PCG 2021/D3 (Finalised) - Imported hybrid mismatch rule - ATO's compliance approach

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Status: **draft only – for comment**

Draft Practical Compliance Guideline

Imported hybrid mismatch rule – ATO's compliance approach

Relying on this draft Guideline

This Practical Compliance Guideline is a draft for consultation purposes only. When the final Guideline issues, it will have the following preamble:

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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Status: **draft only – for comment**

What this draft Guideline is about

1. This draft Guideline[1] 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.*[2] This Guideline does not deal with the core hybrid mismatch rules in Subdivision 832–C to 832–G, which must be considered prior to the application of Subdivision 832–H.[3]

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.[4] 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 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 further references to 'this Guideline' refer to the Guideline as it will read when finalised. Note that this Guideline will not take effect until finalised.
[2] All legislative references in this Guideline are to the *Income Tax Assessment Act 1997* unless otherwise indicated.
[3] 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).
[4] 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.

Status: **draft only – for comment**

Date of effect

3. When finalised, this Guideline will apply both before and after its issue.[5]

4. This Guideline will be under continuous review for two years after the date of its issue.

Overview of the imported hybrid mismatch rule

5. 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.[6] 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.[7]

6. 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.[8]

7. 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.[9]

8. 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 same Division 832 control group[10] or payments made under a structured arrangement to which the taxpayer is a party.

9. 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 arrangement*s 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.[11]

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[5] 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.

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

[7] 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.

[8] Paragraph 1.324 of the EM.

[9] Paragraph 1.323 of the EM.

[10] 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.

[11] Excluding the provisions that extended the operation of Part IVA of the ITAA 1936 to include the Diverted Profits Tax and the Multinational Anti-Avoidance Law. Refer paragraph 1 of PCG 2018/7.

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

10. 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.[12]

11. If a taxpayer makes an importing payment under a structured arrangement covered under table item 1 of subsection 832–615(2)[13], 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)[14] to apply the imported hybrid mismatch rule, and to correctly disallow deductions under section 832–610.

12. 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).

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

13. Where a taxpayer seeks a deduction for a cross border payment made to a member of its Division 832 control group[15] 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.

14. 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.

15. 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. The Division 832 control group should have robust processes in place to identify any relevant hybrid mismatch outcomes and inform the taxpayer accordingly.

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[12] Refer to subsection 832–210(1) for the meaning of a structured arrangement.

[13] For a payment to be an importing payment that is made under a structured arrangement that is covered by table item1 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*.

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

[15] 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.

16. 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

17. 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 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 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

18. 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 enquires (including obtaining complete responses to the requested information), and
- none of the exceptions set out in paragraph 19 of this Guideline apply.

19. The exceptions are:

- 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, or
- 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.

20. Where any of the exceptions apply, the Commissioner will assess the circumstances that resulted in tax shortfall on a case-by-case basis.

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

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

22. 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:

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

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

23. The ATO's recommended approach to undertaking enquiries for non-structured arrangements involves the taxpayer making and documenting formal requests for information and the responses. Taxpayers need to make requests to the responsible individuals or suitably qualified representatives responsible for the relevant Division 832 control group.[16]

24. This could be achieved by reviewing the:

- 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), or
- 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).

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

Suitably qualified or responsible individuals.

25. 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 representatives, for example:

- the person responsible for taxation for the jurisdictions where the related-party transactions have occurred (that is, country or regional tax manager), or
- 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

26. 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 follow the process described below:

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

a. Request the person primarily responsible for the Group's tax obligations to provide information necessary to identify and advise of

[16] For Australian-headquartered Division 832 control groups where the appropriate responsible individual(s) 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.

any payments by members of the Division 832 control group result in a Deduction/Non-Inclusion[17] or Deduction/Deduction[18] outcome.

