





# **Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018**

**No. 84, 2018**

**An Act to amend the law relating to taxation, and  
for related purposes**

Note: An electronic version of this Act is available on the Federal Register of Legislation  
(<https://www.legislation.gov.au/>)



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# Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018

No. 84, 2018

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## An Act to amend the law relating to taxation, and for related purposes

[Assented to 24 August 2018]

The Parliament of Australia enacts:

### 1 Short title

This Act is the *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018*.

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No. 84, 2018      *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018*      1

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## 2 Commencement

- (1) Each provision of this Act specified in column 1 of the table commences, or is taken to have commenced, in accordance with column 2 of the table. Any other statement in column 2 has effect according to its terms.

| <b>Commencement information</b> |  |                     |
|---------------------------------|--|---------------------|
| <b>Column 1</b>                 | <b>Column 2</b>  | <b>Column 3</b>     |
| <b>Provisions</b>               | <b>Commencement</b>  | <b>Date/Details</b> |
| 1. The whole of this Act        | The first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent. | 1 October 2018      |

Note: This table relates only to the provisions of this Act as originally enacted. It will not be amended to deal with any later amendments of this Act.

- (2) Any information in column 3 of the table is not part of this Act. Information may be inserted in this column, or information in it may be edited, in any published version of this Act.

## 3 Schedules

Legislation that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

## **Schedule 1—OECD Hybrid Mismatch Rules**

### **Part 1—Main amendments**

#### *Income Tax Assessment Act 1997*

##### **1 After Division 830**

Insert:

#### **Division 832—Hybrid mismatch rules**

##### **Table of Subdivisions**

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|       | Guide to Division 832   |
| 832-A | Preliminary   |
| 832-B | Concepts relating to mismatches   |
| 832-C | Hybrid financial instrument mismatch                                      |
| 832-D | Hybrid payer mismatch   |
| 832-E | Reverse hybrid mismatch   |
| 832-F | Branch hybrid mismatch  |
| 832-G | Deducting hybrid mismatch   |
| 832-H | Imported hybrid mismatch  |
| 832-I | Dual inclusion income   |
| 832-J | Integrity rule  |
| 832-K | Modifications for Division 230 (about taxation of financial arrangements) |

##### **Guide to Division 832**

###### **832-1 What this Division is about**

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

There is double non-taxation if a deductible payment is not included in a tax base (this is called a deduction/non-inclusion mismatch), or if a payment gives rise to 2 deductions (this is called a deduction/deduction mismatch). Disallowing a deduction, or including an amount in assessable income, “neutralises” this tax advantage.

## Subdivision 832-A—Preliminary

### Guide to Subdivision 832-A

#### 832-5 What this Subdivision is about

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

#### Table of sections

##### Operative provisions

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| 832-10 | Entitlement to receive payment   |
| 832-15 | Entitlement to receive non-cash benefits                                       |
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| 832-25 | Recipients and payers of a payment   |
| 832-30 | Tax provisions to be disregarded in identifying payments and income or profits |
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| 832-40 | Schemes outside Australia  |
| 832-45 | Relationship between this Division and other charging provisions in this Act   |
| 832-50 | Relationship between this Division and Division 820                            |
| 832-55 | Division does not affect foreign residence rules                               |
| 832-60 | Valuation of trading stock affected by hybrid mismatch rules                   |

#### Operative provisions

##### 832-10 Entitlement to receive payment

This Division applies as if an entity (the *payer*) had made a payment to another entity (the *recipient*) if the recipient is entitled

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to receive the payment from the payer, even if the payment is not required to be made until a later time.

### **832-15 Entitlement to receive non-cash benefits**

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

### **832-20 Losses that arise from payments or parts of payments**

- (1) This section applies if:
- (a) a loss gives rise to:
    - (i) a deduction for an entity (the *payer*) for an income year; or
    - (ii) a \*foreign income tax deduction for an entity (also the *payer*) for a \*foreign tax period; and
  - (b) in working out the amount of the loss:
    - (i) all or a part of a payment made, or to be made, to one or more other entities is taken into account; or
    - (ii) 2 or more payments made, or to be made, to one or more other entities are taken into account.

Note: This section also applies to losses from Division 230 financial arrangements: see section 832-780.

#### *Payments made to only one entity*

- (2) If, in working out the amount of the loss, a payment or payments made to only one entity (the *recipient*) are taken into account, this Division applies as if:
- (a) at the end of the income year or \*foreign tax period identified in paragraph (1)(a), the payer made a payment to the recipient; and
  - (b) the amount of the payment was equal to the amount of the deduction or \*foreign income tax deduction; and
  - (c) the payment gave rise to the deduction or foreign income tax deduction.

*Payments made to 2 or more entities*

- (3) If, in working out the amount of the loss, a payment or payments made to 2 or more entities (each of which is a **recipient**) are taken into account, this Division applies as if:
- (a) at the end of the income year or \*foreign tax period identified in paragraph (1)(a), the payer made a payment to each recipient; and
  - (b) the amount of each payment was equal to so much of the amount of the deduction or \*foreign income tax deduction as is reasonable having regard to the amounts of the payments actually made to the recipients; and
  - (c) the payment gave rise to a deduction or foreign income tax deduction equal to the amount of the payment.

*Working out whether the payment has been subject to tax*

- (4) In working out for the purposes of this Division the extent to which a payment that is taken by this section to have been made is \*subject to Australian income tax or \*subject to foreign income tax, regard is to be had to the actual payments made to the recipient.

**832-25 Recipients and payers of a payment**

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

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

- (1) A number of provisions in this Division refer to an entity making a payment to another entity. To avoid doubt, whether an entity

makes a payment to another entity is to be worked out disregarding:

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

Note: As a consequence of paragraph (2)(a), a member of a consolidated group may be a hybrid payer under section 832-320 or a deducting hybrid under section 832-550 (it cannot be a reverse hybrid because of subparagraph 832-410(2)(b)(ii)).

### **832-35 Single entity rule otherwise not disregarded**

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

### **832-40 Schemes outside Australia**

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

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

- (1) This section applies if an amount is included in the assessable income of an entity under a provision of this Division in relation to a payment.

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

*Relationship with section 230-20*

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

### **832-50 Relationship between this Division and Division 820**

- (1) In determining for the purposes of this Division whether a payment gives rise to a deduction, and the amount of the deduction, disregard the effect of Division 820 (about thin capitalisation).
- (2) Nothing in this Division limits Division 820 (about thin capitalisation) in its application to reduce, or further reduce, \*debt deductions of an entity.

### **832-55 Division does not affect foreign residence rules**

Nothing in this Division affects the operation of the provisions of Division 6 that provide for the significance of foreign residence for the assessability of ordinary and statutory income.

Note: Amounts included in assessable income under this Division may be ordinary or statutory income for the purposes of Division 6.

### **832-60 Valuation of trading stock affected by hybrid mismatch rules**

If:

- (a) an amount of a deduction for an outgoing is disallowed under this Division; and
- (b) the outgoing was incurred in connection with acquiring an item of \*trading stock; and
- (c) the item is on hand at the end of an income year;
- the amount disallowed is to be disregarded in working out the \*cost, market selling value or replacement value of the item at the end of the income year under section 70-45.
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## **Subdivision 832-B—Concepts relating to mismatches**

### **Guide to Subdivision 832-B**

#### **832-100 What this Subdivision is about**

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

#### **Table of sections**

##### **Operative provisions**

- 832-105 When a payment gives rise to a deduction/non-inclusion mismatch
- 832-110 When a payment gives rise to a deduction/deduction mismatch
- 832-115 Disregard effect of Division in determining deductions
- 832-120 Meaning of *foreign income tax deduction*
- 832-125 Meaning of *subject to Australian income tax*
- 832-130 Meaning of *subject to foreign income tax*
- 832-135 Safe harbour for translation rates

#### **Operative provisions**

##### **832-105 When a payment gives rise to a deduction/non-inclusion mismatch**

###### *Australian deduction*

- (1) If:
- (a) a deduction (other than a deduction that is solely attributable to a \*currency exchange rate effect) is allowable to an entity in an income year in respect of a payment (including a part or share of the payment); and
  - (b) the amount of the deduction exceeds the sum of the amounts of the payment that are:
    - (i) \*subject to foreign income tax in a foreign country in a \*foreign tax period that starts no later than 12 months after the end of the income year; or

(ii) \*subject to Australian income tax for the income year; then the deduction is the **deduction component** of a **deduction/non-inclusion mismatch** to which the payment gives rise.

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

*Foreign income tax deduction*

- (2) If:
- (a) an entity is entitled to a \*foreign income tax deduction in a foreign country in a \*foreign tax period in respect of a payment (including a part or share of the payment); and
  - (b) the amount of the foreign income tax deduction exceeds the sum of the amounts of the payment that are:
    - (i) \*subject to foreign income tax in a foreign country in a foreign tax period that starts no later than 12 months after the end of the foreign tax period in which the foreign income tax deduction arose; or
    - (ii) \*subject to Australian income tax for an income year that starts no later than 12 months after the end of the foreign tax period in which the foreign income tax deduction arose; and
  - (c) the foreign income tax deduction is not solely attributable to:
    - (i) any currency exchange rate fluctuations; or
    - (ii) a difference between an expressly or implicitly agreed currency exchange rate for a future date or time and the applicable currency exchange rate at that date or time;
- then the foreign income tax deduction is the **deduction component** of a **deduction/non-inclusion mismatch** to which the payment gives rise.

