

EXPOSURE DRAFT

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Inserts for
**Treasury Laws Amendment (OECD
Hybrid Mismatch Rules) Bill 2018:
Amendments**

Commencement information

Column 1	Column 2	Column 3
Provisions	Commencement	Date/Details
1. Schedules 1 and 2	The first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent.	

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Schedule 1—OECD Hybrid Mismatch Rules

Part 1—Main amendments

Income Tax Assessment Act 1997

1 After Division 830

Insert:

Division 832—Hybrid mismatch rules

Table of Subdivisions

Guide to Division 832

832-A Preliminary

832-B Concepts relating to mismatches

832-C Hybrid financial instrument mismatch

832-D Hybrid payer mismatch

832-E Reverse hybrid mismatch

832-F Branch hybrid mismatch

832-G Deducting hybrid mismatch

832-H Imported hybrid mismatch

832-I Dual inclusion income

832-J Integrity rule

832-K Modifications for Division 230 (about taxation of financial arrangements)

Guide to Division 832

832-1 What this Division is about

A “hybrid mismatch” arises if double non-taxation results from the exploitation of differences in the tax treatment of an entity or financial instrument under the laws of 2 or more countries.

There is double non-taxation if a deductible payment is not included in a tax base (this is called a deduction/non-inclusion

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mismatch), or if a payment gives rise to 2 deductions (this is called a deduction/deduction mismatch). Disallowing a deduction, or including an amount in assessable income, “neutralises” this tax advantage.

This Division is based on *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 — 2015 Final Report*, of the Organisation for Economic Cooperation and Development, published on 5 October 2015.

Subdivision 832-A—Preliminary

Guide to Subdivision 832-A

832-5 What this Subdivision is about

This Subdivision sets out some general rules that apply to the provisions of this Division.

Table of sections

Operative provisions

832-10	Entitlement to receive payment
832-15	Entitlement to receive non-cash benefits
832-20	Losses that arise from payments or parts of payments
832-25	Recipients and payers of a payment
832-30	Tax provisions to be disregarded in identifying payments and income or profits
832-35	Single entity rule otherwise not disregarded
832-40	Schemes outside Australia
832-45	Relationship between this Division and other charging provisions in this Act

Operative provisions

832-10 Entitlement to receive payment

This Division applies as if an entity (the *payer*) had made a payment to another entity (the *recipient*) if the recipient is entitled to receive the payment from the payer, even if the payment is not required to be made until a later time.

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1 832-15 Entitlement to receive non-cash benefits

2 This Division applies as if an entity (the *payer*) had made a
3 payment to another entity (the *recipient*) if the recipient received a
4 *non-cash benefit from the payer.

5 832-20 Losses that arise from payments or parts of payments

6 This Division applies to a loss in the same way as it applies to a
7 payment if:

- 8 (a) the loss gives rise to:
- 9 (i) a deduction for an entity (the *payer*) for an income year;
 - 10 or
 - 11 (ii) a *foreign income tax deduction for an entity (also the
 - 12 *payer*) for a *foreign tax period that starts in the income
 - 13 year; and
- 14 (b) the loss consists of all or a part of a payment that will be
- 15 made to another entity (the *recipient*) in a later income year.

16 Note: Section 832-850 affects losses from financial arrangements.

17 832-25 Recipients and payers of a payment

- 18 (1) To the extent this Division applies to a payment only because of
19 section 832-10, 832-15 or 832-20, it applies as if:
- 20 (a) the entity that made the payment were the entity identified in
 - 21 the applicable section as the payer; and
 - 22 (b) the recipient of the payment were the entity identified in the
 - 23 applicable section as the recipient.
- 24 (2) If a payment would, apart from this subsection, be made to 2 or
- 25 more recipients, then this Division applies as if each part of the
- 26 payment made to each such recipient were a separate payment.

27 832-30 Tax provisions to be disregarded in identifying payments and 28 income or profits

- 29 (1) A number of provisions in this Division refer to an entity making a
- 30 payment to another entity. To avoid doubt, whether an entity
- 31 makes a payment to another entity is to be worked out
- 32 disregarding:
- 33 (a) subsection 701-1(1) (the single entity rule); and
 - 34 (b) Part IIIB of the *Income Tax Assessment Act 1936*; and
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(c) any law of a foreign country that, for the purposes of a foreign tax, treats a different entity as having made the payment, or disregards the payment.

- (2) A number of provisions in this Division refer to the income or profits of an entity. To avoid doubt, these entities, and their income or profits, are to be identified disregarding:
- (a) subsection 701-1(1) (the single entity rule); and
 - (b) Part IIIB of the *Income Tax Assessment Act 1936*; and
 - (c) any law of a foreign country that, for the purposes of a *foreign tax, treats those income or profits as income or profits of a different entity.

Note: As a consequence of paragraph (2)(a), a member of a consolidated group may be a hybrid payer under section 832-330 or a deducting hybrid under section 832-590 (it cannot be a reverse hybrid because of subparagraph 832-430(2)(b)(ii)).

832-35 Single entity rule otherwise not disregarded

Subject to section 832-30, subsection 701-1(1) (the single entity rule) is not disregarded in applying this Division.

832-40 Schemes outside Australia

This Division applies in relation to a payment whether or not the *scheme under which the payment is made has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

832-45 Relationship between this Division and other charging provisions in this Act

- (1) This section applies if an amount is included in the assessable income of an entity under a provision of this Division in relation to a payment.
- (2) An amount in relation to the payment that is to be included in the assessable income of the entity under a provision (other than a provision of this Division) is to be reduced to the extent (if any) necessary to ensure that the total amount included in the entity's assessable income in relation to the payment does not exceed the amount of the payment.

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1 *Relationship with section 230-20*

2 (3) This section applies despite section 230-20 (about taxation of
3 financial arrangements).

4 **Subdivision 832-B—Concepts relating to mismatches**

5 **Guide to Subdivision 832-B**

6 **832-95 What this Subdivision is about**

7 This Subdivision sets out rules about identifying
8 deduction/non-inclusion mismatches and deduction/deduction
9 mismatches.

10 **Table of sections**

11 **Operative provisions**

12	832-100	When a payment gives rise to a deduction/non-inclusion mismatch
13	832-105	When a payment gives rise to a deduction/deduction mismatch
14	832-110	Disregard effect of Division in determining deductions
15	832-115	Meaning of <i>foreign income tax deduction</i>
16	832-120	Meaning of <i>subject to Australian income tax</i>
17	832-125	Meaning of <i>subject to foreign income tax</i>

18 **Operative provisions**

19 **832-100 When a payment gives rise to a deduction/non-inclusion 20 mismatch**

21 *Australian deduction*

22 (1) If:

- 23 (a) a deduction (other than a deduction that is solely attributable
24 to a *currency exchange rate effect) is allowable to an entity
25 in an income year in respect of a payment (including a part or
26 share of the payment); and
27 (b) the amount of the deduction exceeds the sum of the amounts
28 of the payment that are:

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- 1 (i) *subject to foreign income tax in a foreign country in a
2 *foreign tax period that ends no later than 12 months
3 after the end of the income year; or
4 (ii) *subject to Australian income tax for the income year;
5 then the deduction is the ***deduction component*** of a
6 ***deduction/non-inclusion mismatch*** to which the payment gives
7 rise.

8 Note: A deduction/non-inclusion mismatch might give rise to a hybrid
9 financial instrument mismatch (see Subdivision 832-C), a hybrid
10 payer mismatch (see Subdivision 832-D), a reverse hybrid mismatch
11 (see Subdivision 832-E), or a branch hybrid mismatch (see
12 Subdivision 832-F).

13 *Foreign income tax deduction*

- 14 (2) If:
- 15 (a) an entity is entitled to a *foreign income tax deduction in a
16 foreign country in a *foreign tax period in respect of a
17 payment (including a part or share of the payment); and
18 (b) the amount of the foreign income tax deduction exceeds the
19 sum of the amounts of the payment that are:
- 20 (i) *subject to foreign income tax in a foreign country in a
21 foreign tax period that ends no later than 12 months
22 after the end of the foreign tax period in which the
23 foreign income tax deduction arose; or
24 (ii) *subject to Australian income tax for an income year
25 that ends no later than 12 months after the end of the
26 foreign tax period in which the foreign income tax
27 deduction arose; and
28 (c) the foreign income tax deduction is not solely attributable to:
- 29 (i) any currency exchange rate fluctuations; or
30 (ii) a difference between an expressly or implicitly agreed
31 currency exchange rate for a future date or time and the
32 applicable currency exchange rate at that date or time;
- 33 then the foreign income tax deduction is the ***deduction component***
34 of a ***deduction/non-inclusion mismatch*** to which the payment
35 gives rise.

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Amount of the deduction/non-inclusion mismatch

- 1
- 2 (3) The amount of the *deduction/non-inclusion mismatch is the
3 amount of the excess worked out under paragraph (1)(b) or (2)(b),
4 as applicable.

5 **832-105 When a payment gives rise to a deduction/deduction**
6 **mismatch**

- 7 (1) A payment gives rise to a ***deduction/deduction mismatch*** if the
8 payment, or a part or share of the payment:
9 (a) gives rise to a *foreign income tax deduction in a foreign
10 country in a *foreign tax period; and
11 (b) also gives rise to:
12 (i) a deduction in an income year; or
13 (ii) a foreign income tax deduction in a foreign country
14 (other than the country mentioned in paragraph (a)).

15 Note: A deduction/deduction mismatch might give rise to a deducting hybrid
16 mismatch (see Subdivision 832-G).

- 17 (2) Each of the following is a ***deduction component*** of the
18 *deduction/deduction mismatch:
19 (a) the *foreign income tax deduction mentioned in
20 paragraph (1)(a);
21 (b) the deduction mentioned in subparagraph (1)(b)(i), or the
22 foreign income tax deduction mentioned in
23 subparagraph (1)(b)(ii), as the case requires.

24 *Amount of the deduction/deduction mismatch*

- 25 (3) The amount of the *deduction/deduction mismatch is the lesser of:
26 (a) the amount of the *foreign income tax deduction mentioned
27 in paragraph (1)(a); and
28 (b) the sum of the amounts of the deduction, or *foreign income
29 tax deduction, mentioned in subparagraph (1)(b)(i) or (ii).

30 *Extended operation in relation to non-payment deductions*

- 31 (4) This section applies in relation to the following amounts in the
32 same way as it applies in relation to a payment:
33 (a) an amount representing the decline in value of an asset;

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1 (b) an amount representing a share in the net loss of a
2 partnership, trust or other transparent entity.

3 (5) For the purposes of subsection (4), a reference in this Division to
4 the *scheme under which a payment is made is taken to be a
5 reference to:

6 (a) if paragraph (4)(a) applies—the scheme under which the
7 asset is held; or

8 (b) if paragraph (4)(b) applies—the scheme under which the net
9 loss arose.

10 **832-110 Disregard effect of Division in determining deductions**

11 In determining for the purposes of this Division whether a payment
12 gives rise to a deduction, disregard the effect of this Division.

13 **832-115 Meaning of *foreign income tax deduction***

14 (1) An amount of a loss or outgoing incurred by an entity is a *foreign*
15 *income tax deduction* in a foreign country in a *foreign tax period
16 if the entity is entitled to deduct the amount in working out its tax
17 base for the foreign tax period under a law of the foreign country
18 dealing with *foreign income tax (except *credit absorption tax,
19 *unitary tax or a withholding-type tax).

20 (2) To avoid doubt, an amount of a loss or outgoing may be a *foreign*
21 *income tax deduction* in a foreign country in a *foreign tax period
22 even if the relevant entity's tax base is nil, or a negative amount.

23 *Effect of foreign hybrid mismatch rules*

24 (3) In determining for the purposes of this section whether an entity is
25 entitled to deduct an amount as mentioned in subsection (1),
26 disregard the effect of the following:

27 (a) any provisions of *foreign hybrid mismatch rules of a foreign
28 country;

29 (b) any provisions of another law of a foreign country relating to
30 *foreign income tax (except *credit absorption tax, *unitary
31 tax or a withholding-type tax) that has substantially the same
32 effect as foreign hybrid mismatch rules.

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Reasonable translation rates

- 1
- 2 (4) To avoid doubt, if a provision of this Division would require the
- 3 amount of a *foreign income tax deduction to be compared with
- 4 another amount, it is reasonable for the purposes of item 11A of
- 5 the table in subsection 960-50(6) (as modified by the regulations)
- 6 to:
- 7 (a) if the other amount is also to be translated into Australian
- 8 currency—apply exchange rates applicable at the same time
- 9 to both translations; or
- 10 (b) if the other amount is denominated in Australian currency—
- 11 apply the exchange rate applicable at the time the other
- 12 amount is recognised under this Act.

13 Note: Item 11A is added to the table in subsection 960-50(6) by

14 regulation 960-50.01 of the *Income Tax Assessment Regulations 1997*.

832-120 Meaning of *subject to Australian income tax*

- 15
- 16 (1) An amount of income or profits is ***subject to Australian income***
- 17 ***tax*** in an income year if it is an amount that is included in an
- 18 entity's assessable income for the income year.
- 19 (2) However, if:
- 20 (a) the entity is a trust or partnership; and
- 21 (b) the trust or partnership has net income for the income year;
- 22 then the amount is only ***subject to Australian income tax*** to the
- 23 extent it reasonably represents an amount included in the
- 24 assessable income of another entity for the income year (other than
- 25 an entity that is a partnership or the trustee of a trust).

Effect of CFC regimes

- 26
- 27 (3) An amount of income or profits of an entity is ***subject to***
- 28 ***Australian income tax*** if the amount is included under section 456
- 29 or 457 of the *Income Tax Assessment Act 1936* in the assessable
- 30 income of another entity.
- 31 (4) In determining for the purposes of this Division whether an amount
- 32 of income or profits is *subject to Australian income tax, disregard
- 33 the effect of this Division, unless the contrary intention appears.

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832-125 Meaning of *subject to foreign income tax*

- 1
- 2 (1) An amount of income or profits is *subject to foreign income tax* in
3 a foreign country in a *foreign tax period if *foreign income tax
4 (except *credit absorption tax, *unitary tax or a withholding-type
5 tax) is payable under a law of the foreign country in respect of the
6 amount because the amount is included in the tax base of that law
7 for the foreign tax period.

