



Deloitte LLP
Bay Adelaide East
8 Adelaide Street West
Suite 200
Toronto ON M5H 0A9
Canada

Tel: 416-601-6150
Fax: 416-601-6151
www.deloitte.ca

September 4, 2026

Tax Policy Branch
Department of Finance Canada
90 Elgin Street
Ottawa, ON K1A 0G5

Via email: consultation-legislation@fin.gc.ca

Re: Deloitte's comments with respect to legislative proposals relating to the Income Tax Act and the Income Tax Regulations contained in the July 23, 2026 draft legislation (Hybrid Mismatch Arrangements)

Dear Sir or Madam:

We are writing to provide our comments on select proposals contained in the Legislative Proposals Relating to the Income Tax Act and the Income Tax Regulations released on July 23, 2026. The purpose of this submission is to focus on a discrete aspect of the hybrid mismatch arrangements where we believe additional legislative clarity would be helpful to taxpayers.

Deloitte and its affiliated entities constitute one of the largest professional services firms in Canada. We work with many taxpayers, ranging from individuals and private businesses to Canadian and global multinationals, to advise and support them in meeting their compliance obligations under the Income Tax Act.¹

Ambiguity concerning application of rules to non-hybrid partnerships

The hybrid mismatch rules are expected to have relevance for complex fact patterns and corporate structures involving a variety of different legal forms, including partnerships. As drafted, it is unclear how the proposed hybrid mismatch rules are intended to apply to payments made by partnerships that are not themselves hybrid payers, but which have hybrid entities / payers as members. Consider the case of an unlimited liability company (ULC) owning a 99.9% interest in a limited partnership (LP) that is not a hybrid entity / payer and the LP pays interest expense to an arm's length lender. Specifically, we note that section 18.4 does not modify the definition of taxpayer to exclude partnerships, as is the case with section 18.2. We expect that approach was adopted because the rules are intended to apply to partnerships that are hybrid entities / payers; however, the question arises how the rules are intended to apply to non-hybrid partnerships with hybrid members.

As drafted, it is possible, though perhaps not intended, for taxpayers to apply proposed subsections 18.4(15.3) and (15.5) at the level of a partnership, but such application requires one to interpret the partnership as the "taxpayer" in question, while simultaneously considering the member of the partnership as "a payer" within the meaning of subsections 18.4(15.3) and (15.5). As noted below, certain interpretive guidance set out in the OECD's

¹ RSC 1985, c.1 (5th Supp.), as amended, herein referred to as "the Act."

report on Action 2 makes such an interpretation possible.² Moreover, there is no requirement in either subsection 18.4(15.3) or (15.5) that the taxpayer be the referenced “payer.” We acknowledge that this is arguably a counter-intuitive application of the legislative language, but one that can lead to adverse outcomes.

In particular, dual inclusion income is defined with reference to income of “the entity.” Thus, if a member of a partnership is itself a hybrid entity or hybrid payer, it may generate amounts of income that would otherwise qualify as dual inclusion income, but because such amounts are not earned by the partnership itself, they would arguably not be available to shelter hybrid mismatch amounts arising at the partnership level pursuant to proposed subsections 18.4(15.4) and (15.6) if the partnership itself is considered to be the relevant taxpayer.

As a general matter, we note that imposing restrictions on deductibility of amounts at the partnership level based on a member’s status as a hybrid entity or hybrid payer may lead to further complexity and unintended outcomes, including additional burdens on taxpayers in structuring and diligence contexts. This is a similar issue to the concerns raised in the context of the proposed, but ultimately abandoned, amendments to paragraph 212(13.1)(a) which would have imposed withholding obligations on partnerships based on the status of their members.

Overall, the amendments required to allow the rules to function seamlessly at the partnership level would appear to be significant. On the other hand, there are several indications in the existing proposals that the rules are intended to apply at the partner, rather than the partnership, level in these circumstances as further outlined below. For these reasons, we would recommend that only targeted minor adjustments be made, as outlined below, in order to clarify that the rules are intended to apply to members of partnerships, rather than to partnerships themselves.

Issues with partner-level application

Payer status rules

With respect to indications in the current proposals that the rules are intended to apply at the level of a member of a partnership, we note that proposed subsections 18.4(15.3) and (15.5) include, as one of the conditions for their respective application, the requirement that a payer of the payment is a hybrid entity or hybrid payer, as the case may be. A partnership that is neither treated as a resident of any foreign jurisdiction, nor carrying on business in any foreign jurisdiction, should not itself meet the proposed definition of either a hybrid entity or a hybrid payer, within the meaning of subsection 18.4(1). Read literally, this could lead to a situation where payments legally made by partnerships could escape the application of proposed subsection 18.4(4). The integrity of the rules appears to be preserved, however, by virtue of the OECD’s report on Action 2 of the BEPS initiative which provides, at paragraph 420, the following:

A payer means any person who makes a payment. This will generally be the person with the legal obligation to the payment. There may be cases, however, where, due to tax transparency of the direct payer, the payment is treated as made by an underlying investor. In this case the taxpayer will have the burden of establishing, to the reasonable satisfaction of the tax administration, how the tax transparency of the payer and the tax treatment of the payment by the underlying investor impacts on the amount of the adjustment required under the rule.³

² OECD (2015), *Neutralizing the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, at paragraph 420.

