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22 December 2017

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

Email: BEPS@treasury.gov.au

Dear William,

EXPOSURE DRAFT LEGISLATION – TREASURY LAWS AMENDMENT (OECD HYBRID MISMATCH RULES) BILL 2017

Thank you for the opportunity to provide comments on the Exposure Draft Legislation ("**ED**") and Explanatory Memorandum ("**EM**") concerning the Treasury Laws Amendment (OECD Hybrid Mismatch Rules) Bill 2017, which contains Australia's proposed response to OECD Action 2; in particular, the discussion and recommendations in the 2015 Report ("**the Action 2 Report**").

We have provided our comments on the issues that we have identified with the ED and EM in Appendix A to this letter. We have limited our comments to aspects of the measures that we believe are particularly relevant to our client base – smaller public companies, large family businesses, small to medium enterprises and high wealth individuals. We would be happy to discuss these matters further with you in detail.

Please contact me on (03) 8612 9700 at any time if you would like to discuss this further.

Yours sincerely

J C CHENG
Executive Director

APPENDIX A – SPECIFIC COMMENTS RELATING TO THE ED AND EM

Issue #	Issue	Comments	Recommendation	Importance
1.	Paragraph 1.99, Explanatory Memorandum	This paragraph is part of the commentary on when a Hybrid Financial Instrument Mismatch arises. Paragraph 1.99 refers to certain passages in the OECD's Action 2 Report. At paragraph 98, the Action 2 Report contains a clear statement that a Hybrid Financial Instrument Mismatch would not arise merely because the counterparty is resident in a territorial tax regime jurisdiction.	We suggest that there be a positive statement in the ED (alternatively the EM) that the proposed rules be interpreted in such a way as to best achieve consistency with the recommendations made in the OECD Action 2 Report, taking into account the recommendations made by the Board of Taxation. Alternatively, we suggest that the EM endorse the comment at paragraph 98 of the Action 2 Report: that is, that a Hybrid Financial Instrument Mismatch would not arise merely because the counterparty is resident in a territorial tax regime jurisdiction (e.g. Malaysia). Another example could also be inserted after example 1.4 to illustrate that a mismatch in tax treatment arising as a result of a payment made to an entity in a territorial tax regime will not arise from the terms of the interest or arrangement.	High

Issue #	Issue	Comments	Recommendation	Importance
2.	832-25	Example 1.14 in the Action 2 Report discusses whether a Hybrid Financial Instrument Mismatch arises where a 'notional' deduction is allowed to the borrower in relation to an interest free loan. The Action 2 Report concludes that the example would not constitute a Hybrid Financial Instrument Mismatch on the basis that there is no "payment" under the instrument that gives rise to a deduction. The Action 2 Report considers the meaning of "payment" at paragraph 28 together with Examples 1.13 and 1.14. In brief, the Report indicates that "payment" includes an actual outgoing as well as an "accrual of a future payment obligation". However, the Action 2 Report is quite clear that "payment" would not include an accrued amount that does not result in the creation of any economic rights between the parties. We note that proposed section 832-25 is consistent with the meaning of "payment" in the Action 2 Report. However, it is unclear how this section would operate in relation to an amount of interest deemed to arise to counteract a transfer pricing benefit under section 815-115(2)(d) if the relevant taxpayer were subsequently allowed to remit the deemed interest to the counterparty so as to align its tax and cash position.	We suggest that the interaction of proposed Division 832 with Division 815 be clarified.	High
3.	832-1010	Unlike section 177D of the *Income Tax Assessment Act 1936 (Cth)*, the proposed section provides no guidance on the 'facts and circumstances' to be considered in determining whether a scheme is a structured arrangement and no assistance is provided in the EM on that process.	We suggest that examples be included in the EM to illustrate the process of determining whether a structured arrangement exists and which entities would be parties to the arrangement.	Medium

Issue #	Issue	Comments	Recommendation	Importance
4.	768-7 Paragraph 1.94	In the case of a taxpayer with a participation interest of, say, 12% it will often be the case that they are unable to obtain information from the dividend payer regarding the payer's ability to obtain a foreign income tax deduction. This could be contrasted with the position where a taxpayer has a controlling interest in a foreign subsidiary and would be expected to have greater access to such information. The requirement in paragraph 1.94 to have 'a reasonable expectation of the likely tax outcome for the counterparty' based on the tax rules in the foreign jurisdiction would seem to place a fairly onerous burden on an SME taxpayer.	We suggest clarifying the steps that a taxpayer would be required to undertake regarding the existence of a foreign income tax deduction before being able to treat a dividend as non-assessable non-exempt income under section 768-5 of the *Income Tax Assessment Act 1997*. For example, if a taxpayer has requested from the dividend payer information regarding the ability to obtain a deduction in the foreign jurisdiction but this has not been provided, the EM should clarify whether the taxpayer would be required to take any further steps.	High