

EXPOSURE DRAFT

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Inserts for
**Treasury Laws Amendment (OECD
Hybrid Mismatch Rules) Bill 2017:
Amendments**

Commencement information

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

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Schedule 1—OECD Hybrid Mismatch Rules

Part 1—Main amendments

Income Tax Assessment Act 1997

1 After Division 830

Insert:

Division 832—Hybrid mismatch rules

Table of Subdivisions

Guide to Division 832

832-A Preliminary

832-B Neutralising hybrid mismatches (deducting entities)

832-C Neutralising hybrid mismatches (non-including entities)

832-D Adjustments (deducting entities)

832-I Hybrid financial instrument mismatch

832-J Hybrid payer mismatch

832-K Reverse hybrid mismatch

832-L Deducting hybrid mismatch

832-M Imported hybrid mismatch

832-P Concepts relating to mismatches

832-Q Other concepts

Guide to Division 832

832-1 What this Division is about

A “hybrid mismatch” arises if double non-taxation results from the exploitation of differences in the tax treatment of an entity or financial instrument under the laws of 2 or more countries.

There is double non-taxation if a deductible payment is not included in a tax base (this is called a deduction/non-inclusion mismatch), or if a payment gives rise to 2 deductions (this is called

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1 a deduction/deduction mismatch). Disallowing a deduction, or
2 including an amount in assessable income, “neutralises” this tax
3 advantage.

4 This Division is based on *Neutralising the Effects of Hybrid*
5 *Mismatch Arrangements, Action 2—2015 Final Report*, of the
6 Organisation for Economic Cooperation and Development,
7 published on 5 October 2015.

8 **Subdivision 832-A—Preliminary**

9 **832-10 What this Subdivision is about**

10 This Subdivision sets out some general rules that apply to the
11 provisions of this Division.

12 **Table of sections**

13 **Operative provisions**

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| 14 | 832-15 | Entitlement to receive payment |
| 15 | 832-20 | Entitlement to receive non-cash benefits |
| 16 | 832-25 | Division also applies to accrual deductions |
| 17 | 832-30 | Recipients and payers of a payment |
| 18 | 832-35 | Tax provisions to be disregarded in identifying payments and income or 19 profits |
| 20 | 832-40 | Single entity rule otherwise not disregarded |
| 21 | 832-45 | Schemes outside Australia |
| 22 | 832-50 | Ordering rule |

23 **Operative provisions**

24 **832-15 Entitlement to receive payment**

25 This Division applies as if an entity (the *payer*) had made a
26 payment to another entity (the *recipient*) if the recipient is entitled
27 to receive the payment from the payer, even if the payment is not
28 required to be made until a later time.

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1 832-20 Entitlement to receive non-cash benefits

2 This Division applies as if an entity (the *payer*) had made a
3 payment to another entity (the *recipient*) if the recipient received a
4 *non-cash benefit from the payer.

5 832-25 Division also applies to accrual deductions

6 This Division applies to a loss in the same way as it applies to a
7 payment if:

- 8 (a) the loss gives rise to:
- 9 (i) an *Australian income reduction amount for an entity
10 (the *payer*) for an income year; or
 - 11 (ii) a *foreign income tax deduction for an entity (also the
12 *payer*) for a *foreign tax period that starts in the income
13 year; and
- 14 (b) the loss consists of all or a part of a payment that will be
15 made to another entity (the *recipient*) in a later income year.

16 832-30 Recipients and payers of a payment

- 17 (1) To the extent this Division applies to a payment only because of
18 section 832-15, 832-20 or 832-25, it applies as if:
- 19 (a) the entity that made the payment were the entity identified in
20 the applicable section as the payer; and
 - 21 (b) the recipient of the payment were the entity identified in the
22 applicable section as the recipient.
- 23 (2) If a payment would, apart from this subsection, be made to 2 or
24 more recipients, then this Division applies as if each part of the
25 payment made to each such recipient were a separate payment.