8 Note: Subdivision 832-C (Non-inclusion mismatches involving hybrid
9 financial instruments) has effect as if certain amounts that are subject
10 to a concessional rate of foreign income tax were not subject to
11 foreign income tax: see section 832-235.

- 12 (2) To avoid doubt, an amount of income or profits may be *subject to*
13 *foreign income tax* in a foreign country in a *foreign tax period
14 even if the relevant entity's tax base is nil, or a negative amount.

Effect of credits etc. for underlying taxes

- 15
- 16 (3) Despite subsection (1), if:
- 17 (a) an amount (the *pre-credit amount*) of income or profits
18 would, apart from this subsection, be *subject to foreign*
19 *income tax* in a foreign country; and
20 (b) an entity is entitled under the law of the foreign country to a
21 credit, rebate or other tax concession in respect of the amount
22 for *foreign tax (other than a withholding-type tax) payable
23 under a tax law of a different country (including Australia);
24 then only so much of the pre-credit amount as reasonably
25 represents an amount not effectively sheltered from *foreign
26 income tax (except *credit absorption tax, *unitary tax or a
27 withholding-type tax) by the credit, rebate or tax concession is
28 *subject to foreign income tax*.

29 Note: This subsection is disregarded in working out whether an amount of
30 income or profits is dual inclusion income: see subsection 832-740(3).

Effect of "dividend received deductions" in foreign countries

- 31
- 32 (4) Despite subsection (1), if:
- 33 (a) an amount (the *pre-deduction amount*) of income or profits
34 would, apart from this subsection, be *subject to foreign*
35 *income tax* in a foreign country; and
36 (b) the amount consists of a dividend received by an entity from
37 a company; and

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1 (c) the entity is entitled to a *foreign income tax deduction in
2 respect of all or part of the amount of the dividend;
3 then only so much of the pre-deduction amount as reasonably
4 represents an amount not effectively sheltered from *foreign
5 income tax (except *credit absorption tax, *unitary tax or a
6 withholding-type tax) by the foreign income tax deduction is
7 ***subject to foreign income tax.***

Effect of CFC regimes

- 8
- 9 (5) An amount of income or profits of an entity is ***subject to foreign***
10 ***income tax*** if the amount is included in working out the tax base of
11 another entity under a provision of a law of a foreign country that
12 corresponds to Part X of the *Income Tax Assessment Act 1936*
13 (including a tax base that is nil, or a negative amount).

Effect of foreign hybrid mismatch rules

- 14
- 15 (6) In determining for the purposes of this section whether a payment
16 is included in a tax base of a law of a foreign country as mentioned
17 in subsection (1), disregard the effect of the following:
18 (a) any provisions of *foreign hybrid mismatch rules of a foreign
19 country;
20 (b) any provisions of another law of a foreign country relating to
21 *foreign income tax (except *credit absorption tax, *unitary
22 tax or a withholding-type tax) that has substantially the same
23 effect as foreign hybrid mismatch rules.

Reasonable translation rates

- 24
- 25 (7) To avoid doubt, if a provision of this Division would require the
26 amount that is *subject to foreign income tax to be compared with
27 another amount, it is reasonable for the purposes of item 11A of
28 the table in subsection 960-50(6) (as modified by the regulations)
29 to:
30 (a) if the other amount is also to be translated into Australian
31 currency—apply exchange rates applicable at the same time
32 to both translations; or
33 (b) if the other amount is denominated in Australian currency—
34 apply the exchange rate applicable at the time the other
35 amount is recognised under this Act.

36 Note: Item 11A is added to the table in subsection 960-50(6) by
37 regulation 960-50.01 of the *Income Tax Assessment Regulations 1997*.

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1 Subdivision 832-C—Hybrid financial instrument mismatch

2 Guide to Subdivision 832-C

3 832-175 What this Subdivision is about

4 This Subdivision neutralises a hybrid financial instrument
5 mismatch if it involves a deduction, or non-inclusion, in Australia.

6 A deduction/non-inclusion mismatch is a hybrid financial
7 instrument mismatch if it is attributable to hybridity in the
8 treatment of a financial instrument or an arrangement to transfer a
9 financial instrument, and either the relevant parties are related or
10 the mismatch arose under a structured arrangement.

11 There is also an integrity rule that covers payments that are made
12 in lieu of hybrid payments.

13 This Subdivision has an extended application in relation to
14 payments that are subject to concessional tax rates in a foreign
15 country.

16 A hybrid financial instrument mismatch that is not neutralised by
17 this Subdivision (or by foreign hybrid mismatch rules) is an
18 offshore hybrid mismatch, which might give rise to an imported
19 hybrid mismatch under Subdivision 832-H.

20 Table of sections

21 Operative provisions

22	832-180	Deduction not allowable—Australian primary response
23	832-185	Inclusion in assessable income—Australian secondary response
24	832-190	Exception where entity not a party to the structured arrangement
25	832-195	When a hybrid financial instrument mismatch is an offshore hybrid 26 mismatch
27	832-200	When a payment gives rise to a hybrid financial instrument mismatch
28	832-205	Meaning of <i>Division 832 control group</i>
29	832-210	Meaning of <i>structured arrangement</i>
30	832-215	Hybrid mismatch
31	832-220	Hybrid requirement—payments under financial instruments
32	832-225	Hybrid requirement—payments under transfers of certain financial 33 instruments

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1	832-230	Hybrid mismatch—integrity rule for substitute payments
2	832-235	Extended operation of this Subdivision in relation to concessional foreign
3		taxes
4	832-240	Adjustment if hybrid financial instrument payment is income in a later year

5 **Operative provisions**

6 **832-180 Deduction not allowable—Australian primary response**

- 7 (1) This section applies to an entity if:
- 8 (a) apart from this section, the entity would be entitled to a
- 9 deduction in an income year in respect of a payment; and
- 10 (b) the deduction is the *deduction component of a *hybrid
- 11 financial instrument mismatch to which the payment gives
- 12 rise.
- 13 (2) So much of the deduction as does not exceed the amount of the
- 14 *hybrid financial instrument mismatch is not allowable as a
- 15 deduction.

16 **832-185 Inclusion in assessable income—Australian secondary**

17 **response**

- 18 (1) This section applies to an entity if:
- 19 (a) the entity is the recipient of a payment that gives rise to a
- 20 *hybrid financial instrument mismatch; and
- 21 (b) the *deduction component of the mismatch is a *foreign
- 22 income tax deduction; and
- 23 (c) the secondary response is required (see subsection (2)).
- 24 (2) For the purposes of paragraph (1)(c), the secondary response is
- 25 required unless the *foreign income tax deduction is in a foreign
- 26 country that has *foreign hybrid mismatch rules, or another law
- 27 that has substantially the same effect as foreign hybrid mismatch
- 28 rules.
- 29 *Inclusion of amount in assessable income*
- 30 (3) An amount equal to the amount of the *hybrid financial instrument
- 31 mismatch is included in the entity's assessable income for the
- 32 income year mentioned in subsection (4). The assessable income is
- 33 taken to have been derived from the same source as the payment.

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1 (4) The income year is:

- 2 (a) if the *foreign tax period in which the *foreign income tax
3 deduction arises falls wholly within an income year of the
4 entity—that income year; or
5 (b) if the foreign tax period in which the foreign income tax
6 deduction arises straddles 2 income years of the entity—the
7 earlier of those income years.

8 **832-190 Exception where entity not a party to the structured**
9 **arrangement**

10 Sections 832-180 and 832-185 do not apply to an entity in respect
11 of a payment if:

- 12 (a) the *scheme under which the payment is made is a
13 *structured arrangement to which the entity is not a *party;
14 and
15 (b) subsection 832-200(3) does not apply.

16 **832-195 When a hybrid financial instrument mismatch is an**
17 **offshore hybrid mismatch**

18 (1) A *hybrid financial instrument mismatch is an *offshore hybrid*
19 *mismatch* if:

- 20 (a) the *deduction component of the mismatch is a *foreign
21 income tax deduction; and
22 (b) no amount becomes *subject to Australian income tax as a
23 result of the application of section 832-185 in relation to the
24 mismatch; and
25 (c) none of the following countries has *foreign hybrid mismatch
26 rules:
27 (i) the country in which the foreign income tax deduction
28 arose;
29 (ii) any country in which income or profits of the recipient
30 of the payment are *subject to foreign income tax.

31 Note: An offshore hybrid mismatch might give rise to an imported hybrid
32 mismatch: see Subdivision 832-H.

33 (2) The amount of the *offshore hybrid mismatch is the amount of the
34 *hybrid financial instrument mismatch.

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832-200 When a payment gives rise to a hybrid financial instrument mismatch

(1) A payment gives rise to a *hybrid financial instrument mismatch* if:

- (a) the payment gives rise to a *hybrid mismatch under section 832-215 or 832-230; and
- (b) subsection (3) or (6) applies.

Note: As a result of ordering rules in later Subdivisions, a payment that gives rise to a hybrid financial instrument mismatch does not also give rise to a hybrid mismatch under a later Subdivision of this Division.

(2) The *deduction component* of the *hybrid financial instrument mismatch is the *deduction component of the *deduction/non-inclusion mismatch.

(3) This subsection applies if the following entities are related for the purposes of subsection (4):

- (a) the entity that made the payment;
- (b) each entity that is a *liable entity in respect of the income or profits of the recipient of the payment.

Note: For the definition of *liable entity*, see section 832-335.

Related persons

(4) Two entities are related for the purposes of this subsection if any of the following apply:

- (a) the entities are in the same *Division 832 control group;
- (b) one of the entities holds a *total participation interest of 25% or more in the other entity;
- (c) a third entity holds a total participation interest of 25% or more in each of the entities.

(5) For the purposes of subsection (4), treat the *direct participation interest of an entity (the *holding entity*) in another entity (the *test entity*) as being the sum of the direct participation interests held by the holding entity and its *associates in the test entity.

Structured arrangement

(6) This subsection applies if the *scheme under which the payment is made is a *structured arrangement.

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832-205 Meaning of *Division 832 control group*

Two or more entities are in the same *Division 832 control group* if any of the following apply:

- (a) each of the entities is a member of a group of entities that are consolidated for accounting purposes as a single group;
- (b) one of the entities holds a *total participation interest of 50% or more in each of the other entities;
- (c) a third entity holds a total participation interest of 50% or more in each of the entities.

832-210 Meaning of *structured arrangement*

(1) A *scheme under which a payment is made is a *structured arrangement* if:

- (a) the payment gives rise to a *hybrid mismatch; and
- (b) either:
 - (i) the hybrid mismatch is priced into the terms of the scheme; or
 - (ii) it is reasonable to conclude that the hybrid mismatch is a design feature of the scheme.

(2) The question whether a *hybrid mismatch is a design feature of a *scheme must be determined by reference to the facts and circumstances that exist in connection with the scheme, including the terms of the scheme.

(3) An entity that entered into or carried out the *scheme or any part of the scheme is a *party* to the *structured arrangement unless:

- (a) the entity could not reasonably have been expected to be aware that the scheme gave rise to a *hybrid mismatch; and
- (b) no other entity in the same *Division 832 control group as the entity could reasonably have been expected to be aware that the scheme gave rise to a hybrid mismatch; and
- (c) the financial position of each entity in the Division 832 control group would reasonably be expected to have been the same if the scheme had not given rise to the hybrid mismatch.

832-215 Hybrid mismatch

(1) A payment gives rise to a *hybrid mismatch* if:

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- 1 (a) the payment is made under any of the following:
2 (i) a *debt interest;
3 (ii) an *equity interest;
4 (iii) a *derivative financial arrangement;
5 (iv) an *arrangement covered by subsection (2); and
6 (b) the payment might reasonably be expected to give rise to a
7 *deduction/non-inclusion mismatch; and
8 (c) the mismatch that might reasonably be expected to arise, or a
9 part of that mismatch, meets a hybrid requirement in
10 section 832-220 or 832-225.

11 *Transfers of financial instruments*

- 12 (2) An *arrangement is covered by this subsection if:
13 (a) the arrangement is any of the following:
14 (i) a reciprocal purchase agreement (otherwise known as a
15 repurchase agreement);
16 (ii) a securities lending arrangement;
17 (iii) a similar arrangement; and
18 (b) an entity acquires any of the following under the
19 arrangement:
20 (i) a *debt interest;
21 (ii) an *equity interest;
22 (iii) a *derivative financial arrangement.

23 *Amount of the hybrid mismatch*

- 24 (3) The amount of the *hybrid mismatch is:
25 (a) the amount of the *deduction/non-inclusion mismatch, unless
26 paragraph (b) applies; or
27 (b) if only a part of the deduction/non-inclusion mismatch meets
28 a hybrid requirement mentioned in paragraph (1)(c)—the
29 amount of that part of the deduction/non-inclusion mismatch.

30 **832-220 Hybrid requirement—payments under financial**
31 **instruments**

- 32 (1) A *deduction/non-inclusion mismatch, or a part of such a
33 mismatch, meets the hybrid requirement in this section if:
34 (a) the payment that gives rise to the mismatch is made under
35 any of the following:
-

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-
- 1 (i) a *debt interest;
2 (ii) an *equity interest;
3 (iii) a *derivative financial arrangement; and
4 (b) the mismatch, or the part of the mismatch, is attributable to
5 differences in the treatment of the debt interest, equity
6 interest or derivative financial arrangement, arising from the
7 terms of the interest or arrangement; and
8 (c) the exception in subsection (2) does not apply.

9 Example: Redeemable preferences shares that are treated under this Act as a
10 debt interest, and in a foreign country as an equity interest.

11 *Exception for deferrals not exceeding 3 years*

- 12 (2) This exception applies if:
13 (a) the difference in treatment mentioned in paragraph (1)(b)
14 primarily relates to a deferral in the recognition of income or
15 profits under the *debt interest, the *equity interest or the
16 *derivative financial arrangement; and
17 (b) the term of the interest or arrangement is 3 years or less.

18 **832-225 Hybrid requirement—payments under transfers of certain**
19 **financial instruments**

- 20 (1) A *deduction/non-inclusion mismatch, or a part of such a
21 mismatch, meets the hybrid requirement in this section if:
22 (a) the payment that gives rise to the mismatch is made under an
23 *arrangement covered by subsection 832-215(2); and
24 (b) the mismatch, or the part of the mismatch, is attributable to
25 differences in the treatment of the arrangement; and
26 (c) the exception in subsection (2) of this section does not apply.

