over form" rule, especially since there is no anti-avoidance rule which would target use of hybrid instruments for achieving tax benefits.

When classifying a hybrid financial instrument, the Czech tax authorities will classify it without looking directly at the classification of the instrument for accounting, tax or legal purposes in the investor's jurisdiction. During the process

of classification, the tax authorities can request submission of such information. The information about the classification of the instrument in the offshore jurisdiction will often be used as supporting argument by the domestic tax authorities, but will not on a stand-alone basis be sufficient for the domestic authorities to decide that domestic classification would follow the offshore jurisdiction.

Classification of the hybrid instrument for withholding tax purposes corresponds to the classification of the instrument by the issuer and does not differ. The periodic return on a hybrid instrument determined by a reference to a specific asset or index can qualify for a more favourable treatment of the return from the referring asset or index. The Czech Republic generally imposes withholding tax at a 25 per cent rate on interest or dividend payments paid to offshore investors. The actual amount of withholding tax to be levied by the Czech entity performing the payment of the periodic return can be reduced by an applicable double tax treaty.

Under the current practice of the Czech tax authorities, the issuer, if using a reduced withholding tax rate, should be able to produce at the authorities' request the investor's tax domicile. If the Czech issuer does not request in advance that it is provided by the necessary tax domicile of the investor, it can obtain the certificate also later.

Gains achieved by a non-resident investor in respect of Czech securities (hybrid instruments) are subject to domestic taxation only if the gain will be treated as domestic source income. To trigger the tax treatment as a domestic source income it is necessary that the security is purchased by a domestic tax resident or Czech permanent establishment of the non-resident investor. However, most of the double tax treaties the Czech Republic has concluded protect the gains realised by an offshore investor from taxation in the domestic jurisdiction. One of the notable exceptions is the double tax treaty between Germany and the Czech Republic where the Czech Republic is entitled to tax gains realised by the sale of securities of German tax residents to domestic investors. Since German investors represent a large number of portfolio investors, this clause causes certain problems with OTC trades in securities.

As already mentioned, in the case of classifying a hybrid financial instrument in the domestic tax jurisdiction, the tax authorities would classify it based on the legal form of the instrument under the issuer's jurisdiction. The tax and accounting treatment of the instrument in the issuer's country would not have as significant an impact but could certainly be used for supporting purposes.

All kinds of instruments should be treated equally irrespective of the issuer and his tax residency. However, as regards the tax treatment applicable for certain types of periodic return from abroad, the taxation is different from domestic instruments. Such a difference arises in the area of taxation of dividends received from a domestic entity and of dividends received from abroad. The domestic dividends are subject to 25 per cent withholding tax at issuer's level (not mentioning the corporate tax burden), but one half of the withholding tax can be used as tax credit in the period in which the dividend was distributed and the tax was withheld. Foreign dividends will be subject to a specific tax rate of 25 per cent applicable for foreign dividends, but no tax credit will be allowed for the amount of tax liability from this income basket.

Denmark
Danemark
Dänemark
Dinamarca

National Reporters
Hans Severin Hansen*
Clive Baxter**

1. General

The tax treatment of hybrid instruments has not been a major issue in the evolution of Danish tax law. Danish tax legislation does not specifically address the tax issues raised by these instruments, except in the case of convertible debentures. Even in the case of convertible debentures, the legislator has not laid down specially tailored tax rules. The law merely sets out the criteria for whether the debentures should be characterised as equity or debt for tax purposes.

This lack of specific tax rules should not be taken to imply that hybrid instruments are not regularly used as an alternative to straightforward equity and debt instruments.

Derivative financial instruments, to which special tax rules apply, fall outside the scope of this report, although the distinction between hybrid financial instruments and derivatives is not always clear.

The tax treatment of hybrid instruments must be determined by characterising these instruments as either equity or debt and applying the relevant tax rules.

Danish tax law contains a basic distinction between income and expenditure on the one hand and capital gains and losses on the other. It should be noted that capital gains on debt instruments arise in line with the repayment of the principal and that capital gains can therefore have a strong likeness to interest if the repayments occur at regular intervals.

From a practical point of view, the relevant question when determining the tax treatment of a hybrid instrument is generally whether the periodic return on the instrument should be treated as dividend, interest or capital gains on a debt instrument.

The debt versus equity issue does not give rise to major problems in so far as national transactions are concerned. In principle, at least in respect of corporate entities, only registered share capital is equity and all other instruments are debt.

It can be more difficult to draw the line between equity and debt in respect of international transactions, especially if the foreign definition of equity differs from the Danish one.

* Partner, Plesner & Grønberg Law Firm

** Partner, Sheltons International Tax Counsel