Friday, 15 January 2016

Board of Taxation Secretariat
C/ - The Treasury
Langton Crescent
PARKES ACT 2600

Also by Email: hybrid@taxboard.gov.au

TAX INTEGRITY: Anti Hybrid Rules

Dear Secretariat,

The American Chamber of Commerce in Australia is writing in response to the request for submissions as set out in the Consultation paper "Implementation of the OECD Anti Hybrid Rules" issued by the Board of Taxation in November 2015.

The American Chamber of Commerce in Australia - better known as AmCham - was founded in 1961 by Australian and American businesses to encourage the two-way flow of trade and investment between Australia and the United States, and to assist its members in furthering business contacts with other nations. In pursuing this goal, AmCham has grown and diversified. It finds itself not only representing the United States' business view, but also speaking increasingly for a broad range of members involved in the Australian business community.

AmCham represents the interest of American companies undertaking business activity in Australia. American investment accounts for 24 per cent of all foreign investment in Australia which makes it, by far, the single largest investor in Australia.

Anti-Hybrid Rules

AmCham recognises that globalisation has profoundly impacted how multinational corporations are organised and the way they conduct business. Multinational companies seek to be competitive in an international market and their investments are likely to be made where profitability is the highest. As profitability is impacted by the taxes paid, it follows that a country's tax system will impact where multinational companies will invest.

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The members of AmCham are aware of, and strongly support, the efforts of the Organisation for Economic Co-operation and Development ("OECD") and the G-20 in working towards a unified movement of tax reform to ensure that global tax rules remain current with business evolution.

AmCham believes that existing domestic legislation and double tax treaties deal adequately with the objective of restricting the level of debt funding that can be allocated to the Australian operations of multinational companies. In particular:

- Australia's thin capitalisation rules were amended in 2014 to reduce the safe harbour debt level for general taxpayers from 75% of adjusted assets to 60%. Unlike other foreign jurisdictions, Australia's thin capitalisation rules include all debt, not just related party debt, providing a secondary protection.

- The treatment of outbound debt that is legal form of equity has been excluded from the dividend exemption regime through the introduction of subdivision 768-A ITAA 1997.

- The treatment of financing arrangements is clear through the operation of Division 974 and Division 230.

- Transfer pricing rules (section 815-140 ITAA1997) provide that the rate of interest charged can be restricted.

- Overriding all these specific provisions is the ability for the Commissioner to apply the general anti avoidance rules to transactions that are undertaken for the dominant purpose of a tax benefit.

It is unlikely that the introduction of such a measure will raise any further revenue and we strongly suggest that this is balanced against the significant cost and complexity of complying with the proposed measures. In particular, any economic costing for the introduction of the rules should take into account the significant costs to the issuer of the debt which may include significant break fees for early repayment, foreign exchange implications (where relevant), advisor costs and overall cost to the organisation.

Where the hybrid rules are implemented, we have set out below some recommendations based on the questions raised in the consultation paper as follows:

- The appropriate date for implementation and scope of the measures should be in alignment with our major foreign trading partners in particular, U.S.A, U.K, Germany, Japan and China.

- The effective start date for the rules should be set far enough in advance, once exposure draft legislation is released, to give taxpayers sufficient time to determine the likely impact of the rules and to restructure existing arrangements.

- The new measures should include restrictions on the application of the general anti avoidance provisions by the Commissioner in the case of a restructure where a taxpayer is seeking to preserve an existing position but mitigate the impact of the new measures.

- There should be grandfathering of existing arrangements until the debt reaches maturity at which time any refinancing can take the new provisions into account in determining structure and pricing. Alternatively, there should be a transition period for existing arrangements. Examples of where transitional measures have been previously adopted include Division 974 (4 year period).

- There should be a de-minimis exemption from the provisions. The introduction of such an exemption is consistent with, for example, the introduction of the Multinational Anti Avoidance Legislation (section 960-555 ITAA 1997), exemption from the thin capitalisation provisions (section 820-35 ITAA 1997) and Taxation of Financial Arrangement provisions (section 230-5 ITAA 1997).

- The anti-hybrid rules will require both taxpayers and the Commissioner to have a detailed understanding of the laws of every jurisdiction. This understanding will be required to identify a hybrid outcome, determine whether the rules apply and, if they do, determine whether or not the hybrid outcome is reversed in the future.

- Additional complexity arises in regard to reversal scenarios given that tax rules differ between jurisdictions.

For example, assume a U.S. multinational establishes an Australian Holding Company (AHC) that is disregarded for U.S. tax purposes and is debt funded which in turn acquires an Australian Target (AT) that is a regarded entity for U.S. tax purposes. AHC and AT elect to consolidate for Australian income tax purposes (Aust Holdco Group).

Prima facie, the interest deduction claimed by the Aust Holdco Group may be captured under Recommendation 3, however the impact can be reversed where there is dual inclusion income. A reversal could occur, for example, where AT pays a dividend to AHC. Whilst the dividend should be ignored for Australian income tax purposes due to the tax consolidation provisions, the U.S. may treat the dividend receipt as assessable. Whether or not an amount is assessable for U.S. income tax purposes depends on whether AT has Earnings and Profits (E&P). E&P is calculated by applying U.S. tax law to the financial results of AT on a stand-alone basis. There is likely to be differences in calculating taxable income for Australian income tax purposes as compared to the U.S.

One significant difference is that under U.S. tax provisions, there is generally an amortisation deduction for goodwill over 15 years, whereas Australia provides no such deduction. In addition, the U.S. may be able to shelter tax payable on that income through foreign tax credits from other foreign jurisdictions. On this basis, we query how a reversal will be taken into account in applying the hybrid provisions.

The imported mismatch rule provides significant challenges particularly for an Australian owned subsidiary of a large multinational group. The application of the imported mismatch rule is extremely broad and the recommendation is either not to adopt or to include a direct tracing or purpose based principal when drafting the provisions.

Conclusion

Australia is a capital dependent country and it is important to ensure there are not inadvertent signals sent to foreign investors, including American investors, which would cause potential or actual investors to question the governance and fairness of the Australian market. AmCham is concerned that the focus of these efforts appears to be very much directed towards foreign companies.

AmCham believes that Australia's tax laws are already among the best in the world. Australia has one of the most rigorous transfer pricing regimes, one of the most highly efficient and respected tax administrations and a general anti-avoidance rule that has worked effectively for over 30 years.

AmCham is supportive of reforming Australia's tax system and the global tax system. We believe effective reform of the global tax system will only be achieved if all of the key global economies participate in a cooperative, coordinated and consistent way.

Yours sincerely,

Niels Marquardt
U.S Ambassador (ret.)
Chief Executive Officer