27 *Exception for deferrals not exceeding 3 years*

- 28 (2) This exception applies if:
29 (a) the difference in treatment mentioned in paragraph (1)(b)
30 primarily relates to a deferral in the recognition of income or
31 profits under the *arrangement; and
32 (b) the term of the arrangement is 3 years or less.

33 **832-230 Hybrid mismatch—integrity rule for substitute payments**

- 34 (1) A payment also gives rise to a *hybrid mismatch* if:
-

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-
- 1 (a) the payment gives rise to a *deduction/non-inclusion
2 mismatch; and
- 3 (b) the payment is made under an *arrangement under which any
4 of the following is transferred:
- 5 (i) a *debt interest;
- 6 (ii) an *equity interest;
- 7 (iii) a *derivative financial arrangement; and
- 8 (c) the payment, or a part of the payment, (the *substitute*
9 *payment*) could reasonably be regarded as having been
10 converted into a form that is in substitution for a *return
11 (however described) on the interest or arrangement; and
- 12 (d) the return is covered by subsection (2).
- 13 (2) This subsection covers a *return (however described) on a *debt
14 interest, an *equity interest, or a *derivative financial arrangement,
15 that is transferred if any of the following apply:
- 16 (a) the return is made to the payer of the substitute payment, and
17 is not *subject to foreign income tax or *subject to Australian
18 income tax;
- 19 (b) the return is not made to the payer of the substitute payment,
20 but if it had been it would not have been subject to foreign
21 income tax or subject to Australian income tax;
- 22 (c) if the return were instead made to the payee of the substitute
23 payment:
- 24 (i) it would be subject to foreign income tax or subject to
25 Australian income tax; or
- 26 (ii) it would give rise to a *hybrid mismatch under
27 section 832-215.

28 *Amount of the hybrid mismatch*

- 29 (3) The amount of the *hybrid mismatch is the amount of the
30 *deduction/non-inclusion mismatch.

31 **832-235 Extended operation of this Subdivision in relation to**
32 **concessional foreign taxes**

- 33 (1) For the purposes of this Subdivision, treat an amount of income or
34 profits covered by subsection (2) as if it were *not* *subject to
35 foreign income tax.

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- 1 (2) This subsection covers an amount of income or profits of an entity
2 if:
3 (a) apart from this section, the amount would be *subject to
4 foreign income tax; and
5 (b) the rate of *foreign income tax (except *credit absorption tax,
6 *unitary tax or a withholding-type tax) (the *lower rate*) on the
7 amount under the law of the relevant foreign country is lower
8 than the rate (the *ordinary rate*) that would ordinarily be
9 imposed on interest income derived by an entity of that kind
10 in the foreign country.

11 *Amount of a deduction/non-inclusion mismatch*

- 12 (3) However, for the purposes of working out the amount of a
13 *deduction/non-inclusion mismatch that is affected by this section,
14 the amount of a payment that is treated by this section as not being
15 *subject to foreign income tax is to be discounted by multiplying it
16 by the following fraction:

$$\frac{\text{Lower rate}}{\text{Ordinary rate}}$$

17
18 where:

19 *lower rate* means the lower rate mentioned in paragraph (2)(b).

20 *ordinary rate* means the ordinary rate mentioned in
21 paragraph (2)(b).

22 **832-240 Adjustment if hybrid financial instrument payment is**
23 **income in a later year**

- 24 (1) There is an adjustment under this section for an entity in an income
25 year (the *adjustment year*) if:
26 (a) an amount was not allowable as a deduction for the entity in
27 an earlier income year under section 832-180 in respect of a
28 payment that gave rise to a *hybrid financial instrument
29 mismatch; and
30 (b) an amount (the *taxed amount*) of the payment is:
31 (i) *subject to foreign income tax in a foreign country in a
32 *foreign tax period that ends within 12 months after the
33 end of the adjustment year; or
34 (ii) *subject to Australian income tax in the adjustment year.

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1 (2) The taxed amount is an amount the entity can deduct in the
2 adjustment year.

3 (3) The total amounts deducted under this section in respect of a
4 payment must not exceed the amount that was not allowable as a
5 deduction in respect of the payment as mentioned in
6 paragraph (1)(a).

7 *No adjustment for concessional taxes*

8 (4) This section does not apply if the ^{*}hybrid mismatch would not have
9 arisen apart from section 832-235.

10 **Subdivision 832-D—Hybrid payer mismatch**

11 **Guide to Subdivision 832-D**

12 **832-290 What this Subdivision is about**

13 This Subdivision neutralises a hybrid payer mismatch if it involves
14 a deduction, or non-inclusion, in Australia.

15 A deduction/non-inclusion mismatch is a hybrid payer mismatch if
16 it is made by a hybrid payer, and the mismatch would not have
17 arisen, or would have been less, if the payment had instead been
18 made by an ungrouped entity. It is also a requirement that the
19 relevant parties are in the same control group or the mismatch
20 arose under a structured arrangement.

21 An entity is a hybrid payer if a payment it makes is disregarded for
22 the purposes of the tax law of one country (resulting in
23 non-inclusion), but is deductible for the purposes of the tax law of
24 another country.

25 The neutralising amount for the hybrid payer mismatch is reduced
26 by dual inclusion income.

27 A hybrid payer mismatch that is not neutralised by this Subdivision
28 (or by foreign hybrid mismatch rules) is an offshore hybrid
29 mismatch, which might give rise to an imported hybrid mismatch
30 under Subdivision 832-H.

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Operative provisions

832-295 Deduction not allowable—Australian primary response

- (1) This section applies to an entity if:
- (a) apart from this section, the entity would be entitled to a deduction in an income year in respect of a payment; and
 - (b) the deduction is the *deduction component of a *hybrid payer mismatch to which the payment gives rise.
- (2) So much of the deduction as does not exceed the *neutralising amount for the *hybrid payer mismatch is not allowable as a deduction.

Note: The neutralising amount is worked out under section 832-340.

832-300 Inclusion in assessable income—Australian secondary response

- (1) This section applies to an entity if:
- (a) the entity is the recipient of a payment that gives rise to a *hybrid payer mismatch; and
 - (b) the *deduction component of the mismatch is a *foreign income tax deduction; and
 - (c) the secondary response is required (see subsection (2)).

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When secondary response is required

- 1
- 2 (2) For the purposes of paragraph (1)(c), the secondary response is
3 required unless the *foreign income tax deduction is in a foreign
4 country that has *foreign hybrid mismatch rules, or another law
5 that has substantially the same effect as foreign hybrid mismatch
6 rules.

7 *Inclusion of amount in assessable income*

- 8 (3) An amount equal to the *neutralising amount for the *hybrid payer
9 mismatch is included in the entity's assessable income for the
10 income year mentioned in subsection (4). The assessable income is
11 taken to have been derived from the same source as the payment.
- 12 (4) The income year (the *inclusion year*) is:
- 13 (a) if the *foreign tax period in which the *foreign income tax
14 deduction arises falls wholly within an income year of the
15 entity—that income year; or
- 16 (b) if the foreign tax period in which the foreign income tax
17 deduction arises straddles 2 income years of the entity—the
18 earlier of those income years.

19 **832-305 Exception where entity not a party to the structured**
20 **arrangement**

21 Sections 832-295 and 832-300 do not apply to an entity in respect
22 of a payment if:

- 23 (a) the *scheme under which the payment is made is a
24 *structured arrangement to which the entity is not a *party;
25 and
26 (b) subsection 832-315(3) does not apply.

27 **832-310 When a hybrid payer mismatch is an offshore hybrid**
28 **mismatch**

- 29 (1) A *hybrid payer mismatch is an *offshore hybrid mismatch* if:
30 (a) the *deduction component of the mismatch is a *foreign
31 income tax deduction; and
32 (b) no amount becomes *subject to Australian income tax as a
33 result of the application of section 832-300 in relation to the
34 mismatch; and

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- 1 (c) none of the following countries has *foreign hybrid mismatch
2 rules:
3 (i) the country in which the *foreign income tax deduction
4 arose;
5 (ii) any country in which income or profits of the recipient
6 of the payment are *subject to foreign income tax.
- 7 Note: An offshore hybrid mismatch might give rise to an imported hybrid
8 mismatch: see Subdivision 832-H.
- 9 (2) The amount of the *offshore hybrid mismatch is the *neutralising
10 amount for the *hybrid payer mismatch.

11 832-315 When a payment gives rise to a hybrid payer mismatch

- 12 (1) A payment gives rise to a *hybrid payer mismatch* if:
13 (a) the payment gives rise to a *hybrid mismatch under
14 section 832-320; and
15 (b) subsection (3) or (4) applies.
- 16 (2) The *deduction component* of the *hybrid payer mismatch is the
17 *deduction component of the *deduction/non-inclusion mismatch
18 mentioned in section 832-320.

19 *Control group*

- 20 (3) This subsection applies if the following entities are in the same
21 *Division 832 control group:
22 (a) the *hybrid payer;
23 (b) each entity that is a *liable entity in respect of the income or
24 profits of the hybrid payer.

25 Note: For the meaning of *Division 832 control group* see section 832-205.

26 *Structured arrangement*

- 27 (4) This subsection applies if the *scheme under which the payment is
28 made is a *structured arrangement.

29 Note: For the meaning of *structured arrangement*, see section 832-210.

30 *Ordering rule*

- 31 (5) However, a payment does not give rise to a *hybrid mismatch* under
32 this section if it gave rise to a *hybrid financial instrument
33 mismatch.
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1 832-320 Hybrid mismatch

- 2 (1) A payment gives rise to a *hybrid mismatch* if:
- 3 (a) the payment gives rise to a *deduction/non-inclusion
- 4 mismatch; and
- 5 (b) the payment meets the hybrid requirement in
- 6 section 832-325.

7 *Amount of the hybrid mismatch*

- 8 (2) The amount of the *hybrid mismatch is the lesser of:
- 9 (a) the amount of the *deduction/non-inclusion mismatch; and
- 10 (b) the amount of the excess from subsection 832-325(2) or (3)
- 11 (whichever is applicable).

12 832-325 Hybrid requirement—assume payment was made to same

13 recipient but by an ungrouped payer

- 14 (1) The payment meets the hybrid requirement in this section if:
- 15 (a) the payment is made by a *hybrid payer; and
- 16 (b) subsection (2) or (3) applies.

17 *Payment would have been taxed in Australia*

- 18 (2) This subsection applies if:
- 19 (a) the non-including country identified in subsection 832-330(3)
- 20 is Australia; and
- 21 (b) the amount of the *deduction/non-inclusion mismatch
- 22 exceeds the amount that would be the amount of that
- 23 mismatch if the amount of the payment that was *subject to
- 24 Australian income tax for an income year was instead worked
- 25 out on the assumption in subsection (4).

26 *Payment would have been taxed in a foreign country*

- 27 (3) This subsection applies if:
- 28 (a) the non-including country identified in subsection 832-330(3)
- 29 is a foreign country; and
- 30 (b) the amount of the *deduction/non-inclusion mismatch
- 31 exceeds the amount that would be the amount of that
- 32 mismatch if the amount of the payment that was *subject to

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1 foreign income tax for a *foreign tax period was instead
2 worked out on the assumption in subsection (4).

3 *Assumption—payer was an ungrouped entity*

- 4 (4) For the purposes of subsections (2) and (3), assume that the
5 payment had instead been made:
6 (a) to the same recipient; but
7 (b) by an entity that was a *liable entity in the non-including
8 country only in respect of its own income or profits.

9 Note: For the meaning of *liable entity*, see section 832-335.

10 832-330 Hybrid payer

- 11 (1) An entity (the *test entity*) is a *hybrid payer* in relation to a payment
12 it makes if:
13 (a) subsection (2) applies to the entity in relation to a country
14 and the payment; and
15 (b) subsection (3) applies to the entity in relation to a different
16 country and the payment.

17 Note: The entity, the payments it makes, and its income or profits are
18 identified disregarding tax provisions: see section 832-30.

19 *Deducting country—entity is not grouped with recipient*

- 20 (2) This subsection applies to a test entity in relation to a country (the
21 *deducting country*) and a payment the test entity makes if:
22 (a) the test entity, or another entity, is a *liable entity in the
23 deducting country in respect of income or profits of the test
24 entity (or a part of those income or profits); and
25 (b) that liable entity is *not* also a liable entity in the deducting
26 country in respect of income or profits of the recipient of the
27 payment.

28 *Non-including country—entity is grouped with recipient*

- 29 (3) This subsection applies to a test entity in relation to a country (a
30 *non-including country*) and a payment the test entity makes if:
31 (a) the test entity, or another entity, is a *liable entity in the
32 non-including country in respect of income or profits of the
33 test entity (or a part of those income or profits); and

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-
- 1 (b) that liable entity is also a liable entity in the non-including
2 country in respect of income or profits of the recipient of the
3 payment.

4 **832-335 Meaning of *liable entity***

5 *Entity is a taxpayer in respect of its own income or profits*

- 6 (1) An entity is a ***liable entity***, in a country, in respect of its income or
7 profits if:
8 (a) for Australia—*tax is imposed on the entity in respect of all
9 or part of its income or profits for an income year; and
10 (b) for a foreign country—*foreign income tax (except *credit
11 absorption tax, *unitary tax or a withholding-type tax) is
12 imposed under the law of the foreign country on the entity in
13 respect of all or part of its income or profits for a *foreign tax
14 period.

15 Note 1: The entity, and its income or profits, are identified disregarding tax
16 provisions: see section 832-30.

17 Note 2: An example is an entity that is a company (and is not a member of a
18 consolidated group). In Australia, a company is the liable entity in
19 respect of its income or profits.

20 *Entity is a taxpayer in respect of another entity's income or profits*

- 21 (2) An entity is a ***liable entity***, in a country, in respect of the income or
22 profits of another entity (the ***test entity***) if:
23 (a) for Australia—*tax is imposed on the entity in respect of all
24 or part of the income or profits of the test entity for an
25 income year; and
26 (b) for a foreign country—*foreign income tax (except *credit
27 absorption tax, *unitary tax or a withholding-type tax) is
28 imposed under the law of the foreign country on the entity in
29 respect of all or part of the income or profits of the test entity
30 for a *foreign tax period.

31 Note 1: The test entity, and its income or profits, are identified disregarding
32 tax provisions: see section 832-30.