*Amount of the deduction/non-inclusion mismatch*

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

**832-110 When a payment gives rise to a deduction/deduction mismatch**

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

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

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

*Amount of the deduction/deduction mismatch*

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

*Extended operation in relation to non-payment deductions*

- (4) This section applies in relation to the following amounts in the same way as it applies in relation to a payment:
- (a) an amount representing the decline in value of an asset;
  - (b) an amount representing a share in the net loss of a partnership or other transparent entity.
- (5) If:

- (a) an amount representing a share in the net loss of a partnership gives rise to a deduction; and
- (b) in a foreign country:
  - (i) the same share in the income or profits of the partnership forms part of the tax base of an entity under a law of the foreign country dealing with \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax); but
  - (ii) that share is brought to account in that tax base on an item-by-item basis, instead of on a net basis;the amount is taken for the purposes of subsection (1) to also give rise to a \*foreign income tax deduction in the foreign country, for an amount representing the share in the net loss of the partnership, and equal to the amount of the deduction mentioned in paragraph (a).
- (6) For the purposes of subsection (4), a reference in this Division to the \*scheme under which a payment is made is taken to be a reference to:
  - (a) if paragraph (4)(a) applies—the scheme under which the asset is held; or
  - (b) if paragraph (4)(b) applies—the scheme under which the net loss arose.

### **832-115 Disregard effect of Division in determining deductions**

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

### **832-120 Meaning of *foreign income tax deduction***

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

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

*Effect of foreign hybrid mismatch rules*

- (3) In determining for the purposes of this section whether an entity is entitled to deduct an amount as mentioned in subsection (1), disregard the effect of the following:
- (a) any provisions of \*foreign hybrid mismatch rules of a foreign country;
  - (b) any provisions of another law of a foreign country relating to \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax) that has substantially the same effect as foreign hybrid mismatch rules.

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

- (1) An amount of income or profits is **subject to Australian income tax** in an income year if it is an amount that is included in an entity's assessable income for the income year.
- (2) However, if:
- (a) the entity is a trust or partnership; and
  - (b) the trust or partnership has net income for the income year;
- then the amount is only **subject to Australian income tax** to the extent it reasonably represents amounts:
- (c) included in the assessable income of another entity for the income year (other than an entity that is a partnership or the trustee of a trust); or
  - (d) for a trust—on which the trustee is liable to be assessed and to pay \*tax.

*Effect of CFC regimes*

- (3) An amount of income or profits of an entity is **subject to Australian income tax** if the amount is included under section 456 or 457 of the *Income Tax Assessment Act 1936* in the assessable income of another entity.

- (4) In determining for the purposes of this Division whether an amount of income or profits is \*subject to Australian income tax, disregard the effect of this Division, unless the contrary intention appears.

### 832-130 Meaning of *subject to foreign income tax*

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

Note: Subdivision 832-C (Hybrid financial instrument mismatch) has effect as if certain amounts that are subject to a concessional rate of foreign income tax were not subject to foreign income tax: see section 832-235.

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

*Effect of credits etc. for underlying taxes*

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

Note: This subsection is disregarded in working out whether an amount of income or profits is dual inclusion income: see subsection 832-680(3).

*Effect of “dividend received deductions” in foreign countries*

- (4) Despite subsection (1), if:
- (a) an amount (the **pre-deduction amount**) of income or profits would, apart from this subsection, be \*subject to foreign income tax in a foreign country; and
  - (b) the amount consists of a dividend received by an entity from a company; and
  - (c) the entity is entitled to a \*foreign income tax deduction in respect of all or part of the amount of the dividend;
- then only so much of the pre-deduction amount as reasonably represents an amount not effectively sheltered from \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax) by the foreign income tax deduction is **subject to foreign income tax**.

*Effect of CFC regimes*

- (5) An amount of income or profits of an entity is **subject to foreign income tax** if the amount is included in working out the tax base of another entity under a provision of a law of a foreign country that corresponds to section 456 or 457 of the *Income Tax Assessment Act 1936* (including a tax base that is nil, or a negative amount).

*Effect of foreign hybrid mismatch rules*

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

**832-135 Safe harbour for translation rates**

If:

- (a) a payment has any of the following effects:

- (i) it gives rise to a deduction;
  - (ii) it gives rise to a \*foreign income tax deduction;
  - (iii) it is \*subject to Australian income tax;
  - (iv) it is \*subject to foreign income tax; and
- (b) for the purposes of this Division, the amount of one or more such effects is to be translated under Subdivision 960-C into an entity's \*applicable functional currency, or into Australian currency;

then it is reasonable for the purposes of item 11A of the table in subsection 960-50(6) (as modified by the regulations) to apply an exchange rate to each translation so as best to achieve a consistent measure of the extent to which the payment had each such effect.

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

## **Subdivision 832-C—Hybrid financial instrument mismatch**

### **Guide to Subdivision 832-C**

#### **832-175 What this Subdivision is about**

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

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

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

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

A hybrid financial instrument mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an

offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

## Table of sections

### Operative provisions

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## Operative provisions

### 832-180 Deduction not allowable—Australian primary response

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

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

- (1) This section applies to an entity if:
  - (a) the entity is the recipient of a payment that gives rise to a \*hybrid financial instrument mismatch; and
  - (b) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (c) the secondary response is required (see subsection (2)).
- (2) For the purposes of paragraph (1)(c), the secondary response is required unless the \*foreign income tax deduction is in a foreign country that has \*foreign hybrid mismatch rules, or another law that has substantially the same effect as foreign hybrid mismatch rules.

*Inclusion of amount in assessable income*

- (3) An amount equal to the amount of the \*hybrid financial instrument mismatch is included in the entity's assessable income for the income year mentioned in subsection (4). The assessable income is taken to have been derived from the same source as the payment.
- (4) The income year is:
  - (a) if the \*foreign tax period in which the \*foreign income tax deduction arises falls wholly within an income year of the entity—that income year; or
  - (b) if the foreign tax period in which the foreign income tax deduction arises straddles 2 income years of the entity—the earlier of those income years.

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

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

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

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

- (1) A \*hybrid financial instrument mismatch is an *offshore hybrid mismatch* if:
- (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (b) no amount becomes \*subject to Australian income tax as a result of the application of section 832-185 in relation to the mismatch; and
  - (c) none of the following countries has \*foreign hybrid mismatch rules, or another law that has substantially the same effect as foreign hybrid mismatch rules:
    - (i) the country in which the foreign income tax deduction arose;
    - (ii) any country in which income or profits of the recipient of the payment are \*subject to foreign income tax.
- Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.
- (2) The amount of the \*offshore hybrid mismatch is the amount of the \*hybrid financial instrument mismatch.

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

- (1) A payment gives rise to a *hybrid financial instrument mismatch* if:
- (a) the payment gives rise to a \*hybrid mismatch under section 832-215 or 832-230; and
  - (b) subsection (3) or (6) applies.
- Note: As a result of ordering rules in later Subdivisions, a payment that gives rise to a hybrid financial instrument mismatch does not also give rise to a hybrid mismatch under a later Subdivision of this Division.
- (2) The *deduction component* of the \*hybrid financial instrument mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch.

- (3) This subsection applies if the following entities are related for the purposes of subsection (4):
- (a) the entity that made the payment;
  - (b) each entity that is a \*liable entity in respect of the income or profits of the recipient of the payment.

Note: For the definition of *liable entity*, see section 832-325.

*Related persons*

- (4) Two entities are related for the purposes of this subsection if any of the following apply:
- (a) the entities are in the same \*Division 832 control group;
  - (b) one of the entities holds a \*total participation interest of 25% or more in the other entity;
  - (c) a third entity holds a total participation interest of 25% or more in each of the entities.
- (5) For the purposes of subsection (4), treat the \*direct participation interest of an entity (the *holding entity*) in another entity (the *test entity*) as being the sum of the direct participation interests held by the holding entity and its \*associates in the test entity.

*Structured arrangement*

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

**832-205 Meaning of *Division 832 control group***

- (1) Two or more entities are in the same *Division 832 control group* if any of the following apply:
- (a) each of the entities is a member of a group of entities that are consolidated for accounting purposes as a single group;
  - (b) one of the entities holds a \*total participation interest of 50% or more in each of the other entities;
  - (c) a third entity holds a total participation interest of 50% or more in each of the entities.
- (2) For the purposes of subsection (1), in determining a \*direct participation interest of one entity in another entity, disregard

paragraph 350(1)(b) of the *Income Tax Assessment Act 1936* (rights of shareholders to vote or participate in certain decision-making).

### **832-210 Meaning of *structured arrangement***

- (1) A payment that gives rise to a \*hybrid mismatch is made under a ***structured arrangement*** if:
  - (a) the hybrid mismatch is priced into the terms of a \*scheme under which the payment is made; or
  - (b) it is reasonable to conclude that the hybrid mismatch is a design feature of a scheme under which the payment is made.
- (2) The question whether a \*hybrid mismatch is a design feature of a \*scheme must be determined by reference to the facts and circumstances that exist in connection with the scheme, including the terms of the scheme.
- (3) An entity that entered into or carried out the \*scheme or any part of the scheme is a ***party*** to the \*structured arrangement unless:
  - (a) the entity could not reasonably have been expected to be aware that the scheme gave rise to a \*hybrid mismatch; and
  - (b) no other entity in the same \*Division 832 control group as the entity could reasonably have been expected to be aware that the scheme gave rise to a hybrid mismatch; and
  - (c) the financial position of each entity in the Division 832 control group would reasonably be expected to have been the same if the scheme had not given rise to the hybrid mismatch.

### **832-215 Hybrid mismatch**

- (1) A payment gives rise to a ***hybrid mismatch*** if:
  - (a) the payment is made under any of the following:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement;
    - (iv) an \*arrangement covered by subsection (2); and

- (b) the payment might reasonably be expected to give rise to a \*deduction/non-inclusion mismatch; and
- (c) the mismatch that might reasonably be expected to arise, or a part of that mismatch, meets a hybrid requirement in section 832-220 or 832-225.

