

PCG 2021/5 - Imported hybrid mismatch rule - ATO's compliance approach

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⚠ There is a Compendium for this document: **PCG 2021/5EC** .



Practical Compliance Guideline

Imported hybrid mismatch rule – ATO's compliance approach

📌 Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. This Guideline contains practical guidance as to the ATO's assessment of the relative levels of tax compliance risk associated with hybrid mismatches addressed by Subdivision 832-H of the *Income Tax Assessment Act 1997*.¹ This Guideline does not deal with the core hybrid mismatch rules in Subdivisions 832-C to 832-G, which must be considered prior to the application of Subdivision 832-H.²
2. This Guideline sets out the expectations regarding the Commissioner's assessment of risk in connection with the imported hybrid mismatch rules, including the Commissioner's approach to reviewing whether a taxpayer has undertaken reasonable enquiries in relation to the rules for non-structured arrangements.³ This includes the level of supporting information the Commissioner requires in order to demonstrate compliance in connection with non-structured arrangements and will also assist you to prepare for any compliance reviews. This Guideline also explains what it means for a payment to be made directly and indirectly to an offshore deducting entity.
3. This Guideline does not limit the operation of the law, and it does not replace, alter or affect our interpretation of the law in any way. It does not relieve you of your legal obligation to comply with all relevant tax laws.

¹ All legislative references in this Guideline are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

² One of the requirements for a payment to give rise to an imported hybrid mismatch is that the payment gives rise to a hybrid mismatch under section 832-620. Subsection 832-620(2) provides that a payment does not give rise to a hybrid mismatch, under section 832-620, if the payment gives rise to a hybrid financial instrument mismatch (Subdivision 832-C), a hybrid payer mismatch (Subdivision 832-D), a reverse hybrid mismatch (Subdivision 832-E), a branch hybrid mismatch (Subdivision 832-F) or a deducting hybrid mismatch (Subdivision 832-G).

³ In this Guideline, non-structured arrangements refers to a hybrid mismatch under section 832-620 where table item 1 of subsection 832-615(2) does not apply, but table items 2 or 3 of subsection 832-615(2) apply to the importing payment.

Date of effect

4. This Guideline applies both before and after its date of issue.⁴
5. This Guideline will be under continuous review for two years from its date of issue.

Overview of the imported hybrid mismatch rule

6. Subdivision 832-H was enacted to implement recommendation 8 of the Organisation for Economic Co-operation and Development (OECD) Action 2 Final Report and recommendation 5 of the OECD Branch Mismatch Arrangements Report.⁵ As stated in the OECD's Action 2 Final Report, the policy behind the imported hybrid mismatch rule is to prevent taxpayers from entering into structured arrangements or other arrangements with group members that shift the effect of an offshore hybrid mismatch into the domestic jurisdiction through the use of a non-hybrid instruments such as an ordinary loan.⁶

7. The imported hybrid mismatch rule operates to disallow deductions for a range of payments (including interest, royalties, rents, payments for the purchase of goods and payments for services) if the income from such payments is set-off, directly or indirectly, against a deduction that arises under a hybrid mismatch arrangement in an offshore jurisdiction.⁷

8. The key objective of the imported hybrid mismatch rule is to maintain the integrity of the other hybrid mismatch rules by removing any incentive for multinational groups to enter into hybrid mismatch arrangements.⁸

9. Where the rules may have application to a taxpayer's arrangements, it will create compliance obligations for taxpayers and their controllers as they are required to obtain sufficient information to identify and assess the expected tax treatment of instruments or entities in a foreign counterparty jurisdiction. However, the measure is limited to arrangements involving members of the taxpayer's Division 832 control group or payments made under a structured arrangement to which the taxpayer is a party.

10. Taxpayers, and their Division 832 control groups, may look to mitigate the cost of compliance by endeavouring to eliminate hybrid mismatch arrangements, including offshore hybrid arrangements, to which Division 832 could apply. Refer to Practical Compliance Guideline PCG 2018/7 *Part IVA of the Income Tax Assessment Act 1936 and restructures of hybrid mismatch arrangements* for the Commissioner's compliance approach to the application of Part IVA of the *Income Tax Assessment Act 1936* and certain restructures of hybrid mismatch arrangements.⁹

⁴ The imported hybrid mismatch rule applies to importing payments made under structured arrangements that are covered by table item 1 of subsection 832-615(2) for income years that commenced on or after 1 January 2019. For importing payments made directly or indirectly to an offshore deducting entity that are covered by table items 2 or 3 of subsection 832-615(2), the imported hybrid mismatch rule applies for income years that commenced on or after 1 January 2020.

⁵ Paragraph 1.322 of the Revised Explanatory Memorandum to the Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018 (the EM).

⁶ OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, paragraph 234.

⁷ Paragraph 1.324 of the EM.

⁸ Paragraph 1.323 of the EM.

⁹ Excluding the provisions that extended the operation of Part IVA of the *Income Tax Assessment Act 1936* to include the Diverted Profits Tax and the Multinational Anti-Avoidance Law (refer to paragraph 1 of PCG 2018/7).

Importing payments made under a structured arrangement to which the taxpayer is a party

11. For a payment to give rise to a hybrid mismatch under a structured arrangement, the hybrid mismatch must be priced into the terms of the scheme under which the payment is made or it is reasonable to conclude that the hybrid mismatch is a design feature of a scheme under which the payment is made.¹⁰

12. If a taxpayer makes an importing payment under a structured arrangement covered under table item 1 of subsection 832-615(2)¹¹, that taxpayer will be a party to the structured arrangement. It is therefore considered that the taxpayer will have all relevant information necessary (or will be able to obtain that relevant information from the other parties to that structured arrangement)¹² to apply the imported hybrid mismatch rule, and to correctly disallow deductions under section 832-610.