33 Note 2: An example is a test entity that is a partnership. In Australia, each
34 partner in the partnership is a liable entity in respect of the income or
35 profits of the partnership.

- 36 (3) To avoid doubt, the following outcomes may arise under
37 subsection (2) in a country:
-

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- 1 (a) there may be one or more *liable entities in respect of the
2 income or profits of a test entity;
3 (b) there may be one or more interposed entities between the test
4 entity and an entity that is a liable entity in respect of the
5 income or profits of the test entity.

6 *Entity not required to be actually liable to pay tax or foreign*
7 *income tax*

- 8 (4) To avoid doubt, an entity may be a *liable entity in respect of its
9 own, or another entity's, income or profits in a country even if any
10 of the following situations exist:
11 (a) there are no actual income or profits;
12 (b) there are income or profits, but no part of those income or
13 profits is:
14 (i) for Australia—*subject to Australian income tax; or
15 (ii) for a foreign country—*subject to foreign income tax in
16 that foreign country;
17 (c) the entity is not actually liable to pay an amount of *tax or
18 *foreign income tax.

19 Note: In determining whether an entity is a liable entity in such a situation,
20 assume that income or profits within the tax base of the country exist.

21 *Effect of CFC regimes*

- 22 (5) An entity is not a **liable entity** in respect of income or profits of
23 another entity (the **test entity**) merely because all or part of the
24 income or profits of the test entity are:
25 (a) included under section 456 or 457 of the *Income Tax*
26 *Assessment Act 1936* in the assessable income of the other
27 entity; or
28 (b) included under a corresponding provision of a law of a
29 foreign country in working out the tax base of the other entity
30 (including a tax base of nil, or a negative amount).

31 **832-340 Neutralising amount**

- 32 (1) The **neutralising amount** for a *hybrid payer mismatch is the
33 amount of the *hybrid mismatch from subsection 832-320(2),
34 reduced (but not below nil) by the amount of any *dual inclusion
35 income that is available to be applied in working out the
36 neutralising amount.

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1 *Australian deduction—inclusions must be in Australia and in the*
2 *non-including country*

- 3 (2) An amount of *dual inclusion income is available to be applied to
4 reduce the *neutralising amount for a *hybrid payer mismatch to
5 which section 832-295 applies if:
6 (a) the *hybrid payer is eligible to apply the amount (see
7 subsection 832-740(7)); and
8 (b) the amount is *subject to Australian income tax for the
9 purposes of subsection 832-740(1) in the income year
10 mentioned in subsection 832-295(1); and
11 (c) the amount is *subject to foreign income tax for the purposes
12 of subsection 832-740(1) in the non-including country
13 identified in subsection 832-330(3).

14 *Australian non-inclusion—inclusions must be in Australia and in*
15 *the deducting country*

- 16 (3) An amount of *dual inclusion income is available to be applied to
17 reduce the *neutralising amount for a *hybrid payer mismatch to
18 which section 832-300 applies if:
19 (a) the recipient of the payment is eligible to apply the amount
20 (see subsection 832-740(7)); and
21 (b) the amount is *subject to Australian income tax for the
22 purposes of subsection 832-740(1) in the inclusion year
23 mentioned in subsection 832-300(4); and
24 (c) in the same *foreign tax period as the period in which the
25 *foreign income tax deduction arose, the amount is *subject
26 to foreign income tax for the purposes of
27 subsection 832-740(1) in the deducting country mentioned in
28 subsection 832-330(2).

29 *Offshore hybrid mismatch—inclusions must be in the deducting*
30 *country and the non-including country*

- 31 (4) An amount of *dual inclusion income is available to be applied to
32 reduce the *neutralising amount for a *hybrid payer mismatch that
33 is an *offshore hybrid mismatch if:
34 (a) the *hybrid payer is eligible to apply the amount (see
35 subsection 832-740(7)); and
36 (b) in the same *foreign tax period as the period in which the
37 *foreign income tax deduction arose, the amount is *subject

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1 to foreign income tax for the purposes of
2 subsection 832-740(1) in the deducting country mentioned in
3 subsection 832-330(2); and

4 (c) the amount is *subject to foreign income tax for the purposes
5 of subsection 832-740(1) in the non-including country
6 identified in subsection 832-330(3).

7 **832-345 Adjustment if hybrid payer has dual inclusion income in a** 8 **later year**

9 (1) There is an adjustment under this section for an entity in an income
10 year (the *adjustment year*) if:

11 (a) in an earlier income year, all or part of a deduction of the
12 entity in respect of a payment that gave rise to a *hybrid
13 payer mismatch was not allowable under section 832-295;
14 and

15 (b) an amount of *dual inclusion income is:

16 (i) available to be applied by the *hybrid payer in the
17 adjustment year; and

18 (ii) *subject to Australian income tax for the purposes of
19 subsection 832-740(1) in the adjustment year; and

20 (iii) *subject to foreign income tax for the purposes of
21 subsection 832-740(1) in the non-including country
22 identified in subsection 832-330(3).

23 (2) So much of the amount of *dual inclusion income that satisfies
24 paragraph (1)(b) as does not exceed the amount that was not
25 allowable as a deduction is an amount the entity can deduct in the
26 adjustment year.

27 (3) For the purposes of a later application of this section, treat the
28 amount that was not allowable as a deduction under
29 section 832-295 as being reduced by the amount deducted under
30 subsection (2) of this section.

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1 Subdivision 832-E—Reverse hybrid mismatch

2 Guide to Subdivision 832-E

3 832-395 What this Subdivision is about

4 This Subdivision neutralises a reverse hybrid mismatch if it
5 involves a deduction in Australia.

6 A deduction/non-inclusion mismatch is a reverse hybrid mismatch
7 if it is made directly or indirectly to a reverse hybrid, and the
8 mismatch would not have arisen, or would have been less, if the
9 payment had instead been made directly to an investor in the
10 reverse hybrid.

11 An entity is a reverse hybrid if it is transparent for the purposes of
12 the tax law of the country in which it is formed, but
13 non-transparent for the purposes of the tax law of the country in
14 which investors in it are subject to tax (resulting in non-inclusion).

15 A reverse hybrid mismatch that is not neutralised by this
16 Subdivision (or by foreign hybrid mismatch rules) is an offshore
17 hybrid mismatch, which might give rise to an imported hybrid
18 mismatch under Subdivision 832-H.

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20 Operative provisions

21	832-400	Deduction not allowable—Australian primary response
22	832-405	Exception where entity not a party to the structured arrangement
23	832-410	When a reverse hybrid mismatch is an offshore hybrid mismatch
24	832-415	When a payment gives rise to a reverse hybrid mismatch
25	832-420	Hybrid mismatch
26	832-425	Hybrid requirement—assume payment was made to an investor
27	832-430	Reverse hybrid

28 Operative provisions

29 832-400 Deduction not allowable—Australian primary response

30 (1) This section applies to an entity if:

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-
- 1 (a) apart from this section, the entity would be entitled to a
2 deduction in an income year in respect of a payment; and
3 (b) the deduction is the *deduction component of a *reverse
4 hybrid mismatch to which the payment gives rise.
- 5 (2) So much of the deduction as does not exceed the amount of the
6 *reverse hybrid mismatch is not allowable as a deduction.

7 **832-405 Exception where entity not a party to the structured** 8 **arrangement**

9 Section 832-400 does not apply to an entity in respect of a payment
10 if:

- 11 (a) the *scheme under which the payment is made is a
12 *structured arrangement to which the entity is not a *party;
13 and
14 (b) subsection 832-415(3) does not apply.

15 **832-410 When a reverse hybrid mismatch is an offshore hybrid** 16 **mismatch**

- 17 (1) A *reverse hybrid mismatch is an *offshore hybrid mismatch* if:
18 (a) the *deduction component of the mismatch is a *foreign
19 income tax deduction; and
20 (b) the country in which the foreign income tax deduction arose
21 does not have *foreign hybrid mismatch rules.

22 Note: An offshore hybrid mismatch might give rise to an imported hybrid
23 mismatch: see Subdivision 832-H.

- 24 (2) The amount of the *offshore hybrid mismatch is the amount of the
25 *reverse hybrid mismatch.

26 **832-415 When a payment gives rise to a reverse hybrid mismatch**

- 27 (1) A payment gives rise to a *reverse hybrid mismatch* if:
28 (a) the payment gives rise to a *hybrid mismatch under
29 section 832-420; and
30 (b) subsection (3) or (4) applies.
- 31 (2) The *deduction component* of the *reverse hybrid mismatch is the
32 *deduction component of the *deduction/non-inclusion mismatch
33 mentioned in section 832-420.

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Control group

- 1
- 2 (3) This subsection applies if the following entities are in the same
3 *Division 832 control group:
- 4 (a) the entity that made the payment;
 - 5 (b) the *reverse hybrid;
 - 6 (c) each entity that is an investor identified in
7 paragraph 832-430(2)(c) in relation to the reverse hybrid.

8 Note: For the meaning of *Division 832 control group* see section 832-205.

Structured arrangement

- 9
- 10 (4) This subsection applies if the *scheme under which the payment is
11 made is a *structured arrangement.

12 Note: For the meaning of *structured arrangement*, see section 832-210.

Ordering rule

- 13
- 14 (5) A payment does not give rise to a **hybrid mismatch** under this
15 section if it gave rise to a *hybrid financial instrument mismatch or
16 a *hybrid payer mismatch.

832-420 Hybrid mismatch

- 17
- 18 (1) A payment gives rise to a **hybrid mismatch** if:
19 (a) the payment gives rise to a *deduction/non-inclusion
20 mismatch; and
21 (b) the payment meets the hybrid requirement in
22 section 832-425.

Amount of the hybrid mismatch

- 23
- 24 (2) The amount of the *hybrid mismatch is the lesser of:
25 (a) the amount of the *deduction/non-inclusion mismatch; and
26 (b) if there is an excess under either
27 subparagraph 832-425(2)(b)(i) or (3)(b)(i)—the amount of
28 the excess.

832-425 Hybrid requirement—assume payment was made to an investor

- 29
- 30
- 31 (1) The payment meets the hybrid requirement in this section if:
-

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-
- 1 (a) the payment is made directly, or indirectly through one or
2 more interposed entities, to a *reverse hybrid; and
3 (b) subsection (2) or (3) applies.

4 *Payment would have been taxed in Australia*

- 5 (2) This subsection applies if:
6 (a) the investor country identified in subsection 832-430(3) is
7 Australia; and
8 (b) either:
9 (i) the amount of the *deduction/non-inclusion mismatch
10 exceeds the amount that would be the amount of that
11 mismatch if the amount of the payment that was
12 *subject to Australian income tax for an income year
13 was instead worked out on the assumption in
14 subsection (4); or
15 (ii) on the assumption in subsection (4), the payment would
16 have given rise to a *hybrid financial instrument
17 mismatch, a *hybrid payer mismatch or a *reverse
18 hybrid mismatch.

19 *Payment would have been taxed in a foreign country*

- 20 (3) This subsection applies if:
21 (a) the investor country identified in subsection 832-430(3) is a
22 foreign country; and
23 (b) either:
24 (i) the amount of the *deduction/non-inclusion mismatch
25 exceeds the amount that would be the amount of that
26 mismatch if the amount of the payment that was
27 *subject to foreign income tax for a *foreign tax period
28 was instead worked out on the assumption in
29 subsection (4); or
30 (ii) on the assumption in subsection (4), the payment would
31 have given rise to a *hybrid financial instrument
32 mismatch, a *hybrid payer mismatch or a *reverse
33 hybrid mismatch.

34 *Assumption—payment was made to the investing taxpayer*

- 35 (4) For the purposes of subsections (2) and (3), assume that the
36 payment had instead been made:

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-
- 1 (a) by the same entity; but
2 (b) directly to the investing taxpayer identified in
3 paragraph 832-430(3)(a) or (b).

4 **832-430 Reverse hybrid**

- 5 (1) An entity (the *test entity*) is a *reverse hybrid* in relation to a
6 payment made to it if:
7 (a) subsection (2) applies to the entity in relation to a country
8 and the payment; and
9 (b) subsection (3) applies to the entity in relation to a different
10 country and the payment.

11 Note: The entity, the payments it makes, and its income or profits are
12 identified disregarding tax provisions: see section 832-30.

13 *Formation country—entity is transparent and payment is not*
14 *within the tax base*

- 15 (2) This subsection applies to a test entity in relation to a country (the
16 *formation country*) and a payment made to the entity if:
17 (a) the test entity is formed in the formation country; and
18 (b) for the formation country, the test entity is:
19 (i) not a *liable entity; and
20 (ii) for Australia—not a *member of a *consolidated group;
21 and
22 (c) for the formation country, another entity (an *investor*) is a
23 liable entity in respect of income or profits of the test entity.

24 Note: For the meaning of *liable entity*, see section 832-335.

25 *Investor country—entity is not transparent*

- 26 (3) This subsection applies to a test entity in relation to a country (the
27 *investor country*) and a payment made to the entity if, in the
28 investor country:
29 (a) an investor identified in paragraph (2)(c) is a *liable entity
30 (an *investing taxpayer*) in respect of its own income or
31 profits, but not in respect of the test entity's income or
32 profits; or
33 (b) an entity that is a liable entity (also an *investing taxpayer*) in
34 respect of the investor's income or profits is not also a liable
35 entity in respect of the test entity's income or profits.

EXPOSURE DRAFT

1 Subdivision 832-F—Branch hybrid mismatch

2 Guide to Subdivision 832-F

3 832-480 What this Subdivision is about

4 This Subdivision neutralises a branch hybrid mismatch if it
5 involves a deduction in Australia (and the non-inclusion was not
6 also in Australia).

7 A deduction/non-inclusion mismatch is a branch hybrid mismatch
8 if it is made directly or indirectly to a branch hybrid, and the
9 mismatch would not have arisen, or would have been less, if the
10 residence country had not recognised the permanent establishment.

11 An entity is a branch hybrid in relation to a payment made to it if,
12 for the purposes of the tax law of the country in which it is a
13 resident, the payment is treated as being allocated to a permanent
14 establishment in another country, but in the other country, the
15 payment is treated as *not* being allocated to a permanent
16 establishment in that country.

17 A branch hybrid mismatch that is not neutralised by this
18 Subdivision (or by foreign hybrid mismatch rules) is an offshore
19 hybrid mismatch, which might give rise to an imported hybrid
20 mismatch under Subdivision 832-H.