Step 2 – filter information by local tax manager

b. Determine whether any of the mismatches identified at Step 1 of paragraph 26 of this Guideline are:

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

ii. 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

c. Obtain further information necessary to determine if the mismatch outcomes identified at Step 1 of paragraph 26 of this Guideline, and not excluded at Step 2 of paragraph 26 of this Guideline, result in there being an amount of a hybrid mismatch that is not fully offset by dual inclusion income[19] in the relevant foreign countries.

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

d. 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 payment[20] and, if so, the calculation of the amount of the imported hybrid mismatch under section 832–630.

e. 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.

27. The Appendix to this Guideline sets out the information the Commissioner considers 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.

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

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

Suitably qualified or responsible individuals

29. 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).

[17] Refer to section 832–105.
[18] Refer to section 832–110.
[19] Refer to section 832–680.
[20] 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.

Status: **draft only – for comment**

Method

30. 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 follow the process described below:

Step 1 – identify all potential importing payments

a. Identify all payments or provision of non-cash benefits[21] 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

b. Request the person(s) responsible for the taxation affairs for the applicable jurisdictions to provide information necessary to identify and advise if any payments identified at Step 1 of paragraph 30 of this Guideline result in a Deduction/Non-Inclusion[22] or Deduction/Deduction[23] outcome (refer to Step 1 of the Appendix of this Guideline).

c. For each mismatch outcome identified at paragraph (b) of Step 2 of paragraph 30 of this Guideline, 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.

d. Request the person(s) responsible for the taxation obligations in the applicable jurisdictions to provide further information necessary to determine if the mismatch outcomes identified at paragraph (b) of Step 2 of paragraph 30 of this Guideline, and not excluded at paragraph (c) of Step 2 of paragraph 30 of this Guideline, result in there being an amount of a hybrid mismatch that is not fully offset by dual inclusion income[24] in the relevant foreign countries (refer to Step 3 of the Appendix to this Guideline).

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

e. 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.

f. If the direct tested entities do not reside in a jurisdiction that has foreign hybrid mismatch rules, request the person(s) responsible for taxation obligations in the applicable jurisdictions to provide details of all payments (or deemed payments)[25] 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.

[21] Refer to section 832–15.
[22] Refer to section 832–105.
[23] Refer to section 832–110.
[24] Refer to section 832–680.
[25] 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.

Step 4 – identify and follow payments

g. Repeat Steps 2 and 3 of paragraph 30 of this Guideline for each indirect tested entity identified at paragraph (f) of paragraph 30 of this Guideline until you identify any payments that have been made to a foreign entity where those payments resulted in an 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

31. 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 prior income years)[26], the taxpayer should request that the person(s) responsible for taxation obligations in the applicable jurisdictions provide in writing:

a. details of the foreign importing payment[27] including the

   i. identity of the payer and payee

   ii. amount and date of the payment(s)

   iii. amount of deduction(s) 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(s) that was neutralised under the imported mismatch rule in that jurisdiction.

b. details of any interposed payment including the

   i. identity of the payer(s) and payee(s)

   ii. amount and date of payment(s)

   iii. amount of deduction claimed and under which provision was that deduction claimed.

c. if the foreign importing payment was treated as made under a structured arrangement[28], the reasons for reaching that conclusion.

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

32. 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

[26] 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.

[27] Foreign importing payments means an importing payment in relation to a foreign country covered by subparagraph 832–625(1)(a)(ii).

[28] As covered by table item 1 of subsection 832–615(2).

statutory positions, the outcome of that analysis may not necessarily be consistent with the application of Subdivision 832–H.

33. 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. Where the outcomes are different, 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.

The risk assessment framework

34. 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.

35. 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.

36. The ATO's imported hybrid mismatch risk framework is made up of eight risk zones, including three 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	Moderate-high risk
Red 1	High risk
Red 2	
Red 3	

Reporting your self–assessment

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

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

38. 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.

Evidencing your self–assessment

39. 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.