13. Where members of the taxpayer's Division 832 control group are also party to the structured arrangement and the taxpayer does not already possess all the relevant information to apply Subdivision 832-H, the relevant members of the taxpayer's Division 832 control group are expected to provide the taxpayer with any information necessary to calculate the amounts of the importing payments and importing deductions. This is included in the evidence the taxpayer would be expected to have to demonstrate that the offshore hybrid mismatch under the structured arrangements has been neutralised (refer to the Appendix to this Guideline).

Payments made directly or indirectly to an offshore deducting entity

14. For the purpose of identifying importing payments and calculating the amount of any importing deduction, a payment will have been made directly to an offshore deducting entity if the taxpayer has made any deductible payments to the offshore deducting entity. Similarly, a payment will have been made indirectly to an offshore deducting entity if the taxpayer makes a deductible payment to a member of its Division 832 control group and payments have been made by each interposed entity to an offshore deducting entity or to another interposed entity.

15. In determining whether there are any payments that have been made directly or indirectly to the offshore deducting entity, it is sufficient that payments exist between each interposed entity, and it is not necessary to demonstrate that each payment in a series of payments funds the next payment, or is made after the previous payment.¹³

Example 1 – payments made indirectly via an interposed entity

16. *Aus Co, B Co and C Co are members of a Division 832 control group.*

17. *On 30 June 2010, C Co granted B Co a license for the use of C Co's intellectual property. In carrying out its business, Aus Co does not use any of C Co's intellectual property.*

¹⁰ Refer to subsection 832-210(1) for the meaning of a structured arrangement.

¹¹ For a payment to be an importing payment that is made under a structured arrangement that is covered by table item 1 in subsection 832-615(2), the taxpayer must be a party to the structured arrangement pursuant to subsection 832-210(3). The meaning of 'party to a structured arrangement' is explained at paragraphs 37 to 43 of Law Companion Ruling LCR 2019/3 *OECD hybrid mismatch rules – concept of structured arrangement* and paragraphs 29 to 35 of Practical Compliance Guideline PCG 2019/6 *OECD hybrid mismatch rules – concept of structured arrangement*.

¹² These other parties to the structured arrangement may or may not be members of the taxpayer's Division 832 control group.

¹³ Refer to paragraph 832-625(3)(a).

18. On 31 May 2019, B Co borrows money from external bank lenders. On the same day, B Co on lends the money to Aus Co on back-to-back terms for the purpose of financing the construction of a manufacturing plant.

19. During the 2022 income year:

- Aus Co made a \$200 deductible interest payment to B Co on 31 May 2022
- B Co made a \$200 deductible interest payment to external third-party lenders on 31 May 2022
- B Co made a \$50 deductible royalty payment to C Co on 15 February 2022.

20. In this case, it would be identified for the purpose of section 832-625 that Aus Co will have made a payment indirectly to C Co.

Taxpayer's obligation in respect of the imported hybrid mismatch rule for non-structured arrangements

21. Where a taxpayer seeks a deduction for a cross-border payment made to a member of its Division 832 control group¹⁴ they need to consider the imported hybrid mismatch rule in Subdivision 832-H. For a taxpayer to be satisfied that they are entitled to deductions for cross-border payments that they make to members of its Division 832 control group, the taxpayer must determine whether any of their cross-border payments result in an offshore hybrid mismatch being directly or indirectly imported into Australia.

22. In relation to non-structured arrangements, the Commissioner expects that the taxpayer would document their enquiries and obtain the information prior to lodgment of the income tax return. This documentation would therefore be capable of being provided to the Commissioner within a reasonable time of a request being made.

23. The Commissioner also expects that the members of the taxpayer's Division 832 control group will provide the taxpayer with full and complete disclosure of all relevant information.¹⁵ The Division 832 control group should have robust processes in place to identify any relevant hybrid mismatch outcomes and inform the taxpayer accordingly.

24. A taxpayer should not claim a deduction for a payment unless they are able to obtain sufficient information to support a conclusion that the deduction in respect of the payment is not disallowed under Subdivision 832-H. Where the taxpayer later obtains further information that confirms entitlement to a deduction for that payment, they can lodge an amendment request to claim the deduction.

The ATO's compliance approach for non-structured arrangements

25. The ATO's compliance approach will be based on reviewing the extent to which taxpayers have obtained information to establish that the imported hybrid mismatch rule

¹⁴ Division 832 control group has the meaning given by section 832-205. In certain circumstances, a taxpayer may be a member of more than one Division 832 control group. A reference in this Guideline to a Division 832 control group (or the taxpayer's Division 832 control group) should be read as being a reference to any Division 832 control group which the taxpayer is a member of.

¹⁵ In certain circumstances, information on the expected tax treatment of an entity (or entities) outside of a taxpayer's control group may be required. In that case, information should be requested from the relevant control group members that are party to the arrangement. For example, if a member of your Division 832 control group (the issuing entity) has entered into a hybrid financing instrument with a third party under a structured arrangement, it would be expected that the issuing entity would obtain any necessary information from the third party.

does not apply to their circumstances, or that they have correctly 'neutralised' any imported hybrid mismatch in respect of non-structured arrangements. The relevant information includes the adequate and complete responses to written enquiries to suitably qualified and responsible individuals or representatives, in accordance with this Guideline.