21 Table of sections

22 Operative provisions

23	832-485	Deduction not allowable
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25	832-495	When a branch hybrid mismatch is an offshore hybrid mismatch
26	832-500	Branch hybrid mismatch
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28	832-510	Hybrid requirement—payment made directly or indirectly to a branch 29 hybrid
30	832-515	Branch hybrid

EXPOSURE DRAFT

1 Operative provisions

2 832-485 Deduction not allowable

- 3 (1) This section applies to an entity if:
- 4 (a) apart from this section, the entity would be entitled to a
- 5 deduction in an income year in respect of a payment; and
- 6 (b) the deduction is the *deduction component of a *branch
- 7 hybrid mismatch to which the payment gives rise.
- 8 (2) So much of the deduction as does not exceed the amount of the
- 9 *branch hybrid mismatch is not allowable as a deduction.
- 10 (3) However, this section does not apply in relation the *branch hybrid
- 11 mismatch if subsection 23AH(2) of the *Income Tax Assessment Act*
- 12 *1936* does not apply in relation to the payment because of
- 13 subsection (4A) of that section.

14 832-490 Exception where entity not a party to the structured

15 arrangement

16 Section 832-485 does not apply to an entity in respect of a payment

17 if:

- 18 (a) the *scheme under which the payment is made is a
- 19 *structured arrangement to which the entity is not a *party;
- 20 and
- 21 (b) subsection 832-500(3) does not apply.

22 832-495 When a branch hybrid mismatch is an offshore hybrid

23 mismatch

- 24 (1) A *branch hybrid mismatch is an *offshore hybrid mismatch* if:
- 25 (a) the *deduction component of the mismatch is a *foreign
- 26 income tax deduction; and
- 27 (b) the country in which the foreign income tax deduction arose
- 28 does not have *foreign hybrid mismatch rules; and
- 29 (c) subsection 23AH(4A) of the *Income Tax Assessment Act*
- 30 *1936* does not apply in relation to the branch hybrid
- 31 mismatch.

32 Note: An offshore hybrid mismatch might give rise to an imported hybrid

33 mismatch: see Subdivision 832-H.

EXPOSURE DRAFT

-
- 1 (2) The amount of the *offshore hybrid mismatch is the amount of the
2 *branch hybrid mismatch.

3 **832-500 Branch hybrid mismatch**

- 4 (1) A payment gives rise to a *branch hybrid mismatch* if:
5 (a) the payment gives rise to a *hybrid mismatch under
6 section 832-505; and
7 (b) subsection (3) or (4) applies.
- 8 (2) The *deduction component* of the *branch hybrid mismatch is the
9 *deduction component of the *deduction/non-inclusion mismatch
10 mentioned in section 832-505.

11 *Control group*

- 12 (3) This subsection applies if the following entities are in the same
13 *Division 832 control group:
14 (a) the entity that made the payment;
15 (b) the *branch hybrid.

16 Note: For the meaning of *Division 832 control group* see section 832-205.

17 *Structured arrangement*

- 18 (4) This subsection applies if the *scheme under which the payment is
19 made is a *structured arrangement.

20 Note: For the meaning of *structured arrangement*, see section 832-210.

21 **832-505 Hybrid mismatch**

- 22 (1) A payment gives rise to a *hybrid mismatch* if:
23 (a) the payment gives rise to a *deduction/non-inclusion
24 mismatch; and
25 (b) the mismatch, or a part of the mismatch, meets the hybrid
26 requirement in section 832-510.

27 *Amount of the hybrid mismatch*

- 28 (2) The amount of the *hybrid mismatch is the lesser of:
29 (a) the amount of the *deduction/non-inclusion mismatch; and

EXPOSURE DRAFT

-
- 1 (b) if there is an excess under either
2 subparagraph 832-510(2)(b)(i) or (3)(b)(i)—the amount of
3 the excess.

4 *Ordering rule*

- 5 (3) A payment does not give rise to a **hybrid mismatch** under this
6 section if it gave rise to a *hybrid financial instrument mismatch, a
7 *hybrid payer mismatch or a *reverse hybrid mismatch.

8 **832-510 Hybrid requirement—payment made directly or indirectly**
9 **to a branch hybrid**

- 10 (1) The payment meets the hybrid requirement in this section if:
11 (a) the payment is made directly, or indirectly through one or
12 more interposed entities, to a *branch hybrid; and
13 (b) subsection (2) or (3) applies.

14 *Payment would have been taxed in Australia*

- 15 (2) This subsection applies if:
16 (a) the residence country identified in subsection 832-515(2) is
17 Australia; and
18 (b) either:
19 (i) the amount of the *deduction/non-inclusion mismatch
20 exceeds the amount that would be the amount of that
21 mismatch if the amount of the payment that was
22 *subject to Australian income tax for an income year
23 was instead worked out on the assumption in
24 subsection (4); or
25 (ii) on the assumption in subsection (4), the payment would
26 have given rise to a *hybrid mismatch under
27 section 832-215 (about hybrid financial instruments) or
28 section 832-320 (about hybrid payers).

29 *Payment would have been taxed in a foreign country*

- 30 (3) This subsection applies if:
31 (a) the residence country identified in subsection 832-515(2) is a
32 foreign country; and
33 (b) either:

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-
- 1 (i) the amount of the *deduction/non-inclusion mismatch
2 exceeds the amount that would be the amount of that
3 mismatch if the amount of the payment that was
4 *subject to foreign income tax for a *foreign tax period
5 was instead worked out on the assumption in
6 subsection (4); or
7 (ii) on the assumption in subsection (4), the payment would
8 have given rise to a *hybrid mismatch under
9 section 832-215 (about hybrid financial instruments) or
10 section 832-320 (about hybrid payers).

11 *Assumption—residence country treated payment as non-branch*
12 *income*

- 13 (4) For the purposes of subsections (2) and (3), assume that the
14 payment was instead treated as income derived by the *liable entity
15 but not in carrying on a business at or through a *PE in another
16 country for the purposes of:
17 (a) if the residence country is Australia—this Act; or
18 (b) if the residence country is a foreign country—the law of the
19 residence country relating to *foreign income tax (except
20 *credit absorption tax, *unitary tax or a withholding-type tax).

21 **832-515 Branch hybrid**

- 22 (1) An entity is a **branch hybrid**, in relation to a payment made to the
23 entity, if subsections (2) and (3) apply to the entity in relation to
24 the payment.

25 *Residence country applies branch profits exemption*

- 26 (2) This subsection applies to an entity in relation to a payment if:
27 (a) for a country (the **residence country**), the entity:
28 (i) is a *liable entity in respect of its own income or profits;
29 and
30 (ii) satisfies the residency test in subsection 832-595(8); and
31 (b) for that liable entity, for the residence country, the payment is
32 treated as income derived by the liable entity in carrying on a
33 business at or through a *PE in another country; and
34 (c) as a result of an exemption or other tax concession to which
35 that liable entity is entitled in respect of income derived in

EXPOSURE DRAFT

1 carrying on a business at or through the PE, the payment is
2 not:

- 3 (i) if the residence country is Australia—*subject to
4 Australian income tax; or
5 (ii) if the residence country is a foreign country—*subject
6 to foreign income tax in that foreign country.

7 Note: For the meaning of *liable entity*, see section 832-335.

8 *Branch country fails to tax payment*

- 9 (3) This subsection applies to an entity in relation to a payment if:
10 (a) the payment is treated as *not* having been derived in carrying
11 on a business at or through a *PE of the entity in the other
12 country mentioned in paragraph (2)(b) (the *branch country*)
13 for the purposes of:
14 (i) if the branch country is Australia—this Act; or
15 (ii) if the branch country is a foreign country—the law of
16 the branch country relating to *foreign income tax
17 (except *credit absorption tax, *unitary tax or a
18 withholding-type tax); and
19 (b) as a result, the payment is not:
20 (i) if the branch country is Australia—*subject to
21 Australian income tax; or
22 (ii) if the branch country is a foreign country—*subject to
23 foreign income tax in that foreign country.

24 *Modified meaning of permanent establishment*

- 25 (4) Subsection (5) applies if:
26 (a) the residence country has entered into, with the branch
27 country:
28 (i) if either the residence country or the branch country is
29 Australia—an *international tax agreement; or
30 (ii) if subparagraph (i) does not apply—a treaty or other
31 agreement relating to the avoidance of double taxation
32 and the prevention of fiscal evasion with respect to
33 taxes on income and capital; and
34 (b) the agreement or treaty (as the case requires) contains:
35 (i) if either the residence country or the branch country is
36 Australia—a *permanent establishment article; or

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(ii) if subparagraph (i) does not apply—a provision corresponding to a permanent establishment article.

(5) A reference in this section to a *PE in a country is taken to be a reference to a permanent establishment within the meaning of the relevant agreement or treaty in the country.

(6) In determining whether paragraph (2)(c) is satisfied, disregard the effect of subsection 23AH(4A) of the *Income Tax Assessment Act 1936*.

Subdivision 832-G—Deducting hybrid mismatch

Guide to Subdivision 832-G

832-565 What this Subdivision is about

This Subdivision neutralises a deducting hybrid mismatch if it involves a deduction in Australia.

A deduction/deduction mismatch is generally a deducting hybrid mismatch.

An entity is a deducting hybrid if a payment it makes is deductible for the purposes of the tax law of 2 countries.

However, unless the deducting hybrid is a dual resident, there are rules identifying which country is the primary response country. If Australia is *not* the primary response country, this Subdivision will not neutralise the deducting hybrid mismatch unless:

- (a) the primary response country does not have hybrid mismatch rules; and
- (b) the relevant parties are in the same control group, or the mismatch arose under a structured arrangement.

The neutralising amount for the deducting hybrid mismatch is reduced by dual inclusion income.

A deducting hybrid mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

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2	Operative provisions
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4	832-575 Additional requirements for secondary response
5	832-580 When a deducting hybrid mismatch is an offshore hybrid mismatch
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7	832-590 Deducting hybrid
8	832-595 Identifying a secondary response country
9	832-600 Neutralising amount
10	832-605 Adjustment if deducting hybrid has dual inclusion income in a later year

Operative provisions

832-570 Deduction not allowable

- (1) This section applies to an entity if:
- (a) apart from this section, the entity would be entitled to a deduction in an income year; and
 - (b) the deduction is a *deduction component of a *deducting hybrid mismatch.
- (2) So much of the deduction as does not exceed the *neutralising amount for the *deducting hybrid mismatch is not allowable as a deduction.

Note: The neutralising amount is worked out under section 832-600.

832-575 Additional requirements for secondary response

- (1) However, if there is a secondary response country in relation to the *deducting hybrid mismatch (see section 832-595), and that country is Australia, section 832-570 does not apply in relation to the *deducting hybrid mismatch unless:
- (a) the secondary response is required (see subsection (2)); and
 - (b) subsection (3) or (4) applies.

When secondary response is required

- (2) For the purposes of paragraph (1)(a), the secondary response is required unless:

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-
- 1 (a) a *liable entity in respect of the income or profits of the
2 *deducting hybrid satisfies the residency test in
3 subsection 832-595(8) in the primary response country; and
4 (b) the primary response country has *foreign hybrid mismatch
5 rules, or another law that has substantially the same effect as
6 foreign hybrid mismatch rules.

Control group

- 7
8 (3) This subsection applies if the following entities are in the same
9 *Division 832 control group:
10 (a) the *deducting hybrid;
11 (b) if one or more entities other than the deducting hybrid is a
12 *liable entity in respect of the income or profits of the
13 deducting hybrid in a deducting country—each such liable
14 entity.

15 Note: For the meaning of *Division 832 control group* see section 832-205.

Structured arrangement

- 16
17 (4) This subsection applies if the *scheme under which the payment is
18 made is a *structured arrangement.

19 Note 1: For the meaning of *structured arrangement*, see section 832-210.

20 Note 2: If the deduction is a non-payment deduction, see also
21 subsection 832-105(5).

832-580 When a deducting hybrid mismatch is an offshore hybrid mismatch

- 22
23
24 (1) A *deducting hybrid mismatch is an *offshore hybrid mismatch* if:
25 (a) the only *deduction components of the mismatch are *foreign
26 income tax deductions; and
27 (b) neither country in which a foreign income tax deduction
28 arose has *foreign hybrid mismatch rules.

29 Note: An offshore hybrid mismatch might give rise to an imported hybrid
30 mismatch: see Subdivision 832-H.

- 31 (2) The amount of the *offshore hybrid mismatch is the *neutralising
32 amount for the *deducting hybrid mismatch.

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1 832-585 When an amount gives rise to a deducting hybrid mismatch

- 2 (1) An amount gives rise to a *deducting hybrid mismatch* if the
3 amount gives rise to a *deduction/deduction mismatch.
- 4 (2) Each *deduction component of the *deduction/deduction mismatch
5 mentioned in subsection (1) is a *deduction component* of the
6 *deducting hybrid mismatch.
- 7 (3) A *deducting hybrid mismatch is also a *hybrid mismatch*.

8 *Ordering rule*

- 9 (4) However, a payment does not give rise to a *deducting hybrid*
10 *mismatch* if it gave rise to a *hybrid financial instrument
11 mismatch, a *hybrid payer mismatch, a *reverse hybrid mismatch
12 or a *branch hybrid mismatch.

13 832-590 Deducting hybrid

14 If an amount gives rise to a *deduction/deduction mismatch, then
15 the following is a *deducting hybrid*:

- 16 (a) if the amount is a payment an entity makes—the entity that
17 makes the payment;
- 18 (b) if the amount is an amount covered by
19 paragraph 832-105(4)(a)—the entity that holds the asset;
- 20 (c) if the amount is an amount covered by
21 paragraph 832-105(4)(b)—the partnership, trust or other
22 transparent entity mentioned in that paragraph.

23 Note: The entity, the payments it makes, and its income or profits are
24 identified disregarding tax provisions: see section 832-30.

25 832-595 Identifying a secondary response country

- 26 (1) This section applies if an amount gives rise to a *deducting hybrid
27 mismatch, other than a deducting hybrid mismatch covered by
28 subsection (2).

29 *Dual residents—no secondary response*

- 30 (2) This subsection covers a *deducting hybrid mismatch if:
31 (a) the only *liable entity in respect of income or profits of the
32 *deducting hybrid is the deducting hybrid; and

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1 (b) the liable entity satisfies the residency test in subsection (8)
2 in both deducting countries.

