

Hybrid mismatch restructures and general anti-avoidance rules- final ATO guidance

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In brief

On 25 October 2018, the Australian Taxation Office (ATO) released Practical Compliance Guideline (PCG 2018/7) which considers the application of the general anti-avoidance provisions (Part IVA of the *Income Tax Assessment Act 1936*) in the context of restructures of hybrid mismatch arrangements.

The hybrid mismatch rules generally take effect for income years commencing on or after 1 January 2019. The application of the hybrid mismatch rules could have the effect of disallowing Australian deductions for a wide range of cross border payments (e.g. costs in respect of related party financing, royalties, services or trading stock purchases) or generating additional taxable income for Australian taxpayers.

As there are no transitional rules or grandfathering of existing arrangements, the hybrid mismatch rules had a deferred commencement date which was intended to allow taxpayers time to review their existing hybrid mismatch arrangements and unwind or restructure out of such arrangements in advance of the rules. The PCG provides guidance on the ATO's compliance approach to the application of the general anti-avoidance provision (Part IVA) to restructures that have the effect of preserving Australian tax benefits that would otherwise be denied under the hybrid mismatch rules.

The purpose of the PCG is to assist taxpayers to manage their compliance risk by outlining straightforward (low risk) restructuring to which the Commissioner of Taxation (Commissioner) would not seek to apply Part IVA.

There are a number of refinements to the finalised PCG as compared to the draft version that was released on 24 May 2018, particularly in the following areas:

- Clarifications around the scope of the PCG and the factors the ATO would consider in making its risk assessment.
- Removal of examples of 'higher risk' scenarios.
- Clarification that it should not be inferred from the PCG that restructuring which does not accord with the 'low risk' characterisation necessitates a conclusion that Part IVA applies to the restructure.
- Inclusion of three additional 'low risk' examples, including one designed to prevent the application of the unilateral low tax rate (10 per cent or less) lender rule.
- Clarifying that references to Part IVA in the PCG do not include the Diverted Profits Tax (DPT) or the Multinational Anti-Avoidance Law elements of Part IVA.

Key changes

The ATO previously released draft PCG 2018/D4 (the draft PCG) which set out the ATO's preliminary views around the factors that may point towards a 'low risk' scenario in terms of the potential for Part IVA to apply. It also had a series of examples which the ATO considered to be 'low risk' and some examples the ATO considered to be 'higher risk'. Further information on the draft PCG can be found in our [TaxTalk Alert](#) published on 21 June 2018.

The broad thrust of the PCG has not changed from the draft PCG. However, the ATO has made a number of refinements which are highlighted below.

Scope of the PCG and 'low risk' categorisation

The PCG acknowledges that restructuring which does not accord with the 'low risk' characterisation outlined in the guidelines does not necessitate a conclusion that Part IVA applies to the restructure, but notes that such restructures may attract further ATO scrutiny.

The PCG explains that information around restructures may need to be disclosed in the International Dealing Schedule (IDS) or Local file - short form (as part of Country by Country reporting) or the Reportable Tax Position (RTP) Schedule. This seems to be an indication that the list of Category C RTPs may be updated to include the notification of restructures that are not 'low risk' under the PCG (further information in relation to RTP reporting is available in our [TaxTalk Alert](#), published on 30 October 2018.).

The PCG is effective from 24 August 2018 but 'applies to restructuring arrangements entered into before and after that date'. However, it is unclear how far back in time taxpayers are expected to apply the PCG risk rating to restructures and it is hoped that the ATO will clarify this point if and when the RTP schedule is updated.

Factors to be present for 'low risk' classification

The PCG states an expectation that the following factors would be present for a restructure to qualify as low risk:

- a. *There is no change to the entities or jurisdictions of entities involved under the replacement arrangement, unless the change in entities is the result of the removal from the original arrangement of an entity whose tax characteristics gave rise to the hybrid outcome. Such a change would represent a rationalisation of the flow of funds or a simplification of the structure under the new arrangement. Essentially this factor is concerned with the interposition of entities or jurisdictions unconnected with the original arrangement, where the interposition might be indicative of tax driven restructuring.*
- b. *The original arrangement prior to the restructure would not have attracted the application of Part IVA.*
- c. *The replacement arrangement on a stand-alone basis would not attract the application of Part IVA. By stand-alone basis we mean the arrangement as viewed without regard to the original arrangement or the restructuring steps.*
- d. *The restructure and replacement arrangement are effected in a straightforward manner, explicable only by an objective of eliminating hybrid outcomes.*
- e. *Both the restructure steps and replacement arrangement are implemented in a commercial manner reflecting arm's length conditions. In this regard, it is to be noted that this Guideline does not deal specifically with pricing of related party transactions as other ATO guidance materials are available to assist taxpayers assessing their risk in respect of arm's length conditions.*

The PCG notes that while ideally all of the factors should be present, there may be some circumstances where not all of the factors are relevant because ‘one of the factors might not be appropriate or relevant in the particular circumstances’.

Examples of ‘low risk’ scenarios

The PCG provides seven examples of restructures that exhibit the above factors which therefore the ATO considers ‘low risk’:

- Replacement of inbound hybrid preference shares with ‘ordinary’ interest bearing debt.
- Replacement of an outbound hybrid profit participating loan with ‘ordinary’ equity.
- Reorganisation of the ownership of a deducting hybrid Australian limited partnership.
- Refinancing a deducting hybrid foreign partnership.
- Changing the entity classification for an Australian hybrid payer using US check-the-box rules (new example).
- Refinancing an inbound loan from a foreign reverse hybrid entity with a replacement ‘ordinary’ loan from the parent (new example).
- Refinancing an inbound loan from a Foreign Interposed Zero or Low Rate lender (FIZLR) with a replacement ‘ordinary’ loan from the parent (new example).

Diverted Profits Tax (DPT) and Multinational Anti-Avoidance Law (MAAL)

The PCG explains that references to Part IVA in the PCG does not include the DPT or the MAAL. As a result, it will be necessary to address the DPT and MAAL in relation to any replacement arrangements notwithstanding a ‘low risk’ rating in accordance with the PCG.

The takeaway

The views expressed in the PCG may provide welcome reassurance for taxpayers that are able to restructure in a manner that satisfies all of the factors required to qualify as a low risk restructure. In these cases, it will also be necessary to separately address, for example, MAAL and DPT.

However, we anticipate that in many circumstances a restructure may not satisfy all the requirements to be considered ‘low risk’. In these circumstances, it will be important to consider the potential application of Part IVA to the particular arrangements to obtain comfort that the restructure does not contain elements that could attract the operation of Part IVA; and it will be critical to ensure that there is sufficient evidence to discharge the taxpayer’s burden of proof.

In addition to the Part IVA aspect highlighted by the draft PCG, restructuring out of hybrid arrangements and FIZLR entities and into alternative arrangements will require careful consideration of a range of issues including legal (including Foreign Investment Review Board), transfer pricing, accounting, treasury, withholding taxes, losses, foreign tax credits, stamp duty and foreign tax issues. Timing will be tight in many cases given the wide range of complexities involved. For example, for calendar year taxpayers that currently have direct or indirect hybrid arrangements or FIZLR entities, there are less than 45 working days to resolve a range of issues and implement any restructuring.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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