The ATO's approach to shortfall penalties for non-structured arrangements

26. The Commissioner will consider that a taxpayer has taken reasonable care to comply with their income tax obligations relating to the imported hybrid mismatch rule for non-structured arrangements when the taxpayer follows the ATO's recommended approach to making enquiries (including obtaining responses to the requested information and the taxpayer has no reasonable basis to consider that the information obtained is not adequate and complete).

27. In all other circumstances, the Commissioner will assess the circumstances that resulted in tax shortfall on a case-by-case basis based on the taxpayer's individual circumstances.¹⁶ A taxpayer should not just assume that responses to requested information are adequate and complete. For example, if at the time the statement was made to the Commissioner there is information known, or that should have been known, by the taxpayer or their agent, and the failure to consider that information results in a tax shortfall, the Commissioner considers that a taxpayer will generally not be able to demonstrate they took reasonable care. Similarly, if a member of a taxpayer's Division 832 control group has deliberately withheld information from the taxpayer or deliberately provided the taxpayer with false or misleading information, the taxpayer will need to demonstrate that they had no reasonable way of knowing that the relevant information was withheld or was false or misleading (as relevant).

28. In addition, the Commissioner considers that a taxpayer will generally not be able to demonstrate they took reasonable care if:

- (a) they claim a deduction for a cross-border payment to a member of their Division 832 control group
- (b) they have not made enquiries or have not received adequate and complete responses from the responsible qualified individuals, and
- (c) it is subsequently determined that the payment has resulted in an imported hybrid mismatch.

29. A taxpayer that the Commissioner treats as having taken reasonable care in respect of the imported hybrid mismatch rule could still be liable to a:

- (a) statement penalty if the taxpayer has a shortfall amount that resulted from the taxpayer adopting a position that was not reasonably arguable¹⁷, or
- (b) scheme penalty if a scheme was entered into for the sole or dominant purpose of obtaining a scheme benefit from the scheme.

¹⁶ See Miscellaneous Taxation Ruling MT 2008/1 *Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard* and Law Administration Practice Statement PS LA 2012/5 *Administration of the false or misleading statement penalty – where there is a shortfall amount*.

¹⁷ See Miscellaneous Taxation Ruling MT 2008/2 *Shortfall penalties: administrative penalty for taking a position that is not reasonably arguable*.

The ATO's recommended approach to demonstrating that reasonable enquiries have been undertaken for non-structured arrangements

30. The ATO's recommended approach to undertaking enquiries for non-structured arrangements involves the taxpayer making and documenting formal requests for information and the adequate and complete responses. Taxpayers need to make requests to the responsible individuals or suitably qualified representatives responsible for the relevant Division 832 control group.¹⁸

31. This could be achieved by reviewing the:

- (a) Division 832 control group to identify whether the group has any mismatch outcomes and determining whether any identified mismatch outcomes are offshore hybrid mismatches subject to Subdivision 832-H, and are being imported into Australia (referred to in this Guideline as a 'top-down' approach)
- (b) cross-border payments made by the taxpayer to members of the Division 832 control group to determine if these payments are directly or indirectly importing any offshore hybrid mismatches (referred to in this Guideline as a 'bottom-up' approach), or
- (c) a combination of both the top-down and bottom-up approach.

32. For taxpayers to be considered to have followed the ATO's recommended approach, they are not required to follow the steps in the order specified in the methods in paragraphs 39 and 41 of this Guideline, as long as the outcome of the enquiries provides sufficient evidence to demonstrate compliance with the imported hybrid mismatch rule.

33. The Appendix to this Guideline sets out the information the Commissioner considers may be relevant to demonstrating compliance with the imported hybrid mismatch rule. It is intended as a general guide for your enquiries and is not an exhaustive list.

34. The information listed in the Appendix to this Guideline may be requested when we are assessing risk during engagement or assurance activity.

Example 2 – followed the ATO approach

35. *Aus Co is a subsidiary of US Inc. The tax manager of Aus Co requests the head of tax for US Inc to provide the information described in Category 1 in the Appendix to this Guideline.*

36. *Based on the information provided, the tax manager identifies:*

- *Foreign Co is a wholly-owned subsidiary of US Inc*
- *Foreign Co is a taxable entity in its country of incorporation*
- *US Inc has elected to treat Foreign Co as a disregarded entity for US income tax purposes*
- *US Inc is a taxable entity for US tax purposes*
- *under US tax law, the income received by Foreign Co for the relevant income years exceeds its allowable deductions, and*

¹⁸ For Australian-headquartered Division 832 control groups where the appropriate responsible individual or suitable representative within the relevant Division 832 control group is located in Australia (for example, the Public Officer of the taxpayer), an internal file note of the relevant information and positions adopted (including justification) will be sufficient.

- *payments made by Foreign Co to third parties result in a deduction for Foreign Co in its country of incorporation and for US Inc in the United States of America.*

37. *The tax manager concludes that to the extent that payments made by Foreign Co may result in a deduction/deduction mismatch, the neutralising amount for any offshore hybrid mismatch will be nil. As a consequence, the tax manager concludes that payments made by Aus Co to Foreign Co (either directly or indirectly) cannot be importing payments.*

The ATO's recommended approach for non-structured arrangements – top-down

Suitably qualified or responsible individuals

38. The appropriately qualified responsible individuals or suitably qualified representatives within the relevant Division 832 control group (the Group) must include the person primarily responsible for the Group's tax obligations, such as the Head of Tax for the Group, and may also include other appropriate qualified responsible individuals or suitably qualified representatives¹⁹; for example:

- (a) the person responsible for taxation for the jurisdictions where the related-party transactions have occurred (that is, country or regional tax manager), or
- (b) representatives of the Group's finance and treasury team, company secretary, representatives of the Group's legal team or the individuals with responsibility for these functions.