3 Note 1: For the meaning of *liable entity*, see section 832-335.

4 Note 2: If the deducting hybrid is a dual resident, the mismatch may be
5 neutralised by any country.

6 *Country is a primary response country unless this section provides*
7 *otherwise*

8 (3) A country in which the amount gives rise to a deduction or *foreign
9 income tax deduction (a *deducting country*) is a primary response
10 country in relation to the *deducting hybrid mismatch unless the
11 country is identified as the secondary response country under
12 subsection (4), (5), (6) or (7).

13 (4) If:

- 14 (a) the *deducting hybrid is itself the *liable entity in each
15 deducting country; and
- 16 (b) in one deducting country, the deducting hybrid does not
17 satisfy the residency test in subsection (8); and
- 18 (c) in the other deducting country, the deducting hybrid *does*
19 satisfy the residency test;

20 then the country mentioned in paragraph (b) is the secondary
21 response country.

22 (5) If:

- 23 (a) the *liable entity for one deducting country is a different
24 entity to the entity that is the liable entity for the other
25 deducting country; and
- 26 (b) in one deducting country, the *deducting hybrid is the liable
27 entity;

28 then the country mentioned in paragraph (b) is the secondary
29 response country.

30 (6) If:

- 31 (a) the *liable entity for one deducting country is a different
32 entity to the entity that is the liable entity for the other
33 deducting country; and
- 34 (b) the *deducting hybrid is not the liable entity in either country;
35 and

EXPOSURE DRAFT

1 (c) in one deducting country, the entity that is a liable entity is
2 also a liable entity in respect of the income or profits of the
3 entity that is the liable entity in the other deducting country;
4 then the country mentioned second in paragraph (c) is the
5 secondary response country.

6 (7) If:

- 7 (a) the *liable entity for one deducting country is a different
8 entity to the entity that is the liable entity for the other
9 deducting country; and
10 (b) subsections (5) and (6) do not apply; and
11 (c) in one deducting country, the deducting hybrid and the liable
12 entity both satisfy the residency test in subsection (8);
13 then the country mentioned in paragraph (c) is the secondary
14 response country.

15 *Residency test*

16 (8) An entity satisfies the residency test in this subsection in relation to
17 a country, if:

- 18 (a) if the country is Australia—the entity is an *Australian entity;
19 or
20 (b) if the country is a foreign country:
21 (i) the entity is a resident of the foreign country for the
22 purposes of the law of the foreign country relating to
23 *foreign income tax (except *credit absorption tax,
24 *unitary tax or a withholding-type tax); or
25 (ii) the tax base, as it relates to foreign income tax (except
26 credit absorption tax, unitary tax or a withholding-type
27 tax), includes income from worldwide sources.

28 **832-600 Neutralising amount**

- 29 (1) The *neutralising amount* for a *deducting hybrid mismatch is
30 worked out by:
31 (a) starting with the lesser of the amounts of each deduction or
32 *foreign income tax deduction to which the amount gives
33 rise; and
34 (b) reducing (but not below nil) the result from paragraph (a) by
35 the amount of any *dual inclusion income that is available to
36 be applied in working out the neutralising amount.

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Australian deduction—inclusions must be in Australia and in the other deducting country

- (2) An amount of *dual inclusion income is available to be applied to reduce the *neutralising amount for a *deducting hybrid mismatch to which section 832-570 applies if:
- (a) the *deducting hybrid is eligible to apply the amount (see subsection 832-740(7)); and
 - (b) the amount is *subject to Australian income tax for the purposes of subsection 832-740(1) in the income year mentioned in subsection 832-570(1); and
 - (c) the amount is *subject to foreign income tax for the purposes of subsection 832-740(1) in the foreign country in which the *foreign income tax deduction arose.

Offshore hybrid mismatch—inclusions must be in the deducting countries

- (3) An amount of *dual inclusion income is available to be applied to reduce the *neutralising amount for a *deducting hybrid mismatch that is an *offshore hybrid mismatch if:
- (a) the *deducting hybrid is eligible to apply the amount (see subsection 832-740(7)); and
 - (b) the amount is *subject to foreign income tax for the purposes of subsection 832-740(1) in the foreign country in which one of the *foreign income tax deductions arose, and in the same *foreign tax period; and
 - (c) the amount is also subject to foreign income tax for the purposes of subsection 832-740(1) in the foreign country in which another of the foreign income tax deductions arose.

832-605 Adjustment if deducting hybrid has dual inclusion income in a later year

- (1) There is an adjustment under this section for an entity in an income year (the *adjustment year*) if:
- (a) in an earlier income year, all or part of a deduction of the entity in respect of an amount that gave rise to a *deducting hybrid mismatch was not allowable under section 832-570; and
 - (b) an amount of *dual inclusion income is:

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-
- 1 (i) available to be applied by the *deducting hybrid in the
2 adjustment year; and
- 3 (ii) *subject to Australian income tax for the purposes of
4 subsection 832-740(1) in the adjustment year; and
- 5 (iii) *subject to foreign income tax for the purposes of
6 subsection 832-740(1) in the foreign country in which
7 the *foreign income tax deduction arose.
- 8 (2) So much of the amount of *dual inclusion income that satisfies
9 paragraph (1)(b) as does not exceed the amount that was not
10 allowable as a deduction is an amount the entity can deduct in the
11 adjustment year.
- 12 (3) For the purposes of a later application of this section, treat the
13 amount that was not allowable as a deduction under
14 section 832-570 as being reduced by the amount deducted under
15 subsection (2) of this section.

16 Subdivision 832-H—Imported hybrid mismatch

17 Guide to Subdivision 832-H

18 832-655 What this Subdivision is about

19 This Subdivision neutralises an imported hybrid mismatch. This
20 mismatch is an integrity rule that applies when one or more entities
21 are interposed between a hybrid mismatch and a country that has
22 hybrid mismatch rules.

23 Identifying an imported hybrid mismatch involves testing whether
24 a hybrid mismatch involving 2 foreign countries has been
25 “imported” into Australia by a deduction. If so, there are priority
26 rules that allocate the neutralisation of the mismatch between
27 countries that have hybrid mismatch rules.

28 Table of sections

29 Operative provisions

30	832-660	Deduction not allowable
31	832-665	Imported hybrid mismatch
32	832-670	Meaning of <i>importing payment</i>

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1	832-675	When an importing payment is eligible to neutralise an offshore hybrid
2		mismatch
3	832-680	Working out the amount of the imported hybrid mismatch
4	832-685	Carry forward of residual offshore hybrid mismatches

5 Operative provisions

6 832-660 Deduction not allowable

7 (1) This section applies in relation to an *imported hybrid mismatch if,
8 apart from this section, an entity would be entitled to a deduction
9 in an income year in respect of a payment that gives rise to the
10 imported hybrid mismatch.

11 (2) So much of the deduction as does not exceed the amount of the
12 *imported hybrid mismatch is not allowable as a deduction.

13 Note: The amount of the imported hybrid mismatch is worked out under
14 section 832-680.

15 832-665 Imported hybrid mismatch

16 (1) A payment gives rise to an *imported hybrid mismatch* if:
17 (a) apart from section 832-660, the payment would give rise to a
18 deduction for an entity in an income year; and
19 (b) the payment is an *importing payment in relation to an
20 *offshore hybrid mismatch; and
21 (c) the importing payment is eligible to neutralise the offshore
22 hybrid mismatch (see section 832-675).

23 Note: For the meaning of *offshore hybrid mismatch* see sections 832-195,
24 832-310, 832-410, 832-495, and 832-580.

25 (2) An *imported hybrid mismatch is also a *hybrid mismatch*.

26 *Ordering rule*

27 (3) A payment does not give rise to an *imported hybrid mismatch* if it
28 gave rise to a *hybrid financial instrument mismatch, a *hybrid
29 payer mismatch, a *reverse hybrid mismatch, a *branch hybrid
30 mismatch or a *deducting hybrid mismatch.

31 Note: However, for an imported hybrid mismatch to arise, a different
32 payment must have given rise to an offshore hybrid mismatch that is
33 of one of these kinds.

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832-670 Meaning of *importing payment*

- 1
2 (1) A payment an entity (the *payer*) makes is an *importing payment* in
3 relation to an *offshore hybrid mismatch if:
4 (a) the payment is made directly, or indirectly through one or
5 more interposed entities, to another entity; and
6 (b) the other entity (the *offshore deducting entity*) is:
7 (i) the entity that made the payment that gave rise to the
8 offshore hybrid mismatch; or
9 (ii) if the offshore hybrid mismatch is a *deducting hybrid
10 mismatch—the *deducting hybrid.
- 11 (2) However, a payment is *not* an *importing payment* if the income or
12 profits of the offshore deducting entity, the recipient of the
13 payment the offshore deducting entity makes, or an interposed
14 entity, are:
15 (a) *subject to Australian income tax; or
16 (b) *subject to foreign income tax in a country that has *foreign
17 hybrid mismatch rules.

Indirect importations

- 18
- 19 (3) For the purposes of determining whether a payment is made
20 indirectly through one or more interposed entities to the offshore
21 deducting entity:
22 (a) it is not necessary to demonstrate that each payment in a
23 series of payments funds the next payment, or is made after
24 the previous payment; and
25 (b) it is sufficient if payments exist between each interposed
26 entity, and each of the payments gives rise to a *foreign
27 income tax deduction (but not a *deduction/non-inclusion
28 mismatch).

Loss surrender and grouping relief

- 29
- 30 (4) Subsection (5) applies if:
31 (a) a payment is made to an entity (the *first entity*); and
32 (b) another entity (the *second entity*) makes a payment (the
33 *second payment*) to a third entity; and
34 (c) the first entity and the second entity are in the same
35 *Division 832 control group; and
-

EXPOSURE DRAFT

1 (d) under the law of a foreign country relating to *foreign income
2 tax (except *credit absorption tax, *unitary tax or a
3 withholding-type tax):

4 (i) a *foreign income tax deduction arises in respect of the
5 second payment; and

6 (ii) the foreign income tax deduction may, as a result of a
7 concessional feature of that law, be transferred to,
8 shared with, or otherwise applied by, the first entity.

9 Note: For the meaning of *Division 832 control group* see section 832-205.

10 (5) For the purposes of this section, treat:

11 (a) a payment as having been made by the first entity to the
12 second entity; and

13 (b) the payment as having given rise to a *foreign income tax
14 deduction (but not a *deduction/non-inclusion mismatch).

15 **832-675 When an importing payment is eligible to neutralise an** 16 **offshore hybrid mismatch**

17 (1) An *importing payment an entity makes is eligible to neutralise an
18 *offshore hybrid mismatch if:

19 (a) the payment, or a part of the payment, gives rise to any of the
20 following:

21 (i) a deduction in an income year covered by
22 subsection (2);

23 (ii) a *foreign income tax deduction, in a foreign country
24 that has *foreign hybrid mismatch rules, in a *foreign
25 tax period covered by subsection (2); and

26 (b) an item in the table in subsection (3) applies to the importing
27 payment.

28 *Period within which mismatch may be neutralised*

29 (2) For the purposes of paragraph (1)(a), a *foreign tax period or
30 income year is covered by this subsection if:

31 (a) it ends at or after the end of the *foreign tax period in which
32 the *deduction component of the *offshore hybrid mismatch
33 arose; and

34 (b) it has at least one day in common with that period.

EXPOSURE DRAFT

Priority rules for importing payments

- 1
- 2 (3) If more than one item in the following table covers an *importing
3 payment in relation to an *offshore hybrid mismatch, apply the first
4 item that covers it. However, an item does *not* apply to an
5 importing payment if:
- 6 (a) an item higher in the table applies to one or more other
7 importing payments in relation to the *offshore hybrid
8 mismatch; and
- 9 (b) the offshore hybrid mismatch is, or will be, fully neutralised
10 by the application of this Subdivision, and equivalent
11 provisions of applicable *foreign hybrid mismatch rules, to
12 those other importing payments.
- 13

Priority table for importing payments

Item	Topic	An *importing payment is covered if:
1	Structured arrangement	(a) the *importing payment, the payment made by the offshore deducting entity, and each payment made by an interposed entity (if applicable), are made under a *structured arrangement; and (b) the payer of the importing payment, the offshore deducting entity, and each interposed entity (if applicable) are all *parties to the structured arrangement
2	Direct payment	(a) the *importing payment is made directly to the offshore deducting entity; and (b) the payer of the importing payment and the offshore deducting entity are members of the same *Division 832 control group
3	Indirect payment	(a) the *importing payment is made indirectly through one or more interposed entities to the offshore deducting entity; and (b) the payer of the importing payment, the offshore deducting entity, and each interposed entity are members of the same *Division 832 control group

14 Note 1: For the offshore deducting entity, see paragraph 832-670(1)(b).

15 Note 2: For the meaning of *structured arrangement*, see section 832-210.

16 Note 3: For the meaning of *Division 832 control group* see section 832-205.

17

EXPOSURE DRAFT

832-680 Working out the amount of the imported hybrid mismatch

- 1
- 2 (1) The amount of the *imported hybrid mismatch is the lesser of:
- 3 (a) the importing deduction amount worked out under
- 4 subsection (2) in relation to the deduction; and
- 5 (b) the amount worked out using the following formula:

6

$$\frac{\text{Importing deduction}}{\text{Total importing deductions of equal priority}} \times \text{Remaining offshore hybrid mismatch}$$

7 where:

8 ***importing deduction*** means the amount of the importing deduction

9 amount worked out under subsection (2) in relation to the

10 deduction.

11 ***remaining offshore hybrid mismatch*** means:

- 12 (a) unless paragraph (b) applies—the amount of the *offshore
- 13 hybrid mismatch; or
- 14 (b) if an item higher in the table in subsection 832-675(3) applies
- 15 to one or more other *importing payments in relation to the
- 16 offshore hybrid mismatch—the amount of the offshore
- 17 hybrid mismatch that is not, or will not be, neutralised by the
- 18 application of this Subdivision, and equivalent provisions of
- 19 applicable *foreign hybrid mismatch rules, in relation to
- 20 those other importing payments.

21 ***total importing deductions of equal priority*** means the amount

22 worked out by:

- 23 (a) identifying each *importing payment in relation to the
- 24 *offshore hybrid mismatch that is eligible to neutralise the
- 25 mismatch, and to which the same item in the table in
- 26 subsection 832-675(3) applies; and
- 27 (b) working out under subsection (2) the importing deduction
- 28 amount in relation to the deduction or *foreign income tax
- 29 deduction to which each such importing payment gives rise;
- 30 and
- 31 (c) summing the results from paragraph (b) for each such
- 32 importing payment.

