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| **EXPOSURE DRAFT** |

Inserts for

Treasury Laws Amendment (Measures for Consultation) Bill 2019: hybrid mismatch rules

| Commencement information |
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| Column 1 | Column 2 | Column 3 |
| Provisions | Commencement | Date/Details |
| 1. Schedule # | The first 1 January, 1 April, 1 July or 1 October to occur after the day this Act receives the Royal Assent. |  |

Schedule #—Hybrid mismatch rules

Part 1—MEC groups

Income Tax Assessment Act 1997

1 Subsection 832‑30(2) (note)

Omit “a member of a consolidated group”, substitute “a subsidiary member of a consolidated group or MEC group”.

2 Subsection 832‑325(1) (note 2)

Omit “a member of a consolidated group”, substitute “a subsidiary member of a consolidated group or MEC group”.

3 Subparagraph 832‑410(2)(b)(ii)

After “\*consolidated group”, insert “or \*MEC group”.

4 Subparagraph 832‑550(c)(ii)

After “\*consolidated group”, insert “or \*MEC group”.

5 Application

The amendments made by this Part apply to assessments for income years starting on or after 1 January 2019.

Part 2—State and municipal foreign taxes

Income Tax Assessment Act 1997

6 Subparagraph 832‑110(5)(b)(i)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

7 Subsection 832‑120(1)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

8 Paragraph 832‑120(3)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

9 Subsection 832‑130(1)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection (7))”.

10 Subsection 832‑130(3)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection (7))”.

11 Subsection 832‑130(4)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection (7))”.

12 Paragraph 832‑130(6)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection (7))”.

13 At the end of section 832‑130

Add:

Certain foreign taxes disregarded in this Division

 (7) This subsection covers each of the following:

 (a) \*credit absorption tax;

 (b) \*unitary tax;

 (c) withholding‑type tax;

 (d) municipal tax;

 (e) in the case of a federal foreign country—a State tax.

Note: The definitions of ***credit absorption tax*** and ***unitary tax*** are in section 770‑15.

14 Paragraph 832‑235(2)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

15 Paragraph 832‑325(1)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

16 Paragraph 832‑325(2)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

17 Paragraph 832‑480(4)(b)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

18 Subparagraph 832‑485(4)(a)(ii)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

19 Subparagraphs 832‑555(9)(b)(i) and (ii)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

20 Paragraph 832‑625(4)(d)

Omit “(except \*credit absorption tax, \*unitary tax or a withholding‑type tax)”, substitute “(except a tax covered by subsection 832‑130(7))”.

21 Application

The amendments made by this Part apply to assessments for income years starting on or after 1 January 2019.

Part 3—Entities

Income Tax Assessment Act 1997

22 Section 832‑30

Repeal the section, substitute:

832‑30 How this Division applies to entities

Identifying payments between entities etc.

 (1) In determining for the purposes of this Division whether an entity makes or receives a payment, the following are to be disregarded:

 (a) subsection 701‑1(1) (the single entity rule);

 (b) Part IIIB of the *Income Tax Assessment Act 1936*;

 (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.

Note 1: As a consequence of paragraph (1)(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)).

Note 2: Part IIIB of the *Income Tax Assessment Act 1936* (which is about Australian branches of foreign banks) is disregarded because it is separately modified to deal with hybrid mismatches: see Division 5 of that Part.

 (2) In addition, in the case of a trust or partnership, the trust or partnership, instead of a trustee or partner, is taken, for the purposes of this Division, to do the following things:

 (a) make or receive a payment;

 (b) hold, acquire or dispose of an asset, interest or other property;

 (c) enter into or carry out a \*scheme or a part of a scheme.

Identifying income or profits of entities

 (3) For the purposes of this Division, things recognised in accordance with subsection (1) or (2) as being done by an entity are to be taken into account in identifying the income or profits of the entity.

Assessable income and deductions

 (4) A reference in this Division to an amount being included in the assessable income of an entity, or being allowable, or not allowable, as a deduction to an entity, is taken in the case of a trust or partnership in respect of which \*net income is being calculated to be a reference to an amount that is included, allowable or not allowable, as the case requires, in determining that net income.

This section does not make a non‑legal person a taxpayer

 (5) Nothing in this section affects whether or not an entity is a \*liable entity (see section 832‑325).

Note: A trust that is not a member of a consolidated group or MEC group can only be a deducting hybrid if the trust itself is a liable entity in a country other than Australia: see paragraph 832‑550(c).

This section does not affect the interpretation of other provisions

 (6) Nothing in this section limits, by implication, any other provision of this Act.

23 Subsection 832‑320(1) (note)

Before “identified”, insert “generally”.

24 Subsections 832‑325(1) and (2) (note 1)

Before “identified”, insert “generally”.

25 At the end of subsection 832‑325(2) (after note 2)

Add:

Note 3: Another example is a test entity that is a trust to which Division 6 of Part III of the *Income Tax Assessment Act 1936* applies. Each beneficiary who is presently entitled to a share of the income of the trust and who is not under any legal disability, and the trustee of the trust, are liable entities in respect of the income or profits of the trust.

26 Subsection 832‑410(1) (note)

Before “identified”, insert “generally”.

27 Application

The amendments made by this Part apply to assessments for income years starting on or after 1 January 2019.

Part 4—Dual inclusion income

Income Tax Assessment Act 1997

28 Paragraph 832‑680(4)(b)

Omit “at a time”.

