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AUSTRALIA + NEW ZEALAND

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Mr Greg Wood
Base Erosion and Profit Shifting Unit
Corporate and International Tax Division
Revenue Group
The Treasury
Langton Crescent
PARKES ACT 2600

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Dear Greg,

Implementing the OECD Hybrid Mismatch Rules

Chartered Accountants Australia and New Zealand welcomes the opportunity to make a submission on the exposure draft legislation to implement the Organisation for Economic Co-operation and Development (**OECD**) hybrid mismatch rules (**draft legislation**) and the accompanying draft explanatory memorandum (**draft EM**).

These materials were released by the Treasurer on 24 November 2017.

Chartered Accountants Australia and New Zealand

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Introductory comments

The OECD's hybrid mismatch rules were developed in response to Action 2 of the G20/OECD 15 point Action Plan to address Base Erosion and Profit Shifting (**BEPS**) by multinational groups. This culminated in the *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2, 2015 Final Report* (**OECD Action 2 Report**) which made recommendations in regard to domestic law changes (Part I) and tax treaty issues (Part II).

The draft legislation concerns Part I of the OECD Action 2 Report.

As explained in the draft EM, the OECD hybrid mismatch rules seek to prevent entities that are liable to income tax in Australia from exploiting differences between the tax treatment of entities and instruments across different jurisdictions to reduce income tax. This is achieved by 'neutralising' the tax advantage of a payment that gives rise to a deduction/non-inclusion mismatch or a deduction/deduction mismatch by including an amount as assessable income or disallowing a deduction.

The proposed amendments insert Division 832 into the Income Tax Assessment Act 1997 **(ITAA 1997**) and make other changes to disallow an exemption for foreign equity distributions (Division 768-A of the ITAA 1997) where the distribution gave rise to a deduction and denial of imputation benefits in some circumstances. .

The draft EM notes that there are some departures in the draft legislation from the OECD's recommendations that were put forward by the Board of Taxation in its March 2016 Report on the implementation of the OECD hybrid mismatch rules (**BoT Report**). This is to allow for "unique features of the Australian tax system that were not specifically contemplated by the OECD recommendations" (paragraph 1.14 of the draft EM).

We support this approach.

Date of effect

The commencement information of the draft legislation (page 1) states that this is to be the first 1 January, 1 April, 1 July or 1 October to occur after the day the legislation receives the royal assent. On the other hand, *Schedule 2 - Other measures* applies in relation to equity distributions made 6 months after the day the legislation receives the Royal Assent.

In our view, it would be preferable for the commencement date to be the first day of a quarter 6 months after Royal Assent. As acknowledged by the government, there needs to be a 6 month lead time. Adopting the next quarter makes the date more likely to coincide with accounting and reporting periods.

In *addition* to the 6 month lead-time, taxpayers would find it useful to align commencement time with the start of their next tax reporting period (refer discussion below).

Proposed integrity rule

When releasing the draft legislation on 24 November 2017, the Treasurer announced that the government would be developing a targeted integrity rule to ensure that the hybrid mismatch rules could not be circumvented by arrangements achieving double non-taxation outcomes.

As the integrity rule will apply from the same date as the general hybrid mismatch rules, we urge Treasury to consult with the tax community on the development of an appropriately targeted integrity rule as a matter of urgency.

This is important as taxpayers in scope of the hybrid mismatch rules will, in all likelihood, be considering restructuring options to obviate otherwise detrimental outcomes (e.g. withholding taxes) once the rules come into effect. Such entities will want to ensure that they do not violate the integrity rule.

In turn the ATO will need to be in a position to be able to effectively administer the law as affected taxpayers may want to engage with it in relation to proposed reorganisations before the hybrid mismatch rules come into effect. Taxpayers may also wish to obtain ATO advice on whether prospective arrangements would or would not trigger the integrity rule.

In the Treasurer's media release, he also stated the government's intention to introduce the recommendations of the OECD's July 2017 report on *Neutralising the Effects of Branch Mismatch Arrangements* with effect from the same date as the general hybrid mismatch rules.

We have concerns that this will not allow adequate time for development and consultation with stakeholders in regard to legislation that will be complex. Our preference is for resources to be focused on developing the integrity rule, with the branch mismatch arrangements coming thereafter and having an effective date of 6 months after that legislation receives the Royal Assent.