The risk zones

Definitions

40. In this section. 'maximum possible importing deduction' means the largest possible deduction that could be neutralised for a taxpayer under section 832–610 if the following assumption is made:

If you have made a payment directly or indirectly to a member of your Division 832 control group (Foreign Co), and you are unable to verify that payments made by Foreign Co do not result in you having an imported hybrid mismatch then assume that, to the extent that those payments cannot be verified, Foreign Co has made the payments under an offshore hybrid arrangement that gave rise to an offshore hybrid mismatch.

'ATO's recommend approach' means the reasonable enquiries described at paragraphs 23 to 33 of this Guideline.

Step 1 – importing payments made under a structured arrangement

41. If you have either:

- not made an importing payment made under a structured arrangement, or
- you 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), then

proceed to paragraph 43 of this Guideline for Step 2 of the risk assessment.

42. Otherwise, you will be in red zone 1.

Step 2 – reasonable enquiries for payments made to members of your Division 832 control group for non-structured arrangements

White zone

43. You are in the white zone where:

- 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
- 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, or
- you were in the white zone under either of the previous dot points in paragraph 43 of this Guideline in any of the last two 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.

Green zone

44. You are in the green zone if you are not covered by red zone 2 and either:

- you have undertaken enquiries using the ATO's recommended approach and, based on the information received, you have evidence to demonstrate that
  - there are no offshore hybrid mismatches within your Division 832 control group, or
  - all offshore hybrids that have been identified have been neutralised under section 832–610 or an equivalent provision of a foreign hybrid mismatch rule (or a combination of both).
- you have insufficient information to determine that application of the imported hybrid mismatch, and you have not sought to claim deductions for payments made to members of your Division 832 control group.

Blue zone

45. You are in the blue zone if the total otherwise deductible payments that you made to any members of your Division 832 control group under non-structured arrangements are less than $2 million.

Yellow zone

46. You are in the yellow zone if you have undertaken enquiries using the ATO's recommended approach and, based on the information received, you have evidence to demonstrate:

- at least 90% of the total payments that are otherwise deductible you made to members of your Division 832 control group under non-structured arrangements do not give rise to an imported hybrid mismatch that has not been neutralised under section 832–610
- for the remaining 10% or less of payments, the maximum possible importing deduction that could be disallowed under section 832–610 is less than 2% of your assessable income, and
- you are not covered by red zone 2.

Amber zone

47. You are in the amber zone if you have undertaken enquiries using the ATO's recommended approach and, based on the information received, you:

- have identified one or more offshore hybrid mismatches where the amount of offshore hybrid mismatch[29] or the neutralising amount[30] is greater than nil

[29] In the case of hybrid financial instrument mismatches, reverse hybrid mismatches or a branch hybrid mismatches.
[30] In the case of hybrid payer mismatches or deducting hybrid mismatches.

- have not disallowed deductions under section 832–610 in respect of one or more offshore hybrid mismatches because you do not consider that an importing payment has been made directly or indirectly to the offshore deducting entity, and
- are not covered by red zone 2.

48. The amber zone (moderate to high) risk level rating reflects that where it is self-assessed an importing payment has not been made we will likely to want to understand the reasons for this conclusion being reached. We are concerned about views being adopted that are inconsistent with paragraph (a) of subsection 832–625(3).[31]

Red zone 1

49. You are in the red zone 1 if you have made a payment that is an importing payment under a structured arrangement and you do not have evidence to demonstrate that the offshore hybrid mismatch under all the structured arrangements to which you are a party have been neutralised under section 832–610 or an equivalent provision of a foreign hybrid mismatch rule.

Red zone 2

50. You are in the red zone 2 if:

- you have made a deductible payment to a member of your Division 832 control group
- payments have been made by each interposed entity to an offshore deducting entity or to another interposed entity, and
- you have treated the deducted payment as not being an importing payment under a structured arrangement[32] only because you take a position that the payment is treated as not made directly or indirectly through one or more interposed entities.[33]

Red zone 3

51. You will be in the red zone 3 if you have made a deductible payment to a member of your Division 832 control group and you do not fit into any 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
21 April 2021

[31] 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.