29 Paragraphs 832‑680(4)(c), (d) and (e)

Repeal the paragraphs, substitute:

 (c) it is reasonable to conclude that:

 (i) the payment was funded by an amount of income or profits of the other member (the ***funding income or profits***); and

 (ii) an outcome mentioned in subsection (1) arose for the funding income or profits in the country mentioned in paragraph (a) of this subsection (including as a result of a previous operation of subsection (5)); and

 (d) the funding income or profits were not \*dual inclusion income in the country.

Note: Because subparagraph (c)(ii) recognises a tax outcome that arises through a previous operation of subsection (5), the tax outcome can effectively be passed through a chain of payments.

30 Subsection 832‑680(5)

Repeal the subsection, substitute:

 (5) The outcome mentioned in subparagraph (4)(c)(ii) is taken to have arisen for the on‑payment amount in the income year, or foreign tax period (as the case requires) in which the payment was received, for the purposes of:

 (a) this section; and

 (b) sections 832‑330 and 832‑335 (about neutralising amounts and adjustments for hybrid payer mismatches); and

 (c) sections 832‑560 and 832‑565 (about neutralising amounts and adjustments for deducting hybrid mismatches).

31 Application

The amendments made by this Part apply to assessments for income years starting on or after 1 January 2019.

Part 5—Hybrid entities integrity rule

Income Tax Assessment Act 1997

32 After subsection 832‑240(2)

Insert:

 (2A) Subsection (2) does not apply if, on the assumption that subsections 832‑180(2) and 832‑725(6) were disregarded, no amount would have been allowable as a deduction in respect of the payment because of subsection 832‑725(3).

33 After subsection 832‑565(2)

Insert:

 (2A) Subsection (2) does not apply if:

 (a) the amount that was not allowable as a deduction under section 832‑530 relates to a payment; and

 (b) on the assumption that subsection 832‑530(2) were disregarded, no amount would have been allowable as a deduction in respect of the payment because of subsection 832‑725(3).

34 Section 832‑720

Omit “an Australian deduction of an entity (the ***paying entity***) for a payment of interest (or a payment of a similar character)”, substitute “an Australian deduction for a payment of interest (or a payment of a similar character) made by an entity (the ***paying entity***)”.

35 Section 832‑720

Omit “a purpose of enabling a deduction to be obtained in respect of the payment, or”, substitute “a purpose of enabling a deduction to be obtained in respect of the payment, and”.

36 Paragraph 832‑725(1)(e)

Omit “the paying entity”, substitute “an entity”.

37 Subsection 832‑725(3)

Repeal the subsection, substitute:

 (3) The entity mentioned in paragraph (1)(e) is not entitled to the deduction mentioned in that paragraph.

38 Subsection 832‑725(6)

Omit “a \*deducting hybrid mismatch”.

39 At the end of section 832‑725

Add:

 (7) Subsection (3) does not apply to the extent that an amount to which the payment relates was not allowable as a deduction under subsection 832‑530(2).

40 Application

The amendments made by this Part apply to assessments for income years starting on or after 2 April 2019.

Part 6—Foreign income tax deductions for regulatory capital

Income Tax Assessment Act 1997

41 Section 207‑158

Repeal the section, substitute:

207‑158 Distributions entitled to a foreign income tax deduction

 (1) This section applies to a \*franked distribution if:

 (a) all or part of the distribution gives rise to a \*foreign income tax deduction; and

 (b) the distribution is not made in respect of a \*non‑share equity interest to which the exception in subsection (2) applies.

Exception for distributions made under certain regulatory capital instruments

 (2) The exception in this subsection applies to a \*non‑share equity interest if:

 (a) the interest forms part(either on a solo or consolidated basis) of the Additional Tier 1 capital of an \*ADI, \*general insurance company or \*life insurance company for the purposes of the applicable prudential standards (see subsection (3)); and

 (b) the ADI, general insurance company or life insurance company notifies the Commissioner that the ADI, general insurance company or life insurance company will not claim any amount of a \*foreign income tax deduction to which distributions on the interest give rise.

 (3) For the purposes of paragraph (2)(a), the applicable prudential standards are:

 (a) for an \*ADI—the \*prudential standards;

 (b) for a \*general insurance company—prudential standards determined by \*APRA and in force under section 32 of the *Insurance Act 1973*;

 (c) for a \*life insurance company—prudential standards determined by APRA and in force under section 230A of the *Life Insurance Act 1995*.

 (4) A notification under paragraph (2)(b) must be made:

 (a) in the \*approved form; and

 (b) on or before:

 (i) the day by which the \*distribution statement is required to be given for the first \*frankable distribution made in respect of the \*non‑share equity interest; or

 (ii) a later day allowed by the Commissioner.

Note: For when a distribution statement is required to be given, see Subdivision 202‑E.

 (5) A choice under paragraph (2)(b) cannot be revoked.

42 Transitional provision—interests already on issue

 In determining for the purposes of subparagraph 207‑158(4)(b)(i) of the *Income Tax Assessment Act 1997*, as inserted by this Part, whether a distribution is the first frankable distribution made in respect of a non‑share equity interest, have regard only to distributions made:

 (a) unless paragraph (b) applies—on or after the day this Act receives the Royal Assent; or

 (b) if subitem 10(2) of Schedule 2 to the *Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Act 2018* applies in relation to the interest—on or after the later of:

 (i) the first scheduled call date referred to in paragraph (b) of that subitem; and

 (ii) the day this Act receives the Royal Assent.

43 Application provision

 The amendments made by this Part apply in relation to distributions made on or after 1 January 2019.