Imported mismatch rule

As recognised by the Board in its report (paragraphs 3.66 - 3.74), the imported mismatch rule could present considerable compliance challenges for taxpayers as well as administrative challenges for the ATO.

That is why the Board recommended that possible measures to reduce uncertainty and compliance costs whilst retaining an appropriate level of integrity should be investigated.

The imported mismatch rule in the draft legislation is certainly difficult to understand, let alone comply with, and the draft EM is of no value in determining its potential scope in a practical sense.

In our view, one such measure would be to delay introduction of the imported mismatch rule until all European Union member states have adopted hybrid mismatch rules. This is to be by 1 January 2020 (paragraph 1.16 of the draft EM).

If our submission is not accepted, we agree with the Board of Taxation's observation[1] that consideration should be given to a de minimis test or safe harbour, if only on a transitional basis. A detailed ATO Law Companion Guide (**LCG**) will also be necessary, and time is required for a suitable LCG to be developed and consulted upon (see further comments below).

Other issues

There are a number of other important points that Chartered Accountants ANZ wishes to make.

- In our view, consideration should be given to including in the legislation and/or EM a clear statement of policy intent. This would assist both taxpayers and the ATO in assessing what might be considered an appropriate restructure versus what is an inappropriate one.

- The draft legislation (Schedules 1 and 2) and EM do not discuss interactions with Australia's other international tax provisions – such as foreign source income rules (i.e. CFCs), forex as well as withholding taxes.

- It would be very helpful if more examples could be included in the EM. For a piece of legislation this complex with many new concepts, there are only eleven worked examples in the draft EM. Some examples could be drawn or adapted from the OECD Action 2 Report (e.g. leasing) and guidance being developed in other jurisdictions. Our preference is for examples to be in the EM rather than having to be developed later by the ATO.

ATO guidance

The ATO will be called upon to produce strong, clear and prompt guidance concerning the hybrid mismatch rules.

Indeed the Board of Taxation recommended that the Commissioner provide detailed administrative guidance contemporaneously with the introduction of the hybrid mismatch legislation.[2]

We are pleased to see that the ATO is in the process of developing guidance materials including a LCG and a Practical Compliance Guideline (PCG) to address practical implications of the law.[3] This will include ATO guidance on:

- Structured arrangements;
- The imported mismatch rule; and
- The application of Part IVA to restructures to avoid the application of the hybrid mismatch rules.

We note however that the development of ATO guidance on this topic may be a drawn out process if overseas experience is anything to go by. In the United Kingdom, HMRC's guidance

[1] Paragraph 3.74 of BoT Report.
[2] Recommendation 16 of the BoT Report.
[3] https://www.ato.gov.au/general/new-legislation/in-detail/other-topics/international/implementation-of-the-oecd-hybrid-mismatch-rules/ (Accessed 19 December 2017)

has been in draft form since December 2016 (updated in March 2017), in a document which is *390 pages long*[4].

Post-implementation review

Given the complexity of the hybrid mismatch rules, including by their very nature involving cross border tax interactions, we think the Second Reading Speech should flag the need for a post implementation review of the hybrid legislation, as recommended by the Board of Taxation[5].

Again, this is borne out by the UK experience, where the hybrid mismatch rules have already undergone amendment[6].

A post-implementation review is also warranted because Australia will be a relatively early adopter of the hybrid mismatch rules and opportunities for harmonization between different jurisdictions may come to light as more countries introduce hybrid mismatch rules.

Conversely, the non-adoption of such rules by other nations (or countries embrace tax policies designed to advance national interests ahead of global collaboration) may undermine the policy intent of the Australian legislation.

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Should you have any queries concerning the matters discussed in our submission, or wish to discuss them in further detail, please contact me via email at: michael.croker@charteredaccountantsanz.com or telephone (02) 9290 5609.

Yours sincerely

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[4] https://www.gov.uk/government/consultations/hybrid-and-other-mismatches-draft-guidance (Accessed 8 January 2018)
[5] Recommendation 17 of the BoT Report.
[6] https://www.gov.uk/government/publications/corporation-tax-amendments-to-the-hybrid-and-other-mismatches-regime/corporation-tax-amendments-to-the-hybrid-and-other-mismatches-regime (Accessed 8 January 2018)