Method

39. For a taxpayer to be considered to have followed the ATO's recommended approach for making enquiries for the purposes of this Guideline, the person responsible for preparing the taxpayer's Australian income tax return should undertake the following steps²⁰:

Step 1 – obtain the core information from the Head of Tax

Request that the person primarily responsible for the Group's tax obligations provide information necessary to identify and advise of any payments by members of the Division 832 control group result in a deduction/non-inclusion²¹ or deduction/deduction²² outcome.

Step 2 – filter information by local tax manager

Determine whether any of the mismatches identified at Step 1 of this paragraph are:

- covered by a relevant foreign hybrid mismatch rule in another jurisdiction pertaining to the identified mismatch outcome, or

¹⁹ A reference to the Head of Tax in this guideline also includes qualified responsible individuals or qualified representatives.

²⁰ As per paragraph 32 of this Guideline, taxpayers are not required to follow the steps in the order specified, as long as the outcome of the enquiries provides sufficient evidence to demonstrate compliance with the imported hybrid mismatch rule.

²¹ Refer to section 832-105.

²² Refer to section 832-110.

- not a hybrid mismatch for the purpose of Division 832 (for example, the mismatch outcome fails the relevant hybrid requirement).

Step 3 – quantify the offshore hybrid mismatch

Obtain further information necessary to determine if the mismatch outcomes identified at Step 1 of this paragraph (and not excluded at Step 2 of this paragraph) result in there being an amount of a hybrid mismatch that is not fully offset by dual inclusion income²³ in the relevant foreign countries.

Step 4 – identify any interposing payments and quantify the imported mismatch

- Obtain further information on deductible transactions between any members of the Division 832 control group that are necessary to determine whether the taxpayer has made an indirect importing payment²⁴ and, if so, the calculation of the amount of the imported hybrid mismatch under section 832-630.
- Based on the information obtained, the person responsible for preparing the Australian income tax return should identify if any of the interposed entities are resident in a jurisdiction that has corresponding hybrid mismatch rules and, if so, also the basis for reaching that conclusion.

The ATO's recommended approach for non-structured arrangements – bottom-up

Suitably qualified or responsible individuals

40. The appropriately qualified responsible individuals or suitably qualified representatives within the relevant Division 832 control group may include the persons responsible for the taxation obligations for the applicable jurisdictions where the cross-border transactions have been paid and received (that is, country or regional tax manager or suitably qualified advisors within the Division 832 control group).

Method

41. For a taxpayer to be considered to have followed the ATO's recommended approach for making enquiries for the purposes of this Guideline, the person responsible for preparing the taxpayer's Australian income tax return should undertake the following steps²⁵:

Step 1 – identify all potential importing payments

Identify all payments or provision of non-cash benefits²⁶ made to non-resident members of the taxpayer's Division 832 control group (the direct tested entity) that would otherwise result in a deduction in the current income year and do not give rise to a hybrid mismatch that is addressed by Subdivisions 832-C to 832-G.

Step 2 – identify mismatch outcomes for the direct tested entities

- For each recipient of a payment identified at Step 1 of this paragraph, request the person responsible for the taxation affairs for the applicable

²³ Refer to section 832-680.

²⁴ Refer to section 832-625. Direct importing payments would be identified by reviewing otherwise deductible payments made by the taxpayer directly to an entity that has made a payment under an offshore hybrid arrangement.

²⁵ As per paragraph 32 of this Guideline, taxpayers are not required to follow the steps in the order specified in paragraph 41 of this Guideline, as long as the outcome of the enquiries provides sufficient evidence to demonstrate compliance with the imported hybrid mismatch rule.

²⁶ Refer to section 832-15.

jurisdictions to provide information necessary to identify and advise if any payments made by those entities result in a deduction/non-inclusion²⁷ or deduction/deduction²⁸ outcome (refer to Category 1 in the Appendix to this Guideline).

- For each mismatch outcome identified, determine if that payment was covered by a relevant foreign hybrid mismatch rule in another jurisdiction and, if so, document the basis for reaching that conclusion.
- For each offshore hybrid mismatch that is not covered by foreign hybrid mismatch rules, request that the person responsible for the taxation obligations in the applicable jurisdictions provide further information necessary to determine if the mismatch outcomes identified results in there being an amount of a hybrid mismatch that is not fully offset by dual inclusion income²⁹ in the relevant foreign countries (refer to Category 2 in the Appendix to this Guideline).

Step 3 – identify potential interposed payments made by direct tested entities

- Identify if any of the direct tested entities reside in a jurisdiction that has foreign hybrid mismatch rules and, if so, document the basis for reaching that conclusion.
- If the direct tested entities do not reside in a jurisdiction that has foreign hybrid mismatch rules, request that the person responsible for taxation obligations in the applicable jurisdictions provide details of all payments (or deemed payments)³⁰ or provision of non-cash benefits made by the relevant direct tested entity to other non-resident members of the Division 832 control group (the indirect tested entity) that result in a foreign tax deduction and do not result in a deduction/non-inclusion mismatch.