*Transfers of financial instruments*

- (2) An \*arrangement is covered by this subsection if:
  - (a) the arrangement is any of the following:
    - (i) a reciprocal purchase agreement (otherwise known as a repurchase agreement);
    - (ii) a securities lending arrangement;
    - (iii) a similar arrangement; and
  - (b) an entity acquires any of the following under the arrangement:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement.

*Amount of the hybrid mismatch*

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

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

- (1) A \*deduction/non-inclusion mismatch, or a part of such a mismatch, meets the hybrid requirement in this section if:
  - (a) the payment that gives rise to the mismatch is made under any of the following:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement; and

- (b) the mismatch, or the part of the mismatch, is attributable to differences in the treatment of the debt interest, equity interest or derivative financial arrangement, arising from the terms of the interest or arrangement; and
- (c) the exception in subsection (2) does not apply.

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

*Exception for deferrals not exceeding 3 years*

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

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

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

*Exception for deferrals not exceeding 3 years*

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

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

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

- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment is made under an \*arrangement under which any of the following is transferred:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement; and
  - (c) the payment, or a part of the payment, (the ***substitute payment***) could reasonably be regarded as having been converted into a form that is in substitution for a \*return (however described) on the interest or arrangement; and
  - (d) the return is covered by subsection (2).
- (2) This subsection covers a \*return (however described) on a \*debt interest, an \*equity interest, or a \*derivative financial arrangement, that is transferred if any of the following apply:
- (a) the return is made to the payer of the substitute payment, and is not \*subject to foreign income tax or \*subject to Australian income tax;
  - (b) the return is not made to the payer of the substitute payment, but if it had been it would not have been subject to foreign income tax or subject to Australian income tax;
  - (c) if the return were instead made to the payee of the substitute payment:
    - (i) it would be subject to foreign income tax or subject to Australian income tax; or
    - (ii) it would give rise to a \*hybrid mismatch under section 832-215.

*Amount of the hybrid mismatch*

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

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

- (1) This section applies in working out, for the purposes of this Subdivision, whether an amount is \*subject to foreign income tax.
-

- (2) An amount of income or profits of an entity is treated as if it were *not* \*subject to foreign income tax if:
- (a) apart from this section, the amount would be \*subject to foreign income tax; and
  - (b) the rate of \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax) (the **lower rate**) on the amount under the law of the relevant foreign country is lower than the rate (the **ordinary rate**) that would ordinarily be imposed on interest income derived by an entity of that kind in the foreign country.

*Amount of a deduction/non-inclusion mismatch*

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

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

where:

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

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

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

- (1) There is an adjustment under this section for an entity in an income year (the **adjustment year**) if:
- (a) an amount was not allowable as a deduction for the entity in an earlier income year under section 832-180 in respect of a payment that gave rise to a \*hybrid financial instrument mismatch; and
  - (b) an amount (the **taxed amount**) of the payment is:

- (i) \*subject to foreign income tax in a foreign country in a \*foreign tax period that ends within 12 months after the end of the adjustment year; or
  - (ii) \*subject to Australian income tax in the adjustment year.
- (2) The taxed amount is an amount the entity can deduct in the adjustment year.
- (3) The total amounts deducted under this section in respect of a payment must not exceed the amount that was not allowable as a deduction in respect of the payment as mentioned in paragraph (1)(a).
- No adjustment for concessional taxes*
- (4) This section does not apply if the \*hybrid mismatch would not have arisen apart from section 832-235.

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

#### **Guide to Subdivision 832-D**

#### **832-280 What this Subdivision is about**

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

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

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

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

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

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## Operative provisions

### 832-285 Deduction not allowable—Australian primary response

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

Note: The neutralising amount is worked out under section 832-330.

**832-290 Inclusion in assessable income—Australian secondary response**

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

*When secondary response is required*

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

*Inclusion of amount in assessable income*

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

**832-295 Exception where entity not a party to the structured arrangement**

Sections 832-285 and 832-290 do not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and

(b) subsection 832-305(3) does not apply.

**832-300 When a hybrid payer mismatch is an offshore hybrid mismatch**

- (1) A \*hybrid payer mismatch is an *offshore hybrid mismatch* if:
- (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (b) no amount becomes \*subject to Australian income tax as a result of the application of section 832-290 in relation to the mismatch; and
  - (c) none of the following countries has \*foreign hybrid mismatch rules, or another law that has substantially the same effect as foreign hybrid mismatch rules:
    - (i) the country in which the \*foreign income tax deduction arose;
    - (ii) any country in which income or profits of the recipient of the payment are \*subject to foreign income tax.

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

- (2) The amount of the \*offshore hybrid mismatch is the \*neutralising amount for the \*hybrid payer mismatch.

**832-305 When a payment gives rise to a hybrid payer mismatch**

- (1) A payment gives rise to a *hybrid payer mismatch* if:
- (a) the payment gives rise to a \*hybrid mismatch under section 832-310; and
  - (b) subsection (3) or (4) applies.
- (2) The *deduction component* of the \*hybrid payer mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch mentioned in section 832-310.

*Control group*

- (3) This subsection applies if the following entities are in the same \*Division 832 control group:
- (a) the \*hybrid payer;

- (b) each entity that is a \*liable entity in respect of the income or profits of the hybrid payer.

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

*Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

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

**832-310 Hybrid mismatch**

- (1) A payment gives rise to a *hybrid mismatch* if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment meets the hybrid requirement in section 832-315.

*Amount of the hybrid mismatch*

- (2) The amount of the \*hybrid mismatch is the lesser of:
- (a) the amount of the \*deduction/non-inclusion mismatch; and
  - (b) if there is an excess under either subparagraph 832-315(2)(b)(i) or 832-315(3)(b)(i)—the amount of the excess.

*Ordering rule*

- (3) However, a payment does not give rise to a *hybrid mismatch* under this section if it gives rise to a \*hybrid financial instrument mismatch.

**832-315 Hybrid requirement—assume payment was made to same recipient but by an ungrouped payer**

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

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
- (a) the non-including country identified in subsection 832-320(3) is Australia; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
- (a) the non-including country identified in subsection 832-320(3) is a foreign country; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to foreign income tax for a \*foreign tax period was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch.

*Assumption—payer was an ungrouped entity*

- (4) For the purposes of subsections (2) and (3), assume that the payment had instead been made:
- (a) to the same recipient; but
  - (b) by an entity that was a \*liable entity in the non-including country identified in subsection 832-320(3) only in respect of its own income or profits.

Note: For the meaning of *liable entity*, see section 832-325.

### 832-320 Hybrid payer

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

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

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

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

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

- (3) This subsection applies to a test entity in relation to a country (a *non-including country*) and a payment the test entity makes if:
- (a) the test entity, or another entity, is a \*liable entity in the non-including country in respect of income or profits of the test entity (or a part of the income or profits); and
  - (b) that liable entity is also a liable entity in the non-including country in respect of income or profits of the recipient of the payment.

### 832-325 Meaning of *liable entity*

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

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

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

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

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

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

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

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

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

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

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

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

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

*Effect of CFC regimes*

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

### **832-330 Neutralising amount**

- (1) The **neutralising amount** for a \*hybrid payer mismatch is the amount of the \*hybrid mismatch from subsection 832-310(2), reduced (but not below nil) by the amount of any \*dual inclusion

income that is available to be applied in working out the neutralising amount.

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

- (2) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch to which section 832-285 applies if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the income year mentioned in subsection 832-285(1); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).

Note: Section 832-680 modifies the meanings of subject to Australian income tax and subject to foreign income tax for the purpose of working out dual inclusion income.

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

- (3) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch to which section 832-290 applies if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the inclusion year mentioned in subsection 832-290(4); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the deducting country mentioned in subsection 832-320(2).

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

- (4) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch that is an \*offshore hybrid mismatch if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) in the same \*foreign tax period as the period in which the \*foreign income tax deduction arose, the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the deducting country mentioned in subsection 832-320(2); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).

**832-335 Adjustment if hybrid payer has dual inclusion income in a later year**

- (1) There is an adjustment under this section for an entity in an income year (the *adjustment year*) if:
- (a) in an earlier income year, all or part of a deduction of the entity in respect of a payment that gave rise to a \*hybrid payer mismatch was not allowable under section 832-285; and
  - (b) an amount of \*dual inclusion income is:
    - (i) available to be applied by the \*hybrid payer in the adjustment year; and
    - (ii) \*subject to Australian income tax for the purposes of subsection 832-680(1) in the adjustment year; and
    - (iii) \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).
- (2) So much of the amount of \*dual inclusion income that satisfies paragraph (1)(b) as does not exceed the amount that was not allowable as a deduction is an amount the entity can deduct in the adjustment year.

- (3) For the purposes of a later application of this section, treat the amount that was not allowable as a deduction under section 832-285 as being reduced by the amount deducted under subsection (2) of this section.

## **Subdivision 832-E—Reverse hybrid mismatch**

### **Guide to Subdivision 832-E**

#### **832-375 What this Subdivision is about**

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

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

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

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

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832-410 Reverse hybrid

## Operative provisions

### 832-380 Deduction not allowable—Australian primary response

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

### 832-385 Exception where entity not a party to the structured arrangement

Section 832-380 does not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-395(3) does not apply.

### 832-390 When a reverse hybrid mismatch is an offshore hybrid mismatch

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

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

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

### **832-395 When a payment gives rise to a reverse hybrid mismatch**

- (1) A payment gives rise to a **reverse hybrid mismatch** if:
  - (a) the payment gives rise to a \*hybrid mismatch under section 832-400; and
  - (b) subsection (3) or (4) applies.
- (2) The **deduction component** of the \*reverse hybrid mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch mentioned in section 832-400.

