



Australian Private Equity & Venture Capital Association Limited

22 December 2017

The Manager
Base Erosion and Profit Shifting Unit
Corporate and Income Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: BEPS@treasury.gov.au

Dear Sir/Madam,

Implementing the OECD Hybrid Mismatch Rules

The Australian Private Equity and Venture Capital Association Limited (AVCAL) welcomes the opportunity to comment on the Government's efforts to implement, via domestic legislation, the OECD rules aimed at eliminating double non-taxation benefits from hybrid mismatch arrangements.

AVCAL represents the private equity (PE) and venture capital (VC) industry in Australia, which has a combined total of around \$30 billion in funds under management on behalf of domestic and overseas investors including Australian and offshore superannuation and pension funds, sovereign wealth funds, and family offices. PE and VC firms invest billions of dollars in early stage and established businesses spanning across almost every sector of our national economy. In the financial year ending 30 June 2017 alone, PE and VC invested around A\$3.6bn into Australian businesses.

A December 2017 study by Deloitte Access Economics provides some deeper insights into the economic contribution of PE including:

- In FY2016, private-equity backed businesses contributed **\$43 billion in total value** added to the Australian economy – equal to **2.6% of Australian GDP**;
- PE-backed businesses **supported 327,000 FTE jobs** (172,000 directly, and 155,000 indirectly);
- In FY2016, private equity-backed businesses added almost 20,000 FTE jobs, accounting for **11% of total Australian employment growth** in FY2016;
- PE-backed businesses typically delivered **annual revenue growth of 20%**, while boosting the size of their workforce by 24%;
- More than 85% of private-equity businesses introduced some type of process or product innovation in FY2016, far greater than the average profile of non-PE backed businesses.

AVCAL has for many years been supportive of reforms to our taxation system that help to ensure that our economy is competitive, and that encourage the growth and expansion of business. In respect of these proposed reforms however, we have some significant concerns.

Given PE funding structures often involve the use shareholder debt there is the potential for the industry, particularly foreign funds, to be negatively impacted by the proposed hybrid reforms if their scope is not appropriately circumscribed. Our key comments on the draft legislation are outlined below.

1. Comments on the draft legislation

On 24 November 2017, exposure draft legislation on the OECD hybrid mismatch rules together with a draft explanatory memorandum were released for consultation by the Treasury, following on from earlier Budget commitments (2016-17 and 2017-18) to implement the OECD recommendations.

The reforms are aimed at eliminating double non-taxation benefits from hybrid mismatch arrangements which exploit differences in the tax treatment of an entity or instrument under the laws of two or more tax jurisdictions.

Structured arrangement

Whilst AVCAL recognises the need to protect Australia's tax base and therefore supports the introduction of these integrity measures, we are however concerned that, based on the current drafting, the legislation could have a broader application than intended. In particular, the exposure draft and explanatory memorandum provide very little guidance on what will be considered a 'structured arrangement' – a key threshold for the rules' application.

Given PE funds typically contain 50 to 100+ investors, each with their own different tax profiles, often from a range of different countries, it will be almost impossible for Australian investee companies to understand whether shareholder loans give rise to a hybrid mismatch, and if so, the extent of the mismatch. As such, the definition of structured arrangement needs to be clarified to ensure such widely held arrangements are not captured by the rules, consistent with Recommendation 13.2 of the Board of Taxation's (BoT) report to the Treasurer on implementation of the OECD hybrid mismatch rules (March 2016).

In the BoT's report, it specifically recommended that the concept of a structured arrangement "be clearly defined in its scope and be well supported by guidance material to ensure taxpayers are able to easily assess whether their arrangements would be caught by the hybrid mismatch rules". The BoT also suggested that legislation and guidance should clarify that in general, widely held (or marketable) securities should not be captured by the definition of structured arrangement.

Deducting hybrid mismatch and common management company structures

AVCAL is also concerned that, based on the current drafting, the legislation could have a broader application than intended with respect to common management company structures, particularly for subsidiaries of US management companies. We have provided an example below and note that the structure described is likely to exist across a range of industries.

It is not uncommon for US management companies of private equity or venture capital funds to set up an Australian sub-advisory company as a wholly owned subsidiary which is disregarded for US tax purposes. Where this is the case, the Australian sub-advisory entity will typically incur various costs for the services it is performing, and will derive income for its services from its US parent company (determined under relevant transfer pricing principles).

This arrangement does not give rise to any actual hybrid outcomes as all of the income and all of the deductions associated with the management services are brought to account as assessable and deductible at the US management company level. However, under the current drafting of the legislation, this arrangement falls within the definition of a deducting hybrid mismatch (double deduction), and as a result, the deductions incurred by the Australian sub-advisory entity would be denied.

In our view, this would be an unintended outcome of the law as it would give rise to a double taxation outcome. Accordingly, we recommend that appropriate amendments are made to this draft legislation to ensure that unintended outcomes such as this do not arise. AVCAL will be deeply concerned if clarification to the draft legislation is not made before the reforms are introduced into Parliament next year.

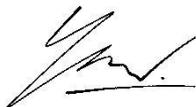
As a complementary measure, we note that the Government has indicated that it will also introduce a separate, targeted integrity measure aimed at counteracting arrangements which do not expressly qualify as "hybrid

mismatches” but which achieve similar results in substance. We look forward to taking part in that consultation process in due course.

2. Next steps

We would like to thank you for considering the views outlined in this submission, and would welcome the opportunity to have a dedicated discussion with Treasury on this matter. In the interim, please do not hesitate to contact either me or Christian Gergis, AVCAL Head of Policy & Research, on 02 8243 7000, if you have any queries.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Yasser El-Ansary', with a horizontal line underneath.

Yasser El-Ansary
Chief Executive