Step 4 – identify and follow payments

Repeat Steps 2 and 3 of this paragraph for each indirect tested entity identified at Step 3 of this paragraph that are not resident in a jurisdiction with foreign hybrid mismatch rules until you identify any payments that have been made to a foreign entity where those payments resulted in a foreign income tax deduction that is the deduction component of an offshore hybrid mismatch (in which case, payments from the taxpayer are likely to be indirectly funding the offshore hybrid mismatch), or until you have reviewed all relevant payments made by all indirect tested entities and you can demonstrate that none of those payments results in an offshore hybrid mismatch.

Foreign importing payments for non-structured arrangements

42. Where the amount of the imported hybrid mismatch is reduced as the result of the application of foreign hybrid mismatch rules in another jurisdiction (in either the current or

²⁷ Refer to section 832-105.

²⁸ Refer to section 832-110.

²⁹ Refer to section 832-680.

³⁰ The loss surrender and grouping relief rule in subsection 832-625(4) can deem an entity to have made a payment to another entity where certain requirements are met.

prior income years)³¹, the taxpayer should request that the person responsible for taxation obligations in the applicable jurisdictions provide in writing:

- (a) Details of the foreign importing payment³², including the
 - (i) identity of the payer and payee
 - (ii) amount and date of the payment
 - (iii) amount of deduction that would have otherwise been allowable in the relevant jurisdiction but for the operation of an imported mismatch rule in that jurisdiction
 - (iv) amount of deduction that was neutralised under the imported mismatch rule in that jurisdiction.
- (b) Details of any interposed payment, including the
 - (i) identity of the payer and payee
 - (ii) amount and date of payment
 - (iii) amount of the deduction and under which provision did the entitlement to the deduction arise.
- (c) If the foreign importing payment was treated as made under a structured arrangement³³, the reasons for reaching that conclusion.

Reliance on analysis undertaken in a foreign jurisdiction for non-structured arrangements

43. Other members of a Division 832 control group may have undertaken analysis based on the OECD principles or a foreign jurisdiction's equivalent of the imported hybrid mismatch rule. However, given each country's implementation of the rules and their statutory positions, the outcome of that analysis may not necessarily be consistent with the application of Subdivision 832-H.

44. The person responsible for preparing the Australian income tax return should review the analysis undertaken (including all working papers) to determine whether Subdivision 832-H results in a different outcome. It is not sufficient to only rely on the analysis performed for the other jurisdiction. The taxpayer must ensure that its obligations under Subdivision 832-H are met.

Example 3 – analysis of a corresponding foreign hybrid mismatch rules

- 45. *Head Co is resident in a country with corresponding foreign hybrid mismatch rules.*
- 46. *Head Co has three subsidiaries – Aus Co, B Co and C Co.*
- 47. *Head Co and Aus Co both make a payment to B Co.*
- 48. *B Co makes a payment to C Co.*

³¹ Where an offshore hybrid mismatch is not fully neutralised in an income year, the residual offshore hybrid mismatch is carried forward to subsequent income years (see section 832-635). In some circumstances, it may be necessary for a taxpayer to obtain information in respect of the application of foreign hybrid mismatch rules in prior years to ensure that the carry forward residual offshore hybrid mismatch has been correctly calculated.

³² 'Foreign importing payments' means an importing payment in relation to a foreign country covered by subparagraph 832-625(1)(a)(ii).

³³ As covered by table item 1 of subsection 832-615(2).

49. *Head Co reviews the payment it makes to B Co under its imported hybrid mismatch rule and concludes that the payment it made to B Co does not result in an imported hybrid mismatch.*

50. *The review undertaken by Head Co is not a sufficient basis to conclude that the payment made by Aus Co to B Co does not result in an imported hybrid mismatch under Division 832. Aus Co must consider if there are any differences between Division 832 and the corresponding foreign hybrid mismatch rule that may result in a different outcome.*

The risk assessment framework

51. The ATO's compliance approach varies with the risk rating of your international related-party dealings. The following principles will assist you to understand how we assess risk in relation to your related-party arrangements and generally allow you to self-assess your compliance risk.

52. If you are outside the low risk zone, we do not presume that your related-party arrangements fail to comply with the Australian tax law. However, where a taxpayer is outside a low risk zone, we consider that there is a greater risk that your related-party arrangements will give rise to inappropriate tax outcomes. In these cases, we are more likely to conduct some form of engagement and assurance activity to further test the taxation outcomes of your arrangements.

53. The ATO's imported hybrid mismatch rule risk framework is made up of seven risk zones, including two different red zones:

Risk zone	Risk level
White	Self-assessment of risk rating not necessary
Green	Low risk
Blue	Low-moderate risk
Yellow	Moderate risk
Amber	High risk
Red 1	Very high risk
Red 2	

Reporting your self-assessment

54. If you are required to complete a Reportable Tax Position (RTP) schedule, you may be asked to disclose:

- your self-assessed risk zone, or
- that you chose not to or could not self-assess your risk.

55. If you have undertaken the self-assessment of your risk zone and you satisfy the requirement for more than one risk zone, for the purposes of completing the RTP you would disclose the risk zone with the highest risk level.

Voluntary disclosure

56. We encourage willing and cooperative compliance and recognise that the publication of this Guideline may prompt you to review your arrangements for prior income years.

57. For the period of 18 months from the date of publication of this Guideline, we will consider reducing shortfall penalties and shortfall interest charge to the base rate if certain pre-conditions are met. The conditions are that you make a voluntary disclosure in relation to all income years where your arrangements are in place. If you do so, we will view this as a strong factor in favour of exercising the Commissioner's discretion to remit.³⁴

58. You can inform us of your intentions to make a voluntary disclosure in respect of your arrangements at any time before you are notified of the commencement of an audit.³⁵

Evidencing your self-assessment

59. We may, in the course of our ordinary engagement and assurance activities, or any specific assurance activity relating to this Guideline, fact-check your self-assessment of your risk zone. If you are unable to provide adequate evidence to support your assessment or the ATO disagrees with your assessment, we may undertake further engagement and assurance activity.