#### *Control group*

- (3) This subsection applies if the following entities are in the same \*Division 832 control group:
  - (a) the entity that made the payment;
  - (b) the \*reverse hybrid;
  - (c) each entity that is an investor identified in paragraph 832-410(2)(c) in relation to the reverse hybrid.

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

#### *Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

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

### **832-400 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if:
  - (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment meets the hybrid requirement in section 832-405.

#### *Amount of the hybrid mismatch*

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

- (b) if there is an excess under either subparagraph 832-405(2)(b)(i) or (3)(b)(i)—the amount of the excess.

*Ordering rule*

- (3) A payment does not give rise to a **hybrid mismatch** under this section if it gives rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

**832-405 Hybrid requirement—assume payment was made to an investor**

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

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
  - (a) the investor country identified in subsection 832-410(3) is Australia; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
  - (a) the investor country identified in subsection 832-410(3) is a foreign country; and

- (b) either:
- (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to foreign income tax for a \*foreign tax period was instead worked out on the assumption in subsection (4); or
  - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.

*Assumption—payment was made to the investing taxpayer*

- (4) For the purposes of subsections (2) and (3), assume that the payment had instead been made:
- (a) by the same entity; but
  - (b) directly to the investing taxpayer identified in paragraph 832-410(3)(a) or (b).

#### **832-410 Reverse hybrid**

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

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

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

- (2) This subsection applies to a test entity in relation to a country (the **formation country**) and a payment made to the entity if:
- (a) the test entity is formed in the formation country; and
  - (b) for the formation country, the test entity is:
    - (i) not a \*liable entity; and

- (ii) for Australia—not a \*member of a \*consolidated group;  
and
- (c) for the formation country, another entity (an *investor*) is a liable entity in respect of income or profits of the test entity.

Note: For the meaning of *liable entity*, see section 832-325.

*Investor country—entity is not transparent*

- (3) This subsection applies to a test entity in relation to a country (the *investor country*) and a payment made to the entity if, in the investor country:
  - (a) an investor identified in paragraph (2)(c) is a \*liable entity (an *investing taxpayer*) in respect of its own income or profits, but not in respect of the test entity’s income or profits; or
  - (b) an entity that is a liable entity (also an *investing taxpayer*) in respect of the investor’s income or profits is not also a liable entity in respect of the test entity’s income or profits.

## **Subdivision 832-F—Branch hybrid mismatch**

### **Guide to Subdivision 832-F**

#### **832-450 What this Subdivision is about**

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

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

An entity is a branch hybrid in relation to a payment made to it if, for the purposes of the tax law of the country in which it is a resident, the payment is treated as being allocated to a permanent establishment in another country, but in the other country, the

payment is treated as *not* being allocated to a permanent establishment in that country.

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

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## Operative provisions

### 832-455 Deduction not allowable

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

**832-460 Exception where entity not a party to the structured arrangement**

Section 832-455 does not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-470(3) does not apply.

**832-465 When a branch hybrid mismatch is an offshore hybrid mismatch**

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

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

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

**832-470 Branch hybrid mismatch**

- (1) A payment gives rise to a *branch hybrid mismatch* if:
  - (a) the payment gives rise to a \*hybrid mismatch under section 832-475; and
  - (b) subsection (3) or (4) applies.
- (2) The *deduction component* of the \*branch hybrid mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch mentioned in section 832-475.

*Control group*

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

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

*Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

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

**832-475 Hybrid mismatch**

- (1) A payment gives rise to a *hybrid mismatch* if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the mismatch, or a part of the mismatch, meets the hybrid requirement in section 832-480.

*Amount of the hybrid mismatch*

- (2) The amount of the \*hybrid mismatch is the lesser of:
- (a) the amount of the \*deduction/non-inclusion mismatch; and
  - (b) if there is an excess under either subparagraph 832-480(2)(b)(i) or (3)(b)(i)—the amount of the excess.

*Ordering rule*

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

**832-480 Hybrid requirement—payment made directly or indirectly to a branch hybrid**

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

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
  - (a) the residence country identified in subsection 832-485(2) is Australia; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
  - (a) the residence country identified in subsection 832-485(2) is a foreign country; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to foreign income tax for a \*foreign tax period was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

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

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

### **832-485 Branch hybrid**

- (1) An entity is a **branch hybrid**, in relation to a payment made to the entity, if:
- (a) subsection (2) applies to the entity in relation to a country and a payment; and
  - (b) subsection (4) applies to the entity in relation to the payment.

*Residence country applies branch profits exemption*

- (2) This subsection applies to an entity in relation to a country (the **residence country**) and a payment made to the entity if, for that country:
- (a) the entity satisfies the residency test in subsection 832-555(9) and is a \*liable entity in respect of its own income or profits; and
  - (b) the payment is treated as income derived by the liable entity in carrying on a business at or through a \*PE in another country; and
  - (c) as a result of an exemption or other tax concession to which that liable entity is entitled in respect of income derived in carrying on a business at or through the PE, the payment is not:
    - (i) if the residence country is Australia—\*subject to Australian income tax; or
    - (ii) if the residence country is a foreign country—\*subject to foreign income tax in that foreign country.

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Note: For the meaning of *liable entity*, see section 832-325.

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

*Branch country fails to tax payment*

- (4) This subsection applies to an entity in relation to the other country mentioned in paragraph (2)(b) (the *branch country*) and a payment made to the entity if:
- (a) the payment is treated as *not* having been derived in carrying on a business at or through a \*PE of the entity, or as otherwise not having a sufficient connection to a taxable presence in the branch country, for the purposes of:
    - (i) if the branch country is Australia—this Act; or
    - (ii) if the branch country is a foreign country—the law of the branch country relating to \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax); and
  - (b) as a result, the payment is not:
    - (i) if the branch country is Australia—\*subject to Australian income tax; or
    - (ii) if the branch country is a foreign country—\*subject to foreign income tax in that foreign country.

*Modified meaning of permanent establishment*

- (5) Subsection (6) applies if:
- (a) the residence country has entered into, with the branch country:
    - (i) if either the residence country or the branch country is Australia—an \*international tax agreement; or
    - (ii) if subparagraph (i) does not apply—a treaty or other agreement relating to the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital; and
  - (b) the agreement or treaty (as the case requires) contains:
    - (i) if either the residence country or the branch country is Australia—a \*permanent establishment article; or

- (ii) if subparagraph (i) does not apply—a provision corresponding to a permanent establishment article.
- (6) A reference in this section to a \*PE in a country is taken to be a reference to a permanent establishment within the meaning of the relevant agreement or treaty in the country.

## **Subdivision 832-G—Deducting hybrid mismatch**

### **Guide to Subdivision 832-G**

#### **832-525 What this Subdivision is about**

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

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

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

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

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

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

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

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- 832-550 Deducting hybrid
- 832-555 Identifying a secondary response country
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- 832-565 Adjustment if deducting hybrid has dual inclusion income in a later year

**Operative provisions**

**832-530 Deduction not allowable**

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

Note: The neutralising amount is worked out under section 832-560.

**832-535 Additional requirements for secondary response**

- (1) However, if there is a secondary response country in relation to the \*deducting hybrid mismatch (see section 832-555), and that country is Australia, section 832-530 does not apply in relation to the \*deducting hybrid mismatch unless:
  - (a) the secondary response is required (see subsection (2)); and
  - (b) subsection (3) or (4) applies.

*When secondary response is required*

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

- (a) a \*liable entity in respect of the income or profits of the \*deducting hybrid satisfies the residency test in subsection 832-555(9) in the primary response country; and
- (b) the primary response country has \*foreign hybrid mismatch rules, or another law that has substantially the same effect as foreign hybrid mismatch rules.

*Control group*

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

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

*Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

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

Note 2: If the deduction is a non-payment deduction, see also subsection 832-110(5).

**832-540 When a deducting hybrid mismatch is an offshore hybrid mismatch**

- (1) A \*deducting hybrid mismatch is an *offshore hybrid mismatch* if:
  - (a) the only \*deduction components of the mismatch are \*foreign income tax deductions; and
  - (b) neither country in which a foreign income tax deduction arose has \*foreign hybrid mismatch rules, or another law that has substantially the same effect as foreign hybrid mismatch rules.

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

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

### 832-545 When an amount gives rise to a deducting hybrid mismatch

- (1) A payment or other amount gives rise to a **deducting hybrid mismatch** if there is a \*deducting hybrid in relation to the payment or other amount.
- (2) Each \*deduction component of the \*deduction/deduction mismatch mentioned in paragraph 832-550(a) is a **deduction component** of the \*deducting hybrid mismatch.
- (3) A \*deducting hybrid mismatch is also a **hybrid mismatch**.

#### *Ordering rule*

- (4) However, a payment does not give rise to a **deducting hybrid mismatch** if it gives rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch, a \*reverse hybrid mismatch or a \*branch hybrid mismatch.

### 832-550 Deducting hybrid

An entity is a **deducting hybrid** in relation to a payment or other amount if:

- (a) the payment or other amount gives rise to a \*deduction/deduction mismatch; and
- (b) the entity is:
- (i) for a payment—the entity that makes the payment; or
  - (ii) for an amount that represents the decline in value of a depreciating asset (see paragraph 832-110(4)(a))—the entity that holds the asset; or
  - (iii) for an amount that represents a share in the net loss of a partnership or other transparent entity (see paragraph 832-110(4)(b))—an entity that has an interest in the partnership or other transparent entity; and
- (c) the entity is:
- (i) a \*liable entity in at least one deducting country; or
  - (ii) a \*member of a \*consolidated group.

### **832-555 Identifying a secondary response country**

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

*Dual residents—no secondary response*

- (2) This subsection covers a \*deducting hybrid mismatch if:
- (a) the only \*liable entity in respect of income or profits of the \*deducting hybrid is the deducting hybrid; and
  - (b) the liable entity satisfies the residency test in subsection (9) in both deducting countries.