- 33 (2) The amount (the ***importing deduction amount***) worked out under
- 34 this subsection in relation to a deduction or *foreign income tax
- 35 deduction is:

EXPOSURE DRAFT

-
- 1 (a) if the *importing payment is made directly to the offshore
2 deducting entity—the amount of the deduction or foreign
3 income tax deduction; or
4 (b) if the importing payment is made indirectly through one or
5 more interposed entities to the offshore deducting entity—the
6 lesser of:
7 (i) the amount of the deduction or foreign income tax
8 deduction; and
9 (ii) the smallest amount of any foreign income tax
10 deduction to which a payment by an interposed entity
11 gave rise.

12 **832-685 Carry forward of residual offshore hybrid mismatches**

- 13 (1) Subsection (2) applies if:
14 (a) a payment made in a particular *foreign tax period gave rise
15 to an *offshore hybrid mismatch (the *original mismatch*);
16 and
17 (b) the original mismatch is only partly neutralised by the
18 application of this Subdivision and equivalent provisions of
19 applicable *foreign hybrid mismatch rules.
- 20 (2) This Subdivision applies as if:
21 (a) the offshore deducting entity had made a payment in the next
22 *foreign tax period; and
23 (b) the payment gave rise to an *offshore hybrid mismatch (the
24 *residual mismatch*); and
25 (c) the amount of the residual mismatch was the amount of the
26 original mismatch that was not neutralised by the application
27 of this Subdivision and equivalent provisions of applicable
28 *foreign hybrid mismatch rules.

29 **Subdivision 832-I—Dual inclusion income**

30 **Guide to Subdivision 832-I**

31 **832-735 What this Subdivision is about**

32

Income that is taxed in 2 countries is dual inclusion income. It can 33 be applied to reduce the neutralising amount for the hybrid payer 34 mismatch and the deducting hybrid mismatch.
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EXPOSURE DRAFT

1 This Subdivision modifies the concepts of “subject to Australian
2 income tax” and “subject to foreign income tax” for the purposes
3 of calculating dual inclusion income.

4 It also identifies which entities are able to apply dual inclusion
5 income.

6 Table of sections

7 Operative provisions

8 832-740 Dual inclusion income, and when an entity is eligible to apply it

9 Operative provisions

10 832-740 Dual inclusion income, and when an entity is eligible to 11 apply it

- 12 (1) An amount of income or profits is *dual inclusion income* if 2 or
13 more of the following outcomes arise for the amount:
- 14 (a) it is *subject to Australian income tax in an income year;
 - 15 (b) it is *subject to foreign income tax in a foreign country in a
16 *foreign tax period;
 - 17 (c) it is subject to foreign income tax in a foreign country (other
18 than the country mentioned in paragraph (b)) in a foreign tax
19 period.

20 Note: In certain circumstances, dual inclusion income can be applied to
21 reduce the neutralising amount for a hybrid payer mismatch (see
22 section 832-340) or a deducting hybrid mismatch (see
23 section 832-600).

24 *Effect of Australian foreign income tax offset for underlying taxes*

- 25 (2) For the purposes of subsection (1), if:
- 26 (a) an amount of assessable income of an entity (the *assessable*
27 *amount*) would, apart from this subsection, be *subject to
28 Australian income tax; and
 - 29 (b) an amount of *foreign income tax (except *credit absorption
30 tax, *unitary tax or a withholding-type tax) paid in respect of
31 the assessable amount counts towards a *tax offset for an
32 entity under Division 770;
- 33 then:

EXPOSURE DRAFT

1 (c) if the amount of the tax offset equals or exceeds the amount
2 of *tax that would, having regard only to the assessable
3 amount and the rate at which tax is imposed on the entity, be
4 payable on the assessable amount—the assessable amount is
5 not *subject to Australian income tax*; and

6 (d) if the amount of the tax offset is a proportion of the amount
7 of that tax—then that proportion of the assessable amount is
8 not *subject to Australian income tax*.

9 *Effect of credits etc. for underlying taxes*

10 (3) In determining for the purposes of subsection (1) whether an
11 amount of income or profits is *subject to foreign income tax in a
12 *foreign tax period, disregard subsection 832-125(3).

13 *Extension for certain on-payments through grouped entities*

14 (4) Subsection (5) applies, if:

15 (a) an entity is a member of a dual inclusion income group in a
16 country (see subsection (6)); and

17 (b) an amount of income or profits of the entity (the *on-payment*
18 *amount*) is a payment received by the entity from another
19 member of the dual inclusion income group at a time; and

20 (c) it is reasonable to conclude that the payment was funded by
21 an amount of income or profits of the other member (the
22 *funding income or profits*); and

23 (d) the funding income or profits were:

24 (i) if the country mentioned in paragraph (a) is Australia—
25 *subject to Australian income tax; or

26 (ii) if the country mentioned in paragraph (a) is a foreign
27 country—*subject to foreign income tax in the foreign
28 country; and

29 (e) the funding income or profits were not *dual inclusion
30 income under subsection (1) (disregarding subsection (5)) in
31 the country.

32 (5) For the purposes of subsection (1), the on-payment amount is
33 treated for the purposes of subsection (1) as if it were:

34 (a) if the country mentioned in paragraph (4)(a) is Australia—
35 *subject to Australian income tax in the income year in which
36 the time mentioned in paragraph (4)(b) occurs; or

EXPOSURE DRAFT

1 (b) if the country mentioned in paragraph (4)(a) is a foreign
2 country—*subject to foreign income tax in the foreign
3 country in the *foreign tax period in which the time
4 mentioned in paragraph (4)(b) occurs.

5 (6) Two or more entities are members of a group (a ***dual inclusion***
6 ***income group***) in a country for the purposes of this Division if in
7 that country:

8 (a) the entity that is a *liable entity in respect of the income or
9 profits of each of the entities is the same entity; and

10 (b) no other entity is a liable entity in respect of the income or
11 profits of any of the entities.

12 *When an entity is eligible to apply dual inclusion income*

13 (7) An entity is eligible to apply an amount of *dual inclusion income
14 if the amount is income or profits of:

15 (a) the entity; or

16 (b) if paragraph (a) does not apply and the entity is a member of
17 a dual inclusion income group in any country—an entity that
18 is a member of the dual inclusion income group.

19 (8) However, an entity is not eligible to apply the amount if it has
20 already been applied by any entity by a previous application of a
21 provision of this Division.

22 **Subdivision 832-J—Integrity rule**

23 **Guide to Subdivision 832-J**

24 **832-795 What this Subdivision is about**

25 This Subdivision contains an integrity measure that disallows an
26 Australian deduction of an entity (the ***paying entity***) for a payment
27 of interest (or a payment of a similar character) to a foreign entity
28 (the ***interposed foreign entity***). The deduction will be disallowed if
29 certain conditions are satisfied, including that:

30 (a) the paying entity, the interposed foreign entity and another
31 foreign entity (the ***ultimate parent entity***) are in the same
32 Division 832 control group; and

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(b) the interposed foreign entity and the ultimate parent entity are not residents of the same foreign country; and

(c) the rate of foreign income tax on the payment in the country of residence of the interposed foreign entity (the *interposed country rate*) is 10% or less.

However, the deduction will not be disallowed if, assuming that the payment had been made directly to the ultimate parent entity:

(a) the rate of foreign income tax on the payment in the country of residence of the ultimate parent entity is less than the interposed country rate; and

(b) the payment would not give rise to a hybrid mismatch of a particular kind.

13

Table of sections

14

Operative provisions

15

832-800 Payments made to interposed foreign entity (integrity measure)

16

Operative provisions

17

832-800 Payments made to interposed foreign entity (integrity measure)

18

19

(1) Subsection (2) applies if:

20

(a) an entity (the *paying entity*) makes a payment under a *scheme to a *foreign entity (the *interposed foreign entity*), either directly or indirectly through one or more interposed *Australian trusts or Australian partnerships (within the meaning of Part X of the *Income Tax Assessment Act 1936*); and

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(b) the paying entity, the interposed foreign entity and another foreign entity (the *ultimate parent entity*) are in the same *Division 832 control group; and

(c) the ultimate parent entity is not controlled by any other entity (other than an entity that is not a member of the Division 832 control group); and

EXPOSURE DRAFT

-
- 1 (d) the interposed foreign entity and the ultimate parent entity are
2 not residents of the same foreign country; and
- 3 (e) the payment is of:
- 4 (i) an amount of interest (within the meaning of
5 subsection 128A(1AB) of the *Income Tax Assessment*
6 *Act 1936*); or
- 7 (ii) an amount under a *derivative financial arrangement;
8 and
- 9 (f) the paying entity is entitled to a deduction in an income year
10 in respect of the payment (disregarding this section); and
- 11 (g) either:
- 12 (i) the payment is *subject to foreign income tax (except
13 *credit absorption tax, *unitary tax or a withholding-type
14 tax) in the country of residence of the interposed foreign
15 entity at a rate (the *interposed country rate*) that is 10%
16 or less; or
- 17 (ii) the payment is not subject to foreign income tax.
- 18 (2) The paying entity is not entitled to the deduction mentioned in
19 paragraph (1)(f).
- 20 (3) Subsection (2) does not apply if it is reasonable to conclude that
21 the amount of the payment is:
- 22 (a) included under section 456 or 457 of the *Income Tax*
23 *Assessment Act 1936* in the assessable income of an entity; or
- 24 (b) included under a corresponding provision of a law of a
25 foreign country in working out the tax base of an entity.
- 26 (4) Subsection (2) does not apply if it is reasonable to conclude that,
27 assuming that the payment had been made directly to the ultimate
28 parent entity:
- 29 (a) the payment would:
- 30 (i) be *subject to foreign income tax at a rate that is the
31 same as, or less than, the interposed country rate; or
- 32 (ii) not be subject to foreign income tax; and
- 33 (b) the payment would not give rise to a *hybrid financial
34 instrument mismatch, a *hybrid payer mismatch or a *reverse
35 hybrid mismatch.
- 36 (5) Subsection (2) does not apply if it is reasonable to conclude that
37 the *scheme was not designed to produce:
- 38 (a) a deduction in relation to the payment; and
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EXPOSURE DRAFT

1 (b) the imposition of *foreign income tax on the payment at a
2 rate of 10% or less, or the absence of imposition of foreign
3 tax on the payment.

4 (6) The question whether a *scheme has been designed to produce the
5 effects mentioned in subsection (5) must be determined by
6 reference to the facts and circumstances that exist in connection
7 with the scheme, including the terms of the scheme.

8 *Back to back arrangements, etc.*

9 (7) Subsection (8) applies if:

- 10 (a) an entity (the *original paying entity*) makes a payment of a
11 kind mentioned in subparagraph (1)(e)(i) or (ii) to another
12 entity; and
13 (b) the other entity, or a further entity, pays an amount of that
14 kind to a foreign entity; and
15 (c) the payments mentioned in paragraphs (a) and (b) are made
16 under an arrangement involving back-to-back loans or an
17 arrangement that is economically equivalent and intended to
18 have a similar effect to back-to-back loans.

19 (8) For the purposes of this section, treat the original paying entity as
20 having made the payment mentioned in paragraph (7)(a) to the
21 foreign entity mentioned in paragraph (7)(b).

22 **Subdivision 832-K—Modifications for Division 230 (about** 23 **taxation of financial arrangements)**

24 **Guide to Subdivision 832-K**

25 **832-845 What this Subdivision is about**

26 This Subdivision contains modifications applying to gains and
27 losses from financial arrangements.

28 **Table of sections**

29 **Operative provisions**

30 832-850 Modifications relating to Division 230 gains and losses

EXPOSURE DRAFT

Operative provisions

832-850 Modifications relating to Division 230 gains and losses

(1) This section applies to the following:

- (a) a gain that, apart from this Division, would be included in an entity's assessable income for an income year under Division 230;
- (b) a loss that, apart from this Division, would be allowable as a deduction to an entity for an income year under Division 230;
- (c) a gain or a loss that, apart from this Division, would be dealt with in accordance with subsection 230-310(4) in relation to an income year.

Separation of currency effects for Division 230 gains and losses

(2) For the purposes of this Division, split the gain or loss as follows:

- (a) to the extent to which the gain or loss represents a *currency exchange rate effect, treat it as a separate gain or loss;
- (b) to the extent that it does not represent that effect, treat it as a separate gain or loss from the *financial arrangement to which this Division applies.

(3) For the purposes of this Division, assume an amount treated under paragraph (2)(b) as a separate loss would, apart from this Division, be allowable as a deduction to the entity for the income year.

This Division applies to a non-currency loss

(4) If:

- (a) there is a loss from a *financial arrangement (including an amount treated under paragraph (2)(b) as a separate loss); and
- (b) in working out the amount of the loss:
 - (i) all or a part of a payment made, or to be made, to another entity is taken into account; or
 - (ii) 2 or more payments made, or to be made, to another entity are taken into account;

then this Division applies as if there was a single payment, made to the other entity (the *recipient*), and giving rise to a deduction or a *foreign income tax deduction.

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Adjusting Division 230 gain or loss

- (5) However, if a provision of this Division would apply to make an amount that is all or a part of the deduction not allowable:
- (a) that provision does not apply; and
 - (b) section 230-522 applies instead.

This Division applies to a non-currency component that is a gain

- (6) If there is an amount treated under paragraph (2)(b) as a separate gain from a *financial arrangement, the gain is treated as consisting of any actual payments made under the financial arrangement and taken into account in working out the amount of the gain or loss the entity made under the arrangement.
- (7) For the purposes of this Division, assume the gain is an amount that is included in the entity's assessable income.

EXPOSURE DRAFT

1 Part 2—Other amendments

2 *Income Tax Assessment Act 1936*

3 2 At the end of subsection 23AH(1)

4 Add:

5 ; and (d) to limit the effect mentioned in paragraph (a) where there is a
6 branch hybrid mismatch for the purposes of Division 832 of
7 the *Income Tax Assessment Act 1997*.

8 3 After subsection 23AH(4)

9 Insert:

10 *Exception relating to hybrid mismatch rules*

11 (4A) Subsection (2) does not apply to foreign income derived by the
12 company if the foreign income is branch hybrid mismatch income
13 (see subsection (14C)).