³ Ibid. We also note that paragraph 417 contains similar guidance with respect to the status of an entity as a payee.

We interpret the above-noted guidance to mean that, in situations where a hybrid entity is a member of a partnership that makes a payment, the hybrid entity member may be considered to be a payer of the amount for purposes of applying the proposed hybrid mismatch rules in section 18.4.

If this is in fact the manner in which the rules are intended to apply, we recommend that a modified definition of taxpayer be included in subsection 18.4(1) in order to exclude partnerships that do not themselves meet the definition of a hybrid payer. Additionally, notwithstanding the general interpretive rule in proposed subsection 18.4(2), we recommend a specific provision reflecting the guidance in paragraphs 417 and 420 of the Action 2 report to clarify that members of partnerships may be considered payers or payees, as the case may be. Such a rule may take the form of an amendment to paragraph 96(1)(f) to provide that “payer”, “payee”, “recipient” status flows through to members of partnerships that do not themselves meet the definition of a hybrid payer.

Interaction with EIFEL rules

We also wish to bring to your attention what we believe is an unintended interaction of the proposed hybrid mismatch rules with the EIFEL rules.

Similar to the situation described above, the issue arises, for example, where a partnership incurs interest and financing expenses (IFE), and at least one member of the partnership is a hybrid entity or hybrid payer within the meaning of proposed subsection 18.4(1). This scenario is common in the context of U.S. inbound investment in real estate, where properties may be owned/debt financed by limited partnerships of which unlimited liability companies are members.

Where a payment is made by a partnership and is in respect of amounts that qualify as interest and financing expenses within the meaning of section 18.2, an interpretive issue arises. Ordinarily, section 18.4 applies in priority to the EIFEL rules in section 18.2. Thus, where an amount is rendered non-deductible by virtue of section 18.4, no amount should remain to be taken into account in the computation of IFE.

Subsection 18.2(1) defines a taxpayer to exclude a partnership, and the application of the EIFEL rules is contingent on the look-through approach set out in paragraph (h) of the IFE definition, and the add-back mechanism in paragraph 12(1)(l.2). More specifically, the EIFEL rules do not apply to deny a deduction at either the partnership or member level, in respect of IFE derived through a partnership. Instead, the rules require an offsetting amount to be included in income to achieve the same economic result as a limitation of the deductible amount.

If the proposed hybrid mismatch rules are only applied in computing the income of a member of the partnership, and not in computing the income of the partnership itself, an amount may be rendered non-deductible by virtue of subsection 18.4(4), while the same amount will continue to be included in IFE, since the amount would otherwise be deductible in computing the income of the partnership. Accordingly, an add-back under paragraph 12(1)(l.2) could still arise, notwithstanding the denial of the deduction under subsection 18.4(4). This would give rise to double taxation.

If the intent is for subsection 18.4(4) to apply at the member, rather than the partnership, level, we recommend that paragraph 12(1)(l.2) be amended to exclude amounts rendered non-deductible by virtue of subsection 18.4(4). A corresponding inclusion would be required where amounts are subsequently permitted as deductions pursuant to proposed paragraphs 20(1)(zz) and (aaa).

Summary of recommendations

In closing, we believe that both taxpayers and the Canada Revenue Agency would be well-served by additional legislative clarifications included in the final package of enacted hybrid mismatch rules. In order to clarify that the

rules are intended to apply at the level of a member of a partnership, we would recommend that a modified definition of “taxpayer” be included in subsection 18.4(1) to exclude partnerships that do not themselves meet the definition of a hybrid payer. We also recommend that the guidance in paragraphs 417 and 420 of the Action 2 report be codified. Finally, we would recommend that paragraph 12(1)(l.2) be modified to exclude amounts in respect of IFE that have been rendered non-deductible by virtue of subsection 18.4(4), and to include amounts rendered deductible by virtue of proposed paragraphs 20(1)(zz) and (aaa).

* * * * *

We hope our specific comments are helpful in your development and implementation of the proposed hybrid mismatch rules. We would be pleased to meet with you or other officials to discuss our submission as Deloitte is committed to making a significant contribution to help shape Canada’s tax policy and its application to the future of our country.

We consent to the disclosure of our comments under the Access to Information Act and have made a copy of our submission available on our website at www.deloitte.ca

Yours very truly,

A handwritten signature in blue ink that reads "Deloitte, LLP".

Rob Jeffery, FCPA, FCA
National Tax Policy Leader
Deloitte LLP