Note 1: For the meaning of *liable entity*, see section 832-325.

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

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

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

*Both countries recognise the same liable entity—residence country is secondary response*

- (4) If:
- (a) the \*deducting hybrid is itself the \*liable entity in each deducting country; and
  - (b) in one deducting country, the deducting hybrid does not satisfy the residency test in subsection (9); and
  - (c) in the other deducting country, the deducting hybrid *does* satisfy the residency test;
- then the country mentioned in paragraph (b) is the secondary response country.

- (5) If:

- (a) in both deducting countries, the same entity is the \*liable entity in respect of the income or profits of the \*deducting hybrid; and
- (b) in one deducting country, the liable entity does not satisfy the residency test in subsection (9); and
- (c) in the other deducting country, the liable entity *does* satisfy the residency test;

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

*Countries recognise different liable entities—non-parent country is secondary response*

(6) If:

- (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
- (b) in one deducting country, the \*deducting hybrid is the liable entity;

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

(7) If:

- (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
- (b) the \*deducting hybrid is not the liable entity in either country; and
- (c) in one deducting country, the entity that is a liable entity is also a liable entity in respect of the income or profits of the entity that is the liable entity in the other deducting country;

then the country mentioned second in paragraph (c) is the secondary response country.

(8) If:

- (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
- (b) subsections (6) and (7) do not apply; and

(c) in one deducting country, the deducting hybrid and the liable entity both satisfy the residency test in subsection (9); then the country mentioned in paragraph (c) is the secondary response country.

*Residency test*

- (9) An entity satisfies the residency test in this subsection in relation to a country, if:
- (a) if the country is Australia—the entity is an \*Australian entity; or
  - (b) if the country is a foreign country:
    - (i) the entity is a resident of the foreign country for the purposes of the law of the foreign country relating to \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax); or
    - (ii) the tax base, as it relates to foreign income tax (except credit absorption tax, unitary tax or a withholding-type tax), includes income from worldwide sources.

**832-560 Neutralising amount**

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

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

- (2) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*deducting hybrid mismatch to which section 832-530 applies if:
- (a) the \*deducting hybrid is eligible to apply the amount (see subsection 832-680(7)); and

- (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the income year mentioned in subsection 832-530(1); and
- (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which the \*foreign income tax deduction arose.

Note: Section 832-680 modifies the meanings of subject to Australian income tax and subject to foreign income tax for the purpose of working out dual inclusion income.

*Offshore hybrid mismatch—inclusions must be in the deducting countries*

- (3) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*deducting hybrid mismatch that is an \*offshore hybrid mismatch if:
  - (a) the \*deducting hybrid is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which one of the \*foreign income tax deductions arose, and in the same \*foreign tax period; and
  - (c) the amount is also subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which another of the foreign income tax deductions arose.

**832-565 Adjustment if deducting hybrid has dual inclusion income in a later year**

- (1) There is an adjustment under this section for an entity in an income year (the *adjustment year*) if:
  - (a) in an earlier income year, all or part of a deduction of the entity in respect of an amount that gave rise to a \*deducting hybrid mismatch was not allowable under section 832-530; and
  - (b) an amount of \*dual inclusion income is:
    - (i) available to be applied by the \*deducting hybrid in the adjustment year; and

- (ii) \*subject to Australian income tax for the purposes of subsection 832-680(1) in the adjustment year; and
  - (iii) \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which the \*foreign income tax deduction arose.
- (2) So much of the amount of \*dual inclusion income that satisfies paragraph (1)(b) as does not exceed the amount that was not allowable as a deduction is an amount the entity can deduct in the adjustment year.
- (3) For the purposes of a later application of this section, treat the amount that was not allowable as a deduction under section 832-530 as being reduced by the amount deducted under subsection (2) of this section.

## **Subdivision 832-H—Imported hybrid mismatch**

### **Guide to Subdivision 832-H**

#### **832-605 What this Subdivision is about**

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

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

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832-635 Carry forward of residual offshore hybrid mismatches

## **Operative provisions**

### **832-610 Deduction not allowable**

- (1) This section applies in relation to an \*imported hybrid mismatch if, apart from this section, an entity would be entitled to a deduction in an income year in respect of a payment that gives rise to the imported hybrid mismatch.
- (2) So much of the deduction as does not exceed the amount of the \*imported hybrid mismatch is not allowable as a deduction.

Note: The amount of the imported hybrid mismatch is worked out under section 832-630.

### **832-615 When a payment gives rise to an imported hybrid mismatch**

- (1) A payment gives rise to an *imported hybrid mismatch* if:
  - (a) the payment gives rise to a \*hybrid mismatch under section 832-620; and
  - (b) an item in the table in subsection (2) applies to the importing payment.

Note: The amount of the imported hybrid mismatch is worked out under section 832-630.

#### *Priority rules for importing payments*

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

**Priority table for importing payments**

| Item | Topic                  | An *importing payment is covered if:  |
|------|------------------------|---|
| 1    | Structured arrangement | (a) the *importing payment is made under a *structured arrangement; and<br>(b) the payer of the importing payment, the offshore deducting entity mentioned in paragraph 832-625(1)(c), and each interposed entity (if applicable) are all *parties to the structured arrangement                                  |
| 2    | Direct payment         | (a) the *importing payment is made directly to the offshore deducting entity mentioned in paragraph 832-625(1)(c); and<br>(b) the payer of the importing payment and the offshore deducting entity are in the same *Division 832 control group  |
| 3    | Indirect payment       | (a) the *importing payment is made indirectly through one or more interposed entities to the offshore deducting entity mentioned in paragraph 832-625(1)(c); and<br>(b) the payer of the importing payment, the offshore deducting entity, and each interposed entity are in the same *Division 832 control group |

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

Note 2: For the meaning of *Division 832 control group*, see section 832-205.

**832-620 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if the payment is an \*importing payment in relation to an \*offshore hybrid mismatch.

Note: For the meaning of *offshore hybrid mismatch* see sections 832-195, 832-300, 832-390, 832-465, and 832-540.

*Ordering rule*

- (2) A payment does not give rise to a **hybrid mismatch** under this section if it gives rise to a \*hybrid financial instrument mismatch, a

\*hybrid payer mismatch, a \*reverse hybrid mismatch, a \*branch hybrid mismatch or a \*deducting hybrid mismatch.

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

### 832-625 Meaning of *importing payment*

- (1) A payment an entity (the *payer*) makes is an *importing payment* in relation to an \*offshore hybrid mismatch if:
- (a) either:
    - (i) apart from section 832-610, the payment, or a part of the payment, gives rise to a deduction in an income year covered by subsection (2); or
    - (ii) the payment, or a part of the payment, gives rise to a \*foreign income tax deduction in a foreign country that has \*foreign hybrid mismatch rules, in a \*foreign tax period covered by subsection (2); and
  - (b) the payment is made directly, or indirectly through one or more interposed entities, to another entity; and
  - (c) the other entity (the *offshore deducting entity*) is:
    - (i) the entity that made the payment that gave rise to the offshore hybrid mismatch; or
    - (ii) if the offshore hybrid mismatch is a \*deducting hybrid mismatch—the \*deducting hybrid.

#### *Period within which mismatch may be imported*

- (2) For the purposes of paragraph (1)(a), a \*foreign tax period or income year is covered by this subsection if:
- (a) it ends at or after the end of the foreign tax period in which a \*deduction component of the \*offshore hybrid mismatch arose; and
  - (b) it has at least one day in common with that period.

#### *Indirect importations*

- (3) For the purposes of determining whether a payment is made indirectly through one or more interposed entities to the offshore deducting entity:
-

- (a) 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; and
- (b) each payment made by an interposed entity must:
  - (i) give rise to a \*foreign income tax deduction in a country that does not have \*foreign hybrid mismatch rules; and
  - (ii) not give rise to a \*deduction/non-inclusion mismatch.

*Loss surrender and grouping relief*

- (4) Subsection (5) applies if:
  - (a) a payment is made to an entity (the **first entity**); and
  - (b) another entity (the **second entity**) makes a payment (the **second payment**) to a third entity; and
  - (c) the first entity and the second entity are in the same \*Division 832 control group; and
  - (d) under the law of a foreign country relating to \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax):
    - (i) a \*foreign income tax deduction arises in respect of the second payment; and
    - (ii) the foreign income tax deduction may, as a result of a concessional feature of that law, be transferred to, shared with, or otherwise applied by, the first entity.

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

- (5) For the purposes of this section, treat:
  - (a) a payment as having been made by the first entity to the second entity; and
  - (b) the payment as having given rise to a \*foreign income tax deduction (but not a \*deduction/non-inclusion mismatch) in the foreign country mentioned in paragraph (4)(d).

**832-630 Working out the amount of the imported hybrid mismatch**

- (1) The amount of the \*imported hybrid mismatch is the lesser of:
  - (a) the importing deduction amount worked out under subsection (2) in relation to the deduction; and

(b) the amount worked out using the following formula:

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

where:

**importing deduction** means the amount of the importing deduction amount worked out under subsection (2) in relation to the deduction.

**remaining offshore hybrid mismatch** means:

- (a) unless paragraph (b) applies—the amount of the \*offshore hybrid mismatch; or
- (b) if an item higher in the table in subsection 832-615(2) applies to one or more other \*importing payments in relation to the offshore hybrid mismatch—the amount of the offshore hybrid mismatch that is not, or will not be, neutralised by the application of this Subdivision, and equivalent provisions of applicable \*foreign hybrid mismatch rules, in relation to those other importing payments.