14 4 After subsection 23AH(14B)

15 Insert:

16 *Branch hybrid mismatch income*

17 (14C) For the purposes of this section, if foreign income derived by the
18 company is an amount that, for the purposes of Division 832 of the
19 *Income Tax Assessment Act 1997*, is a payment:

20 (a) received by the company; and

21 (b) that, apart from subsection (4A) of this section, would give
22 rise to a branch hybrid mismatch;

23 then so much of the foreign income as does not exceed the amount
24 of the branch hybrid mismatch is ***branch hybrid mismatch income***.

25 (14D) For the purposes of this section, ***PE***, when it is used in
26 Division 832 of the *Income Tax Assessment Act 1997*, does not
27 have the meaning it has in that Act but instead has the same
28 meaning as in this section.

29 5 At the end of Part IIIB

30 Add:

EXPOSURE DRAFT

1 Division 5—Modifications relating to hybrid mismatch 2 rules

3 160ZZZL Certain “hybrid mismatch” deductions denied

4 (1) Subsection (2) applies if:

5 (a) either:

6 (i) an amount of interest (a *notional payment*) is taken
7 under section 160ZZZA to be incurred by an Australian
8 branch of a foreign bank in respect of a notional
9 borrowing; or

10 (ii) an amount (also a *notional payment*) is taken under
11 section 160ZZZE to be an amount paid by an Australian
12 branch of a foreign bank in respect of a notional
13 derivative transaction; and

14 (b) the amount would, apart from this section, give rise to a
15 deduction for the Australian branch in a year of income; and

16 (c) the amount of the deduction exceeds the amount worked out
17 under subsection (3).

18 *Neutralising hybrid mismatch outcomes*

19 (2) So much of the deduction as equals the excess worked out under
20 paragraph (1)(c) is not allowable as a deduction for the year of
21 income.

22 *Extent to which notional payment gives rise to a 23 deduction/non-inclusion outcome*

24 (3) For the purposes of paragraph (1)(c), sum the following amounts:

25 (a) the amount of the notional payment that is subject to foreign
26 income tax;

27 (b) so much (if any) of the amount of the notional payment as it
28 is reasonable to conclude is effectively funding expenses
29 covered by subsection (4) or (5) (about non-deductible third
30 party expenses);

31 (c) the amount (if any) of income or profits of the Australian
32 branch that is both:

33 (i) subject to Australian income tax for the purposes of
34 subsection 832-740(1) of the *Income Tax Assessment
35 Act 1997* in the year of income mentioned in
36 paragraph (1)(b); and

EXPOSURE DRAFT

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- 1 (ii) subject to foreign income tax for the purposes of that
2 subsection in the foreign country in which the foreign
3 bank is a resident.

4 *Non-deductible third party expenses*

- 5 (4) For the purposes of paragraph (3)(b), if:
6 (a) the notional payment is in respect of a notional borrowing;
7 and
8 (b) it is reasonable to conclude that the notional borrowing is
9 effectively funded by actual borrowings by the foreign bank;
10 then the expenses in respect of the actual borrowings are covered
11 by this subsection to the extent (if any) that those expenses do not
12 give rise to foreign income tax deductions.
- 13 (5) For the purposes of paragraph (3)(b), if:
14 (a) the notional payment is in respect of a notional derivative
15 transaction; and
16 (b) it is reasonable to conclude that the foreign bank has hedged
17 or managed all or part of its risk in relation to the notional
18 derivative transaction by entering into actual transactions;
19 then the expenses in respect of the actual transactions are covered
20 by this subsection to the extent (if any) that those expenses do not
21 give rise to foreign income tax deductions.

22 **160ZZZN Adjusting if Australian branch derives dual inclusion**
23 **income in a later year**

- 24 (1) There is an adjustment under subsection (2) for the Australian
25 branch in a year of income (the *adjustment year*) if:
26 (a) an amount of a deduction was not allowable for the branch in
27 an earlier year of income under subsection 160ZZZL(2); and
28 (b) this Part applies in the calculation of the foreign bank's
29 taxable income in the adjustment year; and
30 (c) an amount of income or profits of the Australian branch is:
31 (i) subject to Australian income tax for the purposes of
32 subsection 832-740(1) of the *Income Tax Assessment*
33 *Act 1997* in the adjustment year; and
34 (ii) subject to foreign income tax for the purposes of that
35 subsection in the foreign country in which the foreign
36 bank is a resident.

EXPOSURE DRAFT

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- 1 (2) So much of the amount of income or profits that satisfies
2 paragraph (1)(c) as does not exceed the amount of the deduction
3 that was not allowable is an amount the Australian branch can
4 deduct in the adjustment year.
- 5 (3) For the purposes of a later application of this section, treat the
6 amount of the deduction that was not allowable under
7 subsection 160ZZZL(2) as being reduced by the amount deducted
8 under subsection (2).

9 **160ZZZP Dual inclusion income not to be applied more than once**

- 10 (1) For the purposes of paragraphs 160ZZZL(3)(c) and
11 160ZZZN(1)(c), an amount of income or profits is to be
12 disregarded if:
13 (a) the amount is dual inclusion income; and
14 (b) the amount has been applied by a provision of Division 832
15 of the *Income Tax Assessment Act 1997*.
- 16 (2) For the purposes of Division 832 of that Act, an amount of dual
17 inclusion income is not available to be applied by a provision of
18 that Division if it has been taken into account under
19 paragraph 160ZZZL(3)(c) or subsection 160ZZZN(2).

20 **160ZZZR Interpretation**

21 In this Division:

22 *dual inclusion income* has the same meaning as in the *Income Tax*
23 *Assessment Act 1997*.

24 *foreign income tax deduction* has the same meaning as in the
25 *Income Tax Assessment Act 1997*.

26 *foreign tax period* has the same meaning as in the *Income Tax*
27 *Assessment Act 1997*.

28 *subject to Australian income tax* has the same meaning as in the
29 *Income Tax Assessment Act 1997*.

30 *subject to foreign income tax* has the same meaning as in the
31 *Income Tax Assessment Act 1997*.

EXPOSURE DRAFT

6 At the end of section 389

Add:

; (d) Division 832 of the *Income Tax Assessment Act 1997* (about hybrid mismatch rules).

Income Tax Assessment Act 1997

7 After section 230-520

Insert:

230-522 Adjusting a gain or loss that gives rise to a hybrid mismatch

(1) This section applies if:

(a) for the purposes of Division 832, section 832-850 applies to treat:

(i) a part of a gain or loss you make from a *financial arrangement as a separate loss from the financial arrangement; and

(ii) the separate loss as being deductible; and

(b) disregarding this section, a provision of Division 832 would apply to make an amount (the *relevant amount*) that is all or a part of the deduction not allowable.

(2) The following have effect:

(a) if (disregarding section 832-850) you made a loss from the *financial arrangement, and the relevant amount does not exceed the amount of the loss—the amount of the loss you made is reduced by the relevant amount;

(b) if (disregarding section 832-850) you made a loss from the financial arrangement, and the relevant amount exceeds the amount of the loss:

(i) you do not make a loss from the financial arrangement; and

(ii) instead, you make a gain from the financial arrangement equal to the amount of the excess;

(c) if (disregarding section 832-850) you made a gain from the financial arrangement—the amount of the gain is increased by the relevant amount.

EXPOSURE DRAFT

8 Subsection 995-1(1)

Insert:

branch hybrid has the meaning given by section 832-515.

branch hybrid mismatch has the meaning given by section 832-500.

deducting hybrid has the meaning given by section 832-590.

deducting hybrid mismatch has the meaning given by section 832-585.

deduction component:

(a) of a *deduction/non-inclusion mismatch—has the meaning given by subsections 832-100(1) and 832-100(2); and

(b) of a *deduction/deduction mismatch—has the meaning given by subsection 832-105(2); and

(c) of a *hybrid financial instrument mismatch—has the meaning given by subsection 832-200(2); and

(d) of a *hybrid payer mismatch—has the meaning given by subsection 832-315(2); and

(e) of a *reverse hybrid mismatch—has the meaning given by subsection 832-415(2); and

(f) of a *branch hybrid mismatch—has the meaning given by subsection 832-500(2); and

(g) of a *deducting hybrid mismatch—has the meaning given by subsection 832-585(2).

deduction/deduction mismatch has the meaning given by section 832-105.

deduction/non-inclusion mismatch has the meaning given by section 832-100.

Division 832 control group has the meaning given by section 832-205.

dual inclusion income has the meaning given by section 832-740.

foreign hybrid mismatch rules means a *foreign law corresponding to Division 832.

EXPOSURE DRAFT

-
- 1 *foreign income tax deduction* has the meaning given by
2 section 832-115.
- 3 *foreign tax period*, in relation to an entity, in relation to a foreign
4 tax imposed by a tax law of a foreign country, means the
5 accounting period used by the entity for the purposes of
6 determining the tax base under that law.
- 7 *hybrid financial instrument mismatch* has the meaning given by
8 section 832-200.
- 9 *hybrid mismatch* has the meaning given by sections 832-215,
10 832-230, 832-320, 832-420, 832-505, 832-585 and 832-665.
- 11 *hybrid payer* has the meaning given by section 832-330.
- 12 *hybrid payer mismatch* has the meaning given by section 832-315.
- 13 *imported hybrid mismatch* has the meaning given by
14 section 832-665.
- 15 *importing payment*, in relation to an *offshore hybrid mismatch,
16 has the meaning given by section 832-670.
- 17 *liable entity* has the meaning given by section 832-335.
- 18 *offshore hybrid mismatch* has the meaning given by
19 sections 832-195, 832-310, 832-410, 832-495 and 832-580.
- 20 *party*, in relation to a *structured arrangement, has the meaning
21 given by subsection 832-210(3).
- 22 *reverse hybrid* has the meaning given by section 832-430.
- 23 *reverse hybrid mismatch* has the meaning given by
24 section 832-415.
- 25 *structured arrangement* has the meaning given by
26 section 832-210.
- 27 *subject to Australian income tax* has the meaning given by
28 section 832-120.
- 29 *subject to foreign income tax* has the meaning given by
30 section 832-125.
-

EXPOSURE DRAFT

1 **Part 3—Application and transitional provisions**

2

Application and transitional provisions to be included here.

EXPOSURE DRAFT

Schedule 2—Other effects of foreign income tax deductions

Part 1—Denial of imputation benefits

Income Tax Assessment Act 1997

1 After paragraph 207-145(1)(da)

Insert:

(db) the distribution is one to which section 207-158 (which is about foreign income tax deductions) applies;

2 After paragraph 207-150(1)(ea)

Insert:

(eb) the distribution is one to which section 207-158 (which is about foreign income tax deductions) applies;

3 After section 207-157

Insert:

207-158 Distributions entitled to a foreign income tax deduction

This section applies to a distribution if all or part of the distribution gives rise to a *foreign income tax deduction.

EXPOSURE DRAFT

1 **Part 2—Foreign equity distributions**

2 *Income Tax Assessment Act 1936*

3 **4 Section 404**

4 Before “For”, insert “(1)”.

5 **5 At the end of section 404**

6 Add:

7 (2) For the purpose of applying this Act in calculating the attributable
8 income of the eligible CFC, disregard paragraph 768-5(1)(d) of the
9 *Income Tax Assessment Act 1997* if:

- 10 (a) the eligible CFC receives, either directly or indirectly through
11 one or more interposed trusts or partnerships, a foreign equity
12 distribution (within the meaning of the *Income Tax*
13 *Assessment Act 1997*) from a company; and
14 (b) at the time the distribution is made, both the eligible CFC and
15 the company are residents of the same listed country or
16 unlisted country.

17 *Income Tax Assessment Act 1997*

18 **6 At the end of subsection 768-5(1)**

19 Add:

20 ; and (d) the distribution is not one to which section 768-7 (which is
21 about foreign income tax deductions) applies.

22 **7 At the end of subsection 768-5(2)**

23 Add:

24 ; and (f) the distribution is not one to which section 768-7 (which is
25 about foreign income tax deductions) applies.

26 **8 After section 768-5**

27 Insert:

EXPOSURE DRAFT

768-7 Foreign equity distributions entitled to a foreign income tax deduction

- (1) This section applies to a *foreign equity distribution if:
- (a) all or part of the distribution gives rise to a *foreign income tax deduction; and
 - (b) the exception in subsection (2) does not apply to the distribution.

Exception for foreign corporate collective investment vehicles

- (2) This subsection applies to a *foreign equity distribution if:
- (a) the *foreign income tax deduction arises because the company that made the distribution is recognised under the law of the foreign country in which the deduction arises as being used for collective investment; and
 - (b) *foreign income tax or a withholding-type tax was payable in respect of the distribution.

EXPOSURE DRAFT

1 **Part 3—Application**

2 **9 Application—general**

- 3 (1) The amendments made by Part 1 of this Schedule apply in relation to
4 distributions made on or after the day that is 6 months after the day this
5 Act receives the Royal Assent.
- 6 (2) The amendments made by Part 2 of this Schedule apply in relation to
7 foreign equity distributions made on or after the day that is 6 months
8 after the day this Act receives the Royal Assent.

9 **10 Application—regulatory capital**

- 10 (1) Subitem (2) applies if:
- 11 (a) before 9 May 2017, any of the following occurred:
- 12 (i) an ADI issued an Additional Tier 1 capital instrument
13 (within the meaning of the prudential standards
14 determined by APRA under section 11AF of the
15 *Banking Act 1959* and as in force at the time this
16 Schedule commences);
- 17 (ii) a general insurance company issued an Additional Tier
18 1 capital instrument (within the meaning of the
19 prudential standards determined by APRA under
20 section 32 of the *Insurance Act 1973* and as in force at
21 the time this Schedule commences);
- 22 (iii) a life insurance company issued an Additional Tier 1
23 capital instrument (within the meaning of the prudential
24 standards determined by APRA under section 230A of
25 the *Life Insurance Act 1995* and as in force at the time
26 this Schedule commences); and
- 27 (b) the instrument is callable, and there is a scheduled call date
28 of the instrument on or after 9 May 2017.
- 29 (2) Despite subitem 9(1), the amendments made by Part 1 of this Schedule
30 do not apply in relation to distributions on the instrument that are made
31 on or before the first scheduled call date of the instrument that occurs
32 on or after 9 May 2017.
- 33