What you can expect given your risk zone

60. You can expect the following treatment depending on your risk zone.

Risk zone	ATO treatment
White	No review other than to confirm ongoing consistency with the agreed/determined approach.
Green	No review other than to confirm you have satisfied the necessary criteria to fall within the low risk zone.
Blue	Limited review to confirm that your arrangements are low to moderate risk.
Yellow	We may apply compliance resources to review your compliance methodologies and outcomes.
Amber	We are likely to apply compliance resources to review your compliance methodologies and outcomes and resolve any areas of difference.

³⁴ The Commissioner's guidelines on remission of shortfall penalties are relevantly set out in Law Administration Practice Statements PS LA 2012/5, PS LA 2012/4 *Administration of the false or misleading statement penalty – where there is no shortfall amount* and PS LA 2011/30 *Remission of administrative penalties relating to schemes imposed by subsection 284-145(1) of Schedule 1 to the Taxation Administration Act 1953*. The Commissioner's guidelines on remission of shortfall interest charge are set out in Law Administration Practice Statement PS LA 2006/8 *Remission of shortfall interest charge and general interest charge for shortfall periods*.

³⁵ For more information on how to make a voluntary disclosure, refer to: <https://www.ato.gov.au/Forms/Voluntary-disclosures-in-the-approved-form/>.

Red 1	<p>Reviews of your compliance methodologies and outcomes will be commenced as a matter of priority.</p> <p>Cases might proceed directly to audit.</p> <p>We are likely to use formal powers for information gathering.</p>
Red 2	<p>A continuous presence in this zone (that is, two or more years), is likely to result in the commencement of reviews of your compliance methodologies and outcomes as a matter of priority.</p>

The risk zones

Definitions

61. In this section:

- ‘ATO advice’ takes its meaning from Law Administration Practice Statement PS LA 2008/3 *Provision of advice and guidance by the ATO*.
- ‘ATO’s recommend approach’ means the reasonable enquiries described in paragraphs 30 to 44 of this Guideline.

Importing payments made under a structured arrangement

62. If you have either:

- (a) not made an importing payment made under a structured arrangement, or
- (b) have made a payment that is an importing payment under a structured arrangement and you have evidence to demonstrate that the offshore hybrid mismatches under the structured arrangements have been neutralised under section 832-610 or an equivalent provision of a foreign hybrid mismatch rule (or a combination of both),

proceed to paragraph 63 of this Guideline. Otherwise, you will be in red zone 1.

Reasonable enquiries for payments made to members of your Division 832 control group for non-structured arrangements

White zone

63. You are in the white zone if you are in any of the following categories:

- (a) You have self-assessed your risk rating and you do not consider that the assessment is reflective of your actual risk, and you have engaged with us and we are satisfied you are able to demonstrate that all your arrangements are not impacted by the imported hybrid mismatch rule.
- (b) You are subject to a pre-lodgment compliance review and the application of the imported hybrid mismatch rule has been reviewed and been assessed with a ‘low risk’ rating (or a ‘high assurance’ rating in relation to justified trust) in relation to the imported hybrid mismatch rule for all your relevant arrangements.
- (c) If you were in the white zone under subparagraphs 63(a) or (b) of this Guideline in either of the two preceding income years, you will be in the white zone for the current income year if you have reviewed the

circumstances of your Division 832 control group for the current income year and they have not materially changed.

Green zone

64. You are in the green zone if you are in any of the following categories:
- (a) You have followed the ATO's recommended approach and have made reasonable enquiries and received an adequate and complete response and based on that response you have sufficient evidence to demonstrate that
 - (i) there are no hybrid mismatches in your Division 832 control group
 - (ii) you have not made importing payments in respect of the offshore hybrid mismatches in your Division 832 control group, or
 - (iii) you have correctly disallowed any importing deductions under section 832-610 (including where the amount of deduction disallowed is nil; for example, there was a foreign importing payment with a higher priority).
 - (b) You were in the green zone under subparagraph 64(a) of this Guideline in either of the two preceding income years and you have reviewed the circumstances of your Division 832 control group for the current income year and they have not materially changed.
 - (c) You have received inadequate or incomplete responses to your reasonable enquiries, and, to the extent you do not have sufficient evidence to demonstrate that a payment made to members of your Division 832 control group does not result in an importing deduction, you have not claimed a deduction for that payment.
 - (d) The otherwise deductible payments you made to members of your Division 832 control group are less than \$2 million.

Blue zone

65. You are in the blue zone if you are in any of the following categories:
- (a) You have made reasonable enquiries based on the ATO's recommended approach (either top-down, bottom-up or a combination of both) and, as the result of the enquiries, have received evidence that demonstrates that at least 90% of the total payments made to members of your Division 832 control group under non-structured arrangements
 - (i) do not give rise to an imported hybrid mismatch³⁶, or
 - (ii) have been correctly neutralised under section 832-610 to the extent of the imported hybrid mismatch.
 - (b) You were in the blue zone under subparagraph 65(a) of this Guideline in either of the two preceding income years and you have reviewed the circumstances of your Division 832 control group for the current income year and they have not materially changed.

³⁶ Or the amount of the imported hybrid mismatch is nil.