**total importing deductions of equal priority** means the amount worked out by:

- (a) identifying each \*importing payment in relation to the \*offshore hybrid mismatch to which the same item in the table in subsection 832-615(2) applies; and
  - (b) working out under subsection (2) the importing deduction amount in relation to the deduction or \*foreign income tax deduction to which each such importing payment gives rise; and
  - (c) summing the results from paragraph (b) for each such importing payment.
- (2) The amount (the **importing deduction amount**) worked out under this subsection in relation to a deduction or \*foreign income tax deduction is:
- (a) if the \*importing payment is made directly to the offshore deducting entity—the amount of the deduction or foreign income tax deduction; or

- (b) if the importing payment is made indirectly through one or more interposed entities to the offshore deducting entity—the lesser of:
  - (i) the amount of the deduction or foreign income tax deduction; and
  - (ii) the smallest amount of any foreign income tax deduction to which a payment by an interposed entity gave rise.

### **832-635 Carry forward of residual offshore hybrid mismatches**

- (1) Subsection (2) applies if:
  - (a) a payment made in a particular \*foreign tax period gave rise to an \*offshore hybrid mismatch (the *original mismatch*); and
  - (b) the original mismatch is only partly neutralised by the application of this Subdivision and equivalent provisions of applicable \*foreign hybrid mismatch rules.
- (2) This Subdivision applies as if:
  - (a) the offshore deducting entity had made a payment in the next \*foreign tax period; and
  - (b) the payment gave rise to an \*offshore hybrid mismatch (the *residual mismatch*); and
  - (c) the amount of the residual mismatch was the amount of the original mismatch that was not neutralised by the application of this Subdivision and equivalent provisions of applicable \*foreign hybrid mismatch rules.

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

#### **Guide to Subdivision 832-I**

#### **832-675 What this Subdivision is about**

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

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

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

## Table of sections

### Operative provisions

832-680 Dual inclusion income, and when an entity is eligible to apply it

## Operative provisions

### 832-680 Dual inclusion income, and when an entity is eligible to apply it

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

Note: In certain circumstances, dual inclusion income can be applied to reduce the neutralising amount for a hybrid payer mismatch (see section 832-330) or a deducting hybrid mismatch (see section 832-560).

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

- (2) For the purposes of subsection (1), if:
- (a) an amount of assessable income of an entity (the ***assessable amount***) would, apart from this subsection, be \*subject to Australian income tax; and
  - (b) an amount of \*foreign income tax (except \*credit absorption tax, \*unitary tax or a withholding-type tax) paid in respect of

the assessable amount counts towards a \*tax offset for an entity under Division 770;

then:

- (c) if the amount of the tax offset equals or exceeds the amount of \*tax that would, having regard only to the assessable amount and the rate at which tax is imposed on the entity, be payable on the assessable amount—the assessable amount is treated as if it were not subject to Australian income tax; and
- (d) if the amount of the tax offset is a proportion of the amount of that tax—then that proportion of the assessable amount is treated as if it were not subject to Australian income tax.

*Effect of credits etc. for underlying taxes*

- (3) In determining for the purposes of subsection (1) whether an amount of income or profits is \*subject to foreign income tax in a \*foreign tax period, disregard subsection 832-130(3).

*Extension for certain on-payments through grouped entities*

- (4) Subsection (5) applies, if:
  - (a) an entity is a member of a dual inclusion income group in a country (see subsection (6)); and
  - (b) an amount of income or profits of the entity (the ***on-payment amount***) is a payment received by the entity from another member of the dual inclusion income group at a time; and
  - (c) it is reasonable to conclude that the payment was funded by an amount of income or profits of the other member (the ***funding income or profits***); and
  - (d) the funding income or profits were:
    - (i) if the country mentioned in paragraph (a) is Australia—\*subject to Australian income tax; or
    - (ii) if the country mentioned in paragraph (a) is a foreign country—\*subject to foreign income tax in the foreign country; and
  - (e) the funding income or profits were not \*dual inclusion income under subsection (1) (disregarding subsection (5)) in the country.

- (5) For the purposes of subsection (1), the on-payment amount is treated as if it were:
- (a) if the country mentioned in paragraph (4)(a) is Australia—  
\*subject to Australian income tax in the income year in which the time mentioned in paragraph (4)(b) occurs; or
  - (b) if the country mentioned in paragraph (4)(a) is a foreign country—\*subject to foreign income tax in the foreign country in the \*foreign tax period in which the time mentioned in paragraph (4)(b) occurs.
- (6) Two or more entities are members of a group (a **dual inclusion income group**) in a country for the purposes of this Division if in that country:
- (a) the entity that is a \*liable entity in respect of the income or profits of each of the entities is the same entity; and
  - (b) no other entity is a liable entity in respect of the income or profits of any of the entities.

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

- (7) An entity is eligible to apply an amount of \*dual inclusion income if the amount is income or profits of:
- (a) the entity; or
  - (b) if paragraph (a) does not apply and the entity is a member of a dual inclusion income group in any country—an entity that is a member of the dual inclusion income group.
- (8) However, an entity is not eligible to apply the amount if it has already been applied by any entity by a previous application of a provision of this Division.

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

#### **832-720 What this Subdivision is about**

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

- (a) the paying entity, the interposed foreign entity and another foreign entity (the *ultimate parent entity*) are in the same Division 832 control group; and
- (b) the payment is not subject to Australian income tax; and
- (c) the highest rate of foreign income tax (the *foreign country rate*) on the payment is 10% or less; and
- (d) it is reasonable to conclude (having regard to certain matters) that the entity, or one of the entities, that entered into or carried out all part of the scheme did so for a purpose including a purpose of enabling a deduction to be obtained in respect of the payment, or enabling foreign income tax to be imposed on the payment at a rate of 10% or less.

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

- (a) the rate of foreign income tax on the payment in the country of residence of the ultimate parent entity would be less than or equal to the foreign country rate; and
- (b) the payment would not give rise to a hybrid mismatch of a particular kind.

## Table of sections

### Operative provisions

- 832-725 Payments made to interposed foreign entity (integrity measure)—denial of deduction
- 832-730 Back to back arrangements, etc.
- 832-735 Determination may specify kinds of scheme and circumstances where no denial of deduction

## Operative provisions

### 832-725 Payments made to interposed foreign entity (integrity measure)—denial of deduction

- (1) Subsection (3) applies if:
  - (a) an entity (the *paying entity*) makes a payment under a \*scheme to a \*foreign entity (the *interposed foreign entity*),

either directly, or indirectly through one or more interposed \*Australian trusts or Australian partnerships (within the meaning of Part X of the *Income Tax Assessment Act 1936*); and

- (b) the paying entity, the interposed foreign entity and another foreign entity (the ***ultimate parent entity***) are in the same \*Division 832 control group; and
- (c) the ultimate parent entity is not controlled by any other entity (other than an entity that is not a member of the Division 832 control group); and
- (d) the payment is of:
  - (i) an amount of interest (within the meaning of subsection 128A(1AB) of the *Income Tax Assessment Act 1936*); or
  - (ii) an amount under a \*derivative financial arrangement; and
- (e) the paying entity is entitled to a deduction in an income year in respect of the payment (disregarding this section); and
- (f) the payment is not \*subject to Australian income tax; and
- (g) either:
  - (i) the payment is \*subject to foreign income tax in one or more foreign countries, and the highest rate (the ***foreign country rate***) at which the payment is subject to foreign income tax is 10% or less; or
  - (ii) the payment is not subject to foreign income tax; and
- (h) it is reasonable to conclude (having regard to the matters in subsection (2)) that the entity, or one of the entities, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:
  - (i) enabling a deduction to be obtained in respect of the payment; and
  - (ii) enabling foreign income tax to be imposed on the payment at a rate of 10% or less, or enabling foreign income tax not to be imposed on the payment.

- (2) For the purposes of paragraph (1)(h), have regard to the following matters:
-

- (a) the facts and circumstances that exist in relation to the \*scheme;
  - (b) if the payment is an amount of interest as mentioned in subparagraph (1)(d)(i)—the source of the funds used by the interposed foreign entity to provide the paying entity with the loan or other debt interest in respect of which the payment of interest is made;
  - (c) whether the interposed foreign entity engages in substantial commercial activities in carrying on a banking, financial or other similar business.
- (3) The paying entity is not entitled to the deduction mentioned in paragraph (1)(e).
- (4) Subsection (3) does not apply if it is reasonable to conclude that:
- (a) the following requirements are satisfied:
    - (i) the amount of the payment is taken into account under Part X of the *Income Tax Assessment Act 1936*;
    - (ii) the sum of the \*attribution percentages of each \*attributable taxpayer in relation to the interposed foreign entity, for the purposes of sections 456 and 457 of that Act in respect of the income year in which the payment is made, is at least 100%; or
  - (b) requirements similar to those in paragraph (a), under the law of a foreign country that has substantially the same effect as Part X of that Act in respect of that foreign country, are satisfied in relation to the interposed foreign entity; or
  - (c) assuming that the payment were treated as being divided into 2 separate payments:
    - (i) the requirements in paragraph (a) would be satisfied in relation to one of those separate payments; and
    - (ii) the requirements in paragraph (b) would be satisfied in relation to the other of those separate payments.
- (5) Subsection (3) does not apply if it is reasonable to conclude that, assuming that the payment had been made directly to the ultimate parent entity:
- (a) the payment would:
    - (i) be \*subject to foreign income tax at a rate that is the same as, or less than, the foreign country rate; or

- (ii) not be subject to foreign income tax; and
  - (b) the payment would not give rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.
- (6) Subsection (3) does not apply if the payment gives rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch, a \*reverse hybrid mismatch, a \*branch hybrid mismatch, a \*deducting hybrid mismatch or an \*imported hybrid mismatch.

