US GILTI and hybrid mismatches

22 November 2019

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In brief

On 21 November 2019, the Australian Taxation Office (ATO) issued draft guidance in the form of Taxation Determination TD 2019/D12 (Draft TD) on the application of Australia's hybrid mismatch rules in relation to the United States (US) "GILTI" rules which, in essence, include certain income of controlled foreign companies (CFCs) in the US tax base.

In short, the Commissioner of Taxation (Commissioner) considers that US taxation of payments as a result of the application of the GILTI regime does not mean that amount is subject to foreign tax (STFT) because the GILTI regime does not "correspond" to Australia's CFC rules.

This means that under the hybrid mismatch rules, Australian taxpayers could be denied deductions for certain payments, notwithstanding those payments are included in the tax base of a US taxpayer. In addition, where an Australian entity's income is subject to US federal income tax under the GILTI rules, these amounts would not be considered "dual inclusion income" (DII), notwithstanding those amounts are included in the tax base of a US taxpayer. This is an important issue for many US headquartered multinational groups as the Commissioner's interpretation ultimately can result in the double taxation of certain profits.

In detail

Very broadly, the hybrid mismatch rules provide that an amount should be viewed as STFT to the extent it is subject to "direct" foreign taxation or taxation because of a foreign country's CFC regime. In this regard, the legislation (section 832-130 of the *Income Tax Assessment Act 1997 (ITAA 1997)* provides that:

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).

The Explanatory Memorandum to the Bill that introduced Australia's hybrid mismatch rules (at paragraph 1.109) provides further context and explains that:

Where a payment is taken into account under a foreign-controlled foreign company regime in calculating the foreign equivalent of attributable income of a controlled foreign company but the amount that is included in the tax base of another entity (that is, the relevant taxable shareholder under the foreign controlled foreign company regime) is a lesser amount, only the lesser amount (to the extent it reasonably represents the amount of the payment) included in the tax base of the entity is considered to be subject to foreign income tax.

The concept of STFT is relevant for working out whether a "deduction/non-inclusion" (D/NI) outcome arises in respect of a payment (which could result in a denied deduction) and in determining whether a taxpayer has sufficient "dual inclusion income" (which can reduce the adverse impacts of certain hybrid

mismatches). The STFT concept is also relevant for the purposes of the unique Australian low tax lender rule which can apply where interest and certain other payments are subject to foreign tax of 10% or less and certain other conditions are satisfied.

The Draft TD considers whether section 951A of the US Internal Revenue Code is a provision of a law of a foreign country that corresponds to Australia's CFC provisions (specifically, section 456 or 457 of the *Income Tax Assessment Act 1936 (ITAA 1936)*) for the purpose of subsection 832-130(5) of the *ITAA 1997*.

While it is not within the scope of this alert to consider the details of the US GILTI rules, in broad terms, section 951A requires a US shareholder of any CFC for any taxable year to include in gross income the shareholder's GILTI for such taxable year. The Draft TD provides a simplified overview of some key aspects of the GILTI rules.

The Commissioner's preliminary view is that income subject to tax as a result of the operation of section 951A should not be considered STFT because section 951A does not "correspond" to section 456 and/or 457 for the following key reasons:

- Notwithstanding that section 951A is contained within subpart F (i.e. the US CFC rules), section 951A functions as the inclusion provision for the broader GILTI regime. The Commissioner contrasts this to sections 456 and 457 which is considered to not function as inclusion provisions for a global minimum tax regime but inclusion provisions for a general CFC anti-deferral regime.
- GILTI is a different category of income to subpart F income and is determined in a way that is fundamentally different to determining subpart F income. In substance, a GILTI inclusion under section 951A represents a deemed high or above-normal return on certain depreciable property whether or not the deemed return in fact comprises passive or tainted income and whether or not the deemed return in fact comprises intangible income. In the Commissioner's view, this should be contrasted with inclusion under section 456 or 457 which does not represent a deemed high or above-normal return on depreciable property (i.e. amounts included under sections 456 and 457 are comprised of passive or tainted income and irrespective of whether that income represents a below-normal, normal or above-normal return).

The Draft TD does not address commentary in the Explanatory Memorandum introducing the hybrid mismatch rules which could be interpreted as suggesting income subject to the GILTI regime should be considered STFT. In addition, the Draft TD does not address commentary in the OECD Action 2 Report which would also seem to support this view.

The takeaway

Taxpayers that have taken positions that income subject to the GILTI regime (perhaps based on commentary in the Explanatory Memorandum given GILTI is part of the broader Subpart F provisions and commentary provided by the OECD) should be considered STFT will need to consider the impact of the Draft TD. Taxpayers that are interested have until 17 January 2020 to make submissions on the draft Taxation Determination.

More generally, the Draft TD is a reminder that the application of the hybrid mismatch rules is complex and there remains a wide range of unresolved technical issues. These difficulties are particularly acute because of the unique requirement, as demonstrated in this Draft TD, to have an intricate understanding of the operation of foreign tax laws in applying the Australian hybrid mismatch rules. In addition, we are not expecting any further public guidance from the Commissioner in relation to any of these difficult issues before affected taxpayers will be required to file their tax returns.

The hybrid mismatch rules, including the low tax lender rule and the imported mismatch rule in certain circumstances, are operational for income years commencing on or after 1 January 2019. It is critical that taxpayers with any cross-border related party transactions assess the impact of these rules on their tax positions as they can, in some cases, have a drastic adverse impact on Australian tax outcomes. In many

cases, for taxpayers that have not already taken action to comply, it will not be possible to restructure to comply with the hybrid mismatch rules for the 2019 calendar year.

Let's talk

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

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