[32] Within the meaning of table item 1 of subsection 832–615(2).

[33] Within the meaning of paragraph 832–625(1)(b).

Appendix – Information guide

52. This Appendix sets out the information the Commissioner considers relevant to demonstrating compliance with the imported hybrid mismatch rule at Steps 1, 3 and 4 of the top-down approach (described at paragraph 26 of this Guideline) applicable to non-structured arrangements. The information described at Steps 1 and 3 in this Appendix will also be relevant for applying the bottom-up approach (described at paragraph 30 of this Guideline) applicable to non-structured arrangements. It is intended as a general guide for your enquiries and is not an exhaustive list.

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

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

54. The person responsible for preparing the Australian 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.

55. 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 a foreign income tax deduction for an entity in a foreign tax period that ended during the tested income year[34], 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.

d. for each payment identified at paragraph (c) of Step 1 in this Appendix, 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)

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

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 claimed the foreign income tax deduction in respect of the payment, details of the entity that claimed 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 (that is, the 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 (the Investor Entity(s)), details of the Investor Entity(s)

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 are subject to the controlled foreign company regime, and

xi. the reason(s) why the payments was 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 paragraph (c) of Step 1 in this Appendix, 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 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 paragraph (f) of Step 1 of this Appendix, 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 that claimed the foreign income tax deduction in respect of the payments in the second jurisdiction

vi. amount of foreign income tax deductions claimed in the second jurisdiction in respect of the payment(s), and

vii. the reason(s) why the reason why the payment(s) 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 paragraph (f) of Step 1 of this Appendix, provide a written statement confirming that there are no such payments.

Step 3 – obtain further information from the Head of Tax

56. If there are any offshore hybrid mismatches that are identified at Step 2 of this Appendix that are hybrid payer mismatches or a deducting hybrid mismatches, the person responsible for preparing the Australian income tax return should request the person primarily responsible for the Group's tax obligations to provide further information necessary to quantify the amount of offshore hybrid mismatch.

57. 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.

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

58. 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.

59. The information requested should include:

a. identification of any series of payments between the taxpayer to the offshore deducting entity (the Interposed Payments) 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.

When identifying a series of payments, it is not necessary to consider the source of funds or the timing of the payment. All that is required is that a payment has been made by an Interposed Entity to another Interposed Entity, or by an Interposed Entity to the offshore deducting entity.[35]

b. for each Interposed Payment that has been identified, provide the

i. identity of the payer(s) and recipient(s)

ii. amount and date of payment(s)

iii. amount of foreign income tax deduction claimed by the payer(s), and

iv. amount of income included in the recipient(s) tax base for foreign tax purposes.

[35] For example, A Co made a $200 interest payment to B Co on 31 May 2022, and B Co made a $50 royalty payment to C Co on 15 February 2022. In this case, it would be identified that there is a series of payments between A Co and C Co.

Status: **draft only – for comment**

Your comments

60. You are invited to comment on this draft Guideline, including the proposed date of effect. Please forward your comments to the contact officer by the due date.

61. A compendium of comments is prepared when finalising this Guideline, and an edited version (with names and identifying information removed) is published to the Legal database on ato.gov.au

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: **21 May 2021**

Contact officer details have been removed following publication of the final guideline.

Status: **draft only – for comment**

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

LCR 2019/3; PCG 2018/7; PCG 2019/6

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 832–610
- ITAA 1997 832–615(2)
- ITAA 1997 832–620
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- ITAA 1997 832–625
- ITAA 1997 832–625(1)(b)
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- ITAA 1997 832–625(4)
- ITAA 1997 832–630
- ITAA 1997 832–635
- ITAA 1997 832–680

Other references:

- 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

ATO references

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