### **832-730 Back to back arrangements, etc.**

- (1) Subsection (2) applies if:
- (a) an entity (the *original paying entity*) makes a payment of a kind mentioned in subparagraph 832-725(1)(d)(i) to another entity; and
  - (b) the other entity, or a further entity, pays an amount of that kind to a foreign entity; and
  - (c) the payments mentioned in paragraphs (a) and (b) are made under an arrangement involving back-to-back loans or an arrangement that is economically equivalent and intended to have a similar effect to back-to-back loans.
- (2) For the purposes of this Subdivision, treat the original paying entity as having made the payment mentioned in paragraph (1)(a) to the foreign entity mentioned in paragraph (1)(b).

### **832-735 Determination may specify kinds of scheme and circumstances where no denial of deduction**

- (1) Subsection 832-725(3) does not apply if:
- (a) where a determination made for the purposes of paragraph (2)(a) specifies a kind of \*scheme—the scheme mentioned in subsection 832-725(1) is of that kind; or
  - (b) where a determination made for the purposes of paragraph (2)(b) specifies a kind of circumstances in relation to a scheme—circumstances of that kind exist in relation to the scheme mentioned in subsection 832-725(1).

- (2) For the purposes of subsection (1), the Minister may, by legislative instrument, make a determination that:
- (a) specifies kinds of \*schemes; and
  - (b) specifies kinds of circumstances in relation to schemes.

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

### **Guide to Subdivision 832-K**

#### **832-775 What this Subdivision is about**

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

#### **Table of sections**

##### **Operative provisions**

- 832-780 Section 832-20 applies to Division 230 losses  
832-785 Adjusting Division 230 loss  
832-790 Modifications relating to Division 230 gains and losses

#### **Operative provisions**

##### **832-780 Section 832-20 applies to Division 230 losses**

To avoid doubt, the reference in paragraph 832-20(1)(a) to a loss includes:

- (a) a loss from a \*Division 230 financial arrangement; and
- (b) an amount treated under section 832-790 as a separate loss from a Division 230 financial arrangement.

##### **832-785 Adjusting Division 230 loss**

- (1) This section applies if a provision of this Division (a ***disallowing provision***) would, apart from this section, apply to make not allowable all or a part of a deduction for:
- (a) a loss from a \*Division 230 financial arrangement; or

- (b) an amount treated under section 832-790 as a separate loss from a Division 230 financial arrangement.
- (2) The disallowing provision does not apply.  
Note: See instead section 230-522.
- (3) However, the following provisions (about adjustments) apply as if the disallowing provision had applied to make the deduction, or the part of the deduction, not allowable:
  - (a) 832-240(1)(a);
  - (b) 832-335(1)(a);
  - (c) 832-565(1)(a).

### **832-790 Modifications relating to Division 230 gains and losses**

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

#### *Separation of currency effects for Division 230 gains and losses*

- (2) For the purposes of this Division, split a gain into 2 separate gains, or a gain and a loss, as follows:
  - (a) to the extent to which the gain represents a \*currency exchange rate effect, treat it as a separate gain or loss;
  - (b) to the extent that it does not represent that effect, treat it as a separate gain or loss from the \*financial arrangement to which this Division applies.
- (3) For the purposes of this Division, split a loss into 2 separate losses, or a gain and a loss, as follows:
  - (a) to the extent to which the loss represents a \*currency exchange rate effect, treat it as a separate gain or loss;

- (b) to the extent that it does not represent that effect, treat it as a separate gain or loss from the \*financial arrangement to which this Division applies.
- (4) For the purposes of this Division, assume an amount treated under paragraph (2)(b) or (3)(b) as a separate loss would, apart from this Division, be allowable as a deduction to the entity for the income year.

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

- (5) If there is an amount treated under paragraph (2)(b) or (3)(b) as a separate gain from a \*financial arrangement, the gain is treated as consisting of any actual payments made under the financial arrangement and taken into account in working out the amount of the gain or loss the entity made under the arrangement.
- (6) For the purposes of this Division, assume the gain is an amount that, subject to Division 6 (about effect of foreign residence), is included in the entity's assessable income.

## Part 2—Other amendments

### *Income Tax Assessment Act 1936*

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

Add:

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

#### 3 After subsection 23AH(4)

Insert:

##### *Exception relating to hybrid mismatch rules*

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

#### 4 After subsection 23AH(14B)

Insert:

##### *Branch hybrid mismatch income*

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

- (a) received by the company; and
- (b) that, apart from subsection (4A) of this section, would give rise to a branch hybrid mismatch;

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

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

## **5 Subsection 160ZZVB(2)**

Omit “and an agreement (within the meaning of the *International Tax Agreements Act 1953*) that has the force of law applies in relation to the bank.”.

## **6 At the end of Part IIIB**

Add:

## **Division 5—Modifications relating to hybrid mismatch rules**

### **160ZZZL Certain “hybrid mismatch” deductions denied**

- (1) Subsection (2) applies if:
  - (a) either:
    - (i) an amount of interest (a *notional payment*) is taken under section 160ZZZA to be incurred by an Australian branch of a foreign bank in respect of a notional borrowing; or
    - (ii) an amount (also a *notional payment*) is taken under section 160ZZZE to be an amount paid by an Australian branch of a foreign bank in respect of a notional derivative transaction; and
  - (b) the amount would, apart from this section, give rise to a deduction for the Australian branch in a year of income; and
  - (c) the amount of the deduction exceeds the amount worked out under subsection (3).

#### *Neutralising hybrid mismatch outcomes*

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

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

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

- (a) the amount of the notional payment that is subject to foreign income tax;
- (b) so much (if any) of the amount of the notional payment as it is reasonable to conclude is effectively funding expenses covered by subsection (4) or (5) (about non-deductible third party expenses);
- (c) the amount (if any) of income or profits of the Australian branch that is both:
  - (i) subject to Australian income tax for the purposes of subsection 832-680(1) of the *Income Tax Assessment Act 1997* in the year of income mentioned in paragraph (1)(b); and
  - (ii) subject to foreign income tax for the purposes of subsection 832-680(1) of the *Income Tax Assessment Act 1997* in the foreign country in which the foreign bank is a resident.

*Non-deductible third party expenses*

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

*Safe harbour*

- (6) The deduction is taken for the purposes of paragraph (1)(c) not to exceed the amount worked out under subsection (3) if the foreign bank adopts a recognised transfer pricing methodology in allocating expenditure and income between itself and all its branches.

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

- (1) There is an adjustment under subsection (2) for the Australian branch in a year of income (the *adjustment year*) if:
- (a) an amount of a deduction was not allowable for the branch in an earlier year of income under subsection 160ZZZL(2); and
  - (b) this Part applies in the calculation of the foreign bank's taxable income in the adjustment year; and
  - (c) an amount of income or profits of the Australian branch is:
    - (i) subject to Australian income tax for the purposes of subsection 832-680(1) of the *Income Tax Assessment Act 1997* in the adjustment year; and
    - (ii) subject to foreign income tax for the purposes of that subsection in the foreign country in which the foreign bank is a resident.
- (2) So much of the amount of income or profits that satisfies paragraph (1)(c) as does not exceed the amount of the deduction that was not allowable is an amount the Australian branch can deduct in the adjustment year.
- (3) For the purposes of a later application of this section, treat the amount of the deduction that was not allowable under subsection 160ZZZL(2) as being reduced by the amount deducted under subsection (2).

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

- (1) For the purposes of paragraphs 160ZZZL(3)(c) and 160ZZZN(1)(c), an amount of income or profits is to be disregarded if:
- (a) the amount is dual inclusion income; and
-

- (b) the amount has been applied by a provision of Division 832 of the *Income Tax Assessment Act 1997*.
- (2) For the purposes of Division 832 of that Act, an amount of dual inclusion income is not available to be applied by a provision of that Division if it has been taken into account under paragraph 160ZZZL(3)(c) or subsection 160ZZZN(2).

**160ZZZR Interpretation**

In this Division:

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

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

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

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

**7 At the end of section 389**

Add:

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

***Income Tax Assessment Act 1997***

**8 Section 12-5 (after table item headed “higher education assistance”)**

Insert:

**hybrid mismatch rules**

disallowing of deductions ..... Division 832

## **9 Subsection 70-45(2) (at the end of the table)**

Add:

- 6        The hybrid mismatch rules disallow    Section 832-60 of this Act  
          an amount of a deduction for an  
          outgoing incurred in connection  
          with acquiring an item of \*trading  
          stock

## **10 At the end of section 110-38**

Add:

- (9) Expenditure does not form part of any element of the *cost base* to the extent that a provision of Division 832 (about hybrid mismatch rules) prevents it being deducted.

## **11 After subsection 110-55(9J)**

Insert:

- (9K) Expenditure does not form part of the *reduced cost base* to the extent that a provision of Division 832 (about hybrid mismatch rules) prevents it being deducted.

## **12 After section 230-520**

Insert:

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

- (1) This section applies if a provision of Division 832 would, apart from section 832-785, apply to make not allowable an amount (the *relevant amount*) that is all or a part of the deduction for:
- (a) a loss from a \*Division 230 financial arrangement; or
  - (b) an amount treated under section 832-790 as a separate loss from a Division 230 financial arrangement.
- (2) The following have effect:
- (a) if (disregarding section 832-790) you made a loss from the \*financial arrangement, and the relevant amount does not

- exceed the amount of the loss—the amount of the loss you made is reduced by the relevant amount;
- (b) if (disregarding section 832-790) you made a loss from the financial arrangement, and the relevant amount exceeds the amount of the loss:
- (i) you do not make a loss from the financial arrangement; and
  - (ii) instead, you make a gain from the financial arrangement equal to the amount of the excess;
- (c) if (disregarding section 832-790) you made a gain from the financial arrangement—the amount of the gain is increased by the relevant amount.
- (3) The effect of subsection (2) is to be disregarded for the purposes of paragraph (c) of step 1 and paragraph (c) of step 2 of subsection 230-445(1) (about balancing adjustments).