Yellow zone

66. You are in the yellow zone if all of the following apply:
- (a) Your Division 832 control group has a global policy for managing the risk associated with the imported hybrid mismatches and that policy is wholly consistent with the OECD Action Item 2 Report.
 - (b) You have applied the global policy to your Australian economic group to determine the amount of deductions disallowed under section 832-610.
 - (c) The turnover of the Australian economic group is less than \$250 million.

Amber zone

67. You are in the amber zone if both of the following apply:
- (a) You have made reasonable enquiries and received an adequate and complete response and based on the information received you have sufficient evidence to demonstrate that you are complying with your obligations under the imported hybrid mismatch rule.
 - (b) In applying the imported hybrid mismatch rule you have adopted a position that is contrary to ATO advice (for example, LCR 2019/3).

Red zone 1

68. You are in red zone 1 if you are in any of the following categories:
- (a) You have made a payment that is an importing payment under a structured arrangement and you do not have sufficient evidence to demonstrate that all importing payments made under structured arrangements to which you are a party have been correctly neutralised under section 832-610.
 - (b) You satisfy the following requirements
 - (i) you have made a deductible payment to a member of your Division 832 control group
 - (ii) payments have been made by each interposed entity to an offshore deducting entity or to another interposed entity, and
 - (iii) you have treated the deducted payment as not being an importing payment under a structured arrangement³⁷ only because you take a position that the payment is treated as not made directly or indirectly³⁸ through one or more interposed entities³⁹, other than by reason of the operation of paragraph 832-625(3)(b).

³⁷ Within the meaning of table item 1 of subsection 832-615(2).

³⁸ Within the meaning of paragraph 832-625(1)(b).

³⁹ Under subsection 832-625(3), a requirement for an imported hybrid mismatch is that a payment is made directly or indirectly through one or more interposed entities to an offshore deducting entity.

Paragraph 832-625(3)(a) clarifies that:

it is sufficient if payments exist between each interposed entity, and it is not necessary to demonstrate that each payment in a series of payments funds the next payment, or is made after the previous payment ...

We are concerned about views being taken that a payment is not made indirectly through one or more interposed entities despite payments existing between the entities involved in the relevant sense.

Red zone 2

69. You will be in red zone 2 if you have made a deductible payment to a member of your Division 832 control group, you have claimed the deduction and you do not fit into any of the other risk zones. This includes where you have sought information from your Division 832 control group and have received insufficient information to determine the application of the imported hybrid mismatch rule to your circumstances.

Commissioner of Taxation

16 December 2021

Appendix – Information guide

70. This Appendix sets out the categories of information the Commissioner considers may be relevant to demonstrating compliance with the imported hybrid mismatch rule at Steps 1, 3 and 4 of the top-down approach (described at paragraph 38 of this Guideline) applicable to non-structured arrangements. The information in Category 1 and Category 3 of this Appendix may also be relevant for applying the bottom-up approach (described at paragraph 40 of this Guideline) applicable to non-structured arrangements. It is intended as a general guide for your enquiries and is not an exhaustive list.

71. The information listed in this Appendix may be requested when we are assessing risk during engagement or assurance activity.

Category 1 – obtain the core information from the Head of Tax

72. The person responsible for preparing the Australian income tax return should request the person primarily responsible for the Group's tax obligations to provide the information necessary to identify any payments made by members of the Division 832 control group that result in a deduction/non-inclusion mismatch or deduction/deduction mismatch.

73. The information requested should include:

Group information

- (a) a list of all entities that are members of each Division 832 control group that the taxpayer is a member of, and the
 - (i) shareholders/members of those entities
 - (ii) jurisdiction of formation (for example, place of incorporation) of those entities, and
 - (iii) tax residency of those entities
- (b) a description of the process undertaken to identify any mismatch outcomes (either deduction/non-inclusion or deduction/deduction mismatches).

Deduction/non-inclusion mismatches

- (c) identification of all payments made by a member of a Division 832 control group to another member where
 - (i) it resulted in an entitlement for a foreign income tax deduction for an entity in a foreign tax period that ended during the tested income year⁴⁰, and
 - (ii) the payment was not wholly included in the tax base of an entity in a foreign country (broadly, the foreign equivalent of assessable income) in any jurisdiction.

⁴⁰ For example, if a taxpayer is preparing an Australian income tax return for the year ended 30 June 2022, it is necessary to consider foreign income tax deductions in a foreign tax period that ended anytime between 1 July 2021 and 30 June 2022.

- (d) for each payment identified at subparagraph 73(c) of this Guideline, provide all information necessary to determine whether the identified mismatch is an offshore hybrid mismatch. This should include
- (i) a description of the nature of the payments (for example, interest, royalty or cost of goods sold)
 - (ii) the entity that made the payments (the Payer)
 - (iii) the entity that received the payments (the Recipient)
 - (iv) the amount of payments that result in a foreign income tax deduction during a foreign tax period that ended during the tested income year
 - (v) the amounts (if any) included in the tax base of a foreign country in any jurisdiction in respect of the payment
 - (vi) if the Payer is not the entity that is entitled to the foreign income tax deduction in respect of the payment, details of the entity that is entitled to the foreign income tax deduction
 - (vii) if the Recipient is treated as 'fiscally transparent' for tax purposes (including 'disregarded'; that is, not treated as a separate entity from its direct or indirect owner) in any jurisdiction (of a director or indirect investor), the details of those direct or indirect investors and the jurisdictions which regard the Recipient as 'fiscally transparent' or disregarded
 - (viii) if the Recipient's jurisdiction regards the payment as having been received or derived in carrying on a business at or through a branch or permanent establishment in another country, details of the branch or permanent establishment
 - (ix) if the Recipient's jurisdiction imposes income tax on the Recipient's income or profits on a direct or indirect investor in the Recipient, details of each direct or indirect investor
 - (x) if income tax is imposed on an entity in any jurisdiction under a controlled foreign company regime in respect of the income or profits of the Payer or the Recipient, provide the details of any entity that is subject to the controlled foreign company regime, and
 - (xi) the reason why the payments were not wholly included in any entity's tax base in a foreign country, including an explanation of the tax treatment of the payments in all relevant jurisdictions for all relevant entities
- (e) if there are no payments covered by subparagraph 73(c) of this Guideline, provide a written statement confirming that there are no such payments.