### 13 Subsection 995-1(1)

Insert:

*branch hybrid* has the meaning given by section 832-485.

*branch hybrid mismatch* has the meaning given by section 832-470.

*deducting hybrid* has the meaning given by section 832-550.

*deducting hybrid mismatch* has the meaning given by section 832-545.

*deduction component*:

- (a) of a \*deduction/non-inclusion mismatch—has the meaning given by subsections 832-105(1) and 832-105(2); and
- (b) of a \*deduction/deduction mismatch—has the meaning given by subsection 832-110(2); and
- (c) of a \*hybrid financial instrument mismatch—has the meaning given by subsection 832-200(2); and
- (d) of a \*hybrid payer mismatch—has the meaning given by subsection 832-305(2); and

- (e) of a *\*reverse hybrid mismatch*—has the meaning given by subsection 832-395(2); and
- (f) of a *\*branch hybrid mismatch*—has the meaning given by subsection 832-470(2); and
- (g) of a *\*deducting hybrid mismatch*—has the meaning given by subsection 832-545(2); and
- (h) of an *\*offshore hybrid mismatch*—means the *\*deduction component of the relevant hybrid financial instrument mismatch, hybrid payer mismatch, reverse hybrid mismatch, branch hybrid mismatch or deducting hybrid mismatch.*

*deduction/deduction mismatch* has the meaning given by section 832-110.

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

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

*dual inclusion income* has the meaning given by section 832-680.

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

*foreign income tax deduction* has the meaning given by section 832-120.

*foreign tax period*, in relation to an entity, in relation to a foreign tax imposed by a tax law of a foreign country, means the accounting period used by the entity for the purposes of determining the tax base under that law.

*hybrid financial instrument mismatch* has the meaning given by section 832-200.

*hybrid mismatch* has the meaning given by sections 832-215, 832-230, 832-310, 832-400, 832-475, 832-545 and 832-620.

*hybrid payer* has the meaning given by section 832-320.

*hybrid payer mismatch* has the meaning given by section 832-305.

***imported hybrid mismatch*** has the meaning given by section 832-615.

***importing payment***, in relation to an \*offshore hybrid mismatch, has the meaning given by section 832-625.

***liable entity*** has the meaning given by section 832-325.

***neutralising amount***:

- (a) for a \*hybrid payer mismatch—has the meaning given by section 832-330; and
- (b) for a \*deducting hybrid mismatch—has the meaning given by section 832-560.

***offshore hybrid mismatch*** has the meaning given by sections 832-195, 832-300, 832-390, 832-465 and 832-540.

***party***, in relation to a \*structured arrangement, has the meaning given by subsection 832-210(3).

***reverse hybrid*** has the meaning given by section 832-410.

***reverse hybrid mismatch*** has the meaning given by section 832-395.

***structured arrangement*** has the meaning given by section 832-210.

***subject to Australian income tax*** has the meaning given by section 832-125.

***subject to foreign income tax*** has the meaning given by section 832-130.

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

### ***Income Tax (Transitional Provisions) Act 1997***

#### **14 After Division 830**

Insert:

### **Division 832—Hybrid mismatch rules**

#### **Table of Subdivisions**

832-A Application of Division 832 of the *Income Tax Assessment Act 1997*

### **Subdivision 832-A—Application of Division 832 of the *Income Tax Assessment Act 1997***

#### **Table of sections**

832-10 Application of Division 832 of the *Income Tax Assessment Act 1997* (other than imported hybrid mismatch rule)

832-15 Application of imported hybrid mismatch rule

### **832-10 Application of Division 832 of the *Income Tax Assessment Act 1997* (other than imported hybrid mismatch rule)**

- (1) The Subdivisions of Division 832 of the *Income Tax Assessment Act 1997* covered by subsection (2) apply to assessments for income years starting on or after 1 January 2019.
- (2) The Subdivisions are as follows:
  - (a) Subdivision 832-C (Hybrid financial instrument mismatch);
  - (b) Subdivision 832-D (Hybrid payer mismatch);
  - (c) Subdivision 832-E (Reverse hybrid mismatch);
  - (d) Subdivision 832-F (Branch hybrid mismatch);
  - (e) Subdivision 832-G (Deducting hybrid mismatch);
  - (f) Subdivision 832-J (Integrity rule).



## **Schedule 2—Other effects of foreign income tax deductions**

### **Part 1—Denial of imputation benefits**

#### ***Income Tax Assessment Act 1997***

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

Insert:

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

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

Insert:

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

##### **3 After section 207-157**

Insert:

#### **207-158 Distributions entitled to a foreign income tax deduction**

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

## Part 2—Foreign equity distributions

### *Income Tax Assessment Act 1936*

#### 4 Section 404

Before “For”, insert “(1)”.

#### 5 At the end of section 404

Add:

- (2) For the purpose of applying this Act in calculating the attributable income of the eligible CFC, disregard paragraph 768-5(1)(d) of the *Income Tax Assessment Act 1997* if:
- (a) the eligible CFC receives, either directly or indirectly through one or more interposed trusts or partnerships, a foreign equity distribution (within the meaning of the *Income Tax Assessment Act 1997*) from a company; and
  - (b) at the time the distribution is made, both the eligible CFC and the company are residents of the same listed country or unlisted country.

### *Income Tax Assessment Act 1997*

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

Add:

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

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

Add:

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

#### 8 After section 768-5

Insert:

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

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

*Exception for foreign corporate collective investment vehicles*

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

## Part 3—Application

### 9 Application—general

- (1) The amendments made by Part 1 of this Schedule apply in relation to distributions made on or after 1 January 2019.
- (2) The amendments made by Part 2 of this Schedule apply in relation to foreign equity distributions made on or after 1 January 2019.
- (3) However, the amendments do not apply unless the foreign income tax deduction to which all or part of the distribution or foreign equity distribution gives rise arises in a foreign tax period ending on or after 1 January 2019.

### 10 Application—regulatory capital

- (1) Subitem (2) applies if:
    - (a) before 9 May 2017, any of the following occurred:
      - (i) an ADI issued an Additional Tier 1 capital instrument (within the meaning of the prudential standards determined by APRA under section 11AF of the *Banking Act 1959* and as in force at the time this Schedule commences);
      - (ii) a general insurance company issued an Additional Tier 1 capital instrument (within the meaning of the prudential standards determined by APRA under section 32 of the *Insurance Act 1973* and as in force at the time this Schedule commences);
      - (iii) a life insurance company issued an Additional Tier 1 capital instrument (within the meaning of the prudential standards determined by APRA under section 230A of the *Life Insurance Act 1995* and as in force at the time this Schedule commences); and
    - (b) the instrument is callable, and there is a scheduled call date of the instrument on or after 9 May 2017.
  - (2) Despite subitem 9(1), the amendments made by Part 1 of this Schedule do not apply in relation to a distribution on the instrument if:
-

- (a) at the time the distribution is made, the instrument is an Additional Tier 1 capital instrument within the meaning of the applicable prudential standards as in force at that time; and
  - (b) the distribution is made on or before the first scheduled call date of the instrument that occurs on or after 9 May 2017.
- (3) In determining for the purposes of paragraph (2)(b) whether a call date is the first scheduled call date occurring on or after 9 May 2017, disregard a call date if:
  - (a) the ADI, general insurance company or life insurance company sought prior written approval from APRA to exercise the call option; and
  - (b) the prior written approval was not received.

## **Schedule 3—Strengthening the integrity of the film producer offset**

### ***Income Tax Assessment Act 1997***

#### **1 After subsection 376-170(3)**

Insert:

- (3A) Expenditure incurred for the purchase of services is not covered by item 4 of the table in subsection (2) if the services are, to any extent, performed by an individual who is not an Australian resident.

#### **2 Application of amendment**

The amendment made by this Schedule applies in relation to films commencing principal photography on or after 1 July 2018.

## **Schedule 4—Income tax and withholding exemptions for the ICC World Twenty20**

### ***Income Tax Assessment Act 1936***

#### **1 Subparagraph 128B(3)(a)(i)**

Omit “or 9.2”, substitute “, 9.2 or 9.3”.

### ***Income Tax Assessment Act 1997***

#### **2 Section 11-5 (table item headed “sports, culture or recreation”)**

After:

game society etc. .... 50-45

insert:

ICC Business Corporation FZ-LLC ..... 50-45

#### **3 Section 50-40 (table item 8.4)**

Omit “in assessable income”, substitute “as \*ordinary income or \*statutory income”.

#### **4 Section 50-45 (at the end of the table)**

Add:

- |     |                                    |   |
|-----|------------------------------------|---|
| 9.3 | ICC Business Corporation<br>FZ-LLC | both of the following:<br>(a) the entity is a *wholly-owned subsidiary of International Cricket Council Limited;<br>(b) only amounts included as *ordinary income or *statutory income:<br>(i) on or after 1 July 2018;<br>and<br>(ii) before 1 July 2023 |
|-----|------------------------------------|---|

## Schedule 5—Deductible gift recipients

### *Income Tax Assessment Act 1997*

#### **1 In the appropriate position in subsection 30-50(2) (table)**

Insert:

|        |  |  |
|--------|--|--|
| 5.2.34 | Melbourne Korean War Memorial Committee Incorporated | the gift must be made after 31 December 2017 and before 1 January 2020 |
|--------|--|--|

#### **2 Section 30-315 (after table item 72)**

Insert:

|       |  |             |
|-------|--|-------------|
| 72AAA | Melbourne Korean War Memorial Committee Incorporated | item 5.2.34 |
|-------|--|-------------|

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[*Minister's second reading speech made in—  
House of Representatives on 24 May 2018  
Senate on 27 June 2018*]

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(102/18)