Deduction/deduction mismatches

- (f) identification of all payments (as well as amounts of tax depreciation or amortisation with respect to fixed life assets or share of partnership losses) made by a member of a Division 832 control group where it
- (i) resulted in a foreign income tax deduction for an entity in a foreign tax period that ended during the tested income year (the first jurisdiction), and
 - (ii) also resulted in a foreign income tax deduction for an entity in another foreign jurisdiction (the second jurisdiction)

- (g) for each payment identified at subparagraph 73(f) of this Guideline, provide all information necessary to determine whether the identified mismatch is an offshore hybrid mismatch. This should include
- (i) a description of the nature of the payments (for example, interest, royalty or cost of goods sold)
 - (ii) the entity that made the payments (the Payer)
 - (iii) the entity that received the payments (the Recipient)
 - (iv) the amount of payments that result in a foreign income tax deduction during a foreign tax period that ended during the tested income year in the first jurisdiction
 - (v) the identity of the entity entitled to the foreign income tax deduction in respect of the payments in the second jurisdiction
 - (vi) amount of foreign income tax deductions in the second jurisdiction in respect of the payment, and
 - (vii) the reason why the payment resulted in a foreign income tax deduction in more than one jurisdiction, including an explanation of the tax treatment of the payments in each relevant jurisdiction for each relevant entity
- (h) if there are no payments covered by subparagraph 73(f) of this Guideline, provide a written statement confirming that there are no such payments.

Category 2 – obtain further information from the Head of Tax if required

74. If there are any offshore hybrid mismatches that are identified under Category 1 of this Appendix that are hybrid payer mismatches or deducting hybrid mismatches, the person responsible for preparing the Australian income tax return should request that the person primarily responsible for the Group's tax obligations provide further information necessary to quantify the amount of offshore hybrid mismatch.

75. The information requested should include

- (a) identification of any amounts of income or profits that have been included in the tax base of more than one foreign country in respect of the identified offshore hybrid mismatches (the double-taxed income)
- (b) where double-taxed income is identified, provide all information necessary to determine whether the double-taxed income is dual-inclusion income that is available to be applied to reduce the neutralising amount in respect of the offshore hybrid mismatch. This should include
 - (i) the identity of the entity which included the income or profits in the tax base of the first foreign country, and the amount of income or profits included in the tax base of that country
 - (ii) the identity of the entity which included the income or profits in the tax base of the second foreign country, and the amount of income or profits included in the tax base of that country, and
 - (iii) a description of the income or profits derived, and the basis upon it was included in the tax base of both foreign countries.

Category 3 – identify any interposing payments and quantify the imported mismatch

76. If there are any offshore hybrid mismatches and the amount of offshore hybrid mismatches exceeds the dual inclusion income that is eligible to be applied against that mismatch, the person responsible for preparing the Australian income tax return must request the person primarily responsible for the Group's tax obligations to provide further information necessary to determine if there is an importing payment.

77. The information requested should include:

- (a) identification of any series of payments between the taxpayer to the offshore deducting entity (the Interposed Payments)⁴¹ via one or more members of the Division 832 control group (the Interposed Entities) where each payment is
 - (i) deductible for the payer, and
 - (ii) included in the recipient's tax base for foreign tax
- (b) for each Interposed Payment that has been identified, provide the
 - (i) identity of the payer and recipient
 - (ii) amount and date of payment
 - (iii) amount of the foreign income tax deduction that the payer is entitled to deduct, and
 - (iv) amount of income included in the recipient's tax base for foreign tax purposes.

⁴¹ Refer to paragraphs 14 and 15 of this Guideline for an explanation of when a payment will have been made directly or indirectly to an offshore deducting entity.

References

Previous draft:

PCG 2021/D3

Related Rulings/Determinations:

MT 2008/1; MT 2008/2; LCR 2019/3

Legislative references:

- ITAA 1997 Div 832
- ITAA 1997 SubDiv 832-C
- ITAA 1997 SubDiv 832-D
- ITAA 1997 SubDiv 832-E
- ITAA 1997 SubDiv 832-F
- ITAA 1997 SubDiv 832-G
- ITAA 1997 SubDiv 832-H
- ITAA 1997 832-15
- ITAA 1997 832-105
- ITAA 1997 832-110
- ITAA 1997 832-205
- ITAA 1997 832-210(1)
- ITAA 1997 832-210(3)
- ITAA 1997 832-610
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- ITAA 1997 832-625
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- ITAA 1997 832-625(3)(b)
- ITAA 1997 832-625(4)
- ITAA 1997 832-630
- ITAA 1997 832-635
- ITAA 1997 832-680

Other references:

- PCG 2018/7
- PCG 2019/6
- PS LA 2006/8
- PS LA 2008/3
- PS LA 2011/30
- PS LA 2012/4
- PS LA 2012/5
- OECD, Action 2 Final Report (2015)
- Revised Explanatory Memorandum to the Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018

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