26 832-35 Tax provisions to be disregarded in identifying payments and 27 income or profits

- 28 (1) A number of provisions in this Division refer to an entity making a
29 payment to another entity. To avoid doubt, whether an entity
30 makes a payment to another entity is to be worked out
31 disregarding:
- 32 (a) subsection 701-1(1) (the single entity rule); and

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(b) 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.

(2) A number of provisions in this Division refer to the income or profits of an entity. To avoid doubt, these entities, and their income or profits, are to be identified disregarding:

(a) subsection 701-1(1) (the single entity rule); and

(b) any law of a foreign country that, for the purposes of a foreign tax, treats those income or profits as income or profits of a different entity.

Note: As a consequence of paragraph (2)(a), a member of a consolidated group may be a hybrid payer under section 832-585 or a deducting hybrid under section 832-725 (it cannot be a reverse hybrid because of subparagraph 832-655(a)(ii)).

832-40 Single entity rule otherwise not disregarded

Subject to section 832-35, subsection 701-1(1) (the single entity rule) is not disregarded in applying this Division.

832-45 Schemes outside Australia

This Division applies in relation to a payment whether or not the *scheme under which the payment is made has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

832-50 Ordering rule

If a payment gives rise to a *hybrid mismatch under a Subdivision of this Division, the payment does not also give rise to a hybrid mismatch under a later Subdivision of this Division.

Subdivision 832-B—Neutralising hybrid mismatches (deducting entities)

832-100 What this Subdivision is about

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|---|
| This Subdivision neutralises a hybrid mismatch if it gives rise to a deduction (or another amount that has the effect of reducing assessable income). |
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The types of mismatch covered by this Subdivision are both deduction/non-inclusion mismatches and deduction/deduction mismatches. Payments that “import” a hybrid mismatch from offshore are also covered.

Table of sections

Operative provisions

- 832-105 Hybrid mismatch rule for amounts that reduce Australian income
832-110 Working out the neutralising amount

Operative provisions

832-105 Hybrid mismatch rule for amounts that reduce Australian income

- (1) Subsection (2) applies to an entity if, apart from this section, the entity would have an *Australian income reduction amount in an income year in respect of a payment that gives rise to any of the following:
- (a) a *hybrid financial instrument mismatch (see Subdivision 832-I);
 - (b) a *hybrid payer mismatch (see Subdivision 832-J);
 - (c) a *reverse hybrid mismatch (see Subdivision 832-K);
 - (d) a *deducting hybrid mismatch (see Subdivision 832-L);
 - (e) an *imported hybrid mismatch (see Subdivision 832-M).
- (2) This subsection neutralises the *hybrid mismatch by:
- (a) if the *Australian income reduction amount is an amount the entity could, apart from this section, deduct in an income year—disallowing all or a part of the deduction; or
 - (b) if the Australian income reduction amount is an amount of the kind mentioned in paragraph 832-930(b) or (c)—disregarding all or part of the Australian income reduction amount in performing the calculation mentioned in the relevant paragraph.
- (3) The amount that is disallowed, or disregarded, under subsection (2) is worked out under section 832-110.

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Exception if entity not a party to structured arrangement

- 1
- 2 (4) However, subsection (2) does not apply to an entity in respect of a
- 3 payment (other than a payment that gives rise to an *imported
- 4 hybrid mismatch) if:
- 5 (a) the *scheme under which the payment is made is a
- 6 *structured arrangement; and
- 7 (b) if the scheme were not a structured arrangement,
- 8 subsection (2) would not apply; and
- 9 (c) the entity is not a *party to the structured arrangement.

832-110 Working out the neutralising amount

- 10
- 11 (1) This section works out the amount (the *neutralising amount*) that
- 12 is disallowed, or disregarded, under subsection 832-105(2) in
- 13 relation to an *Australian income reduction amount an entity
- 14 would, apart from that subsection, have in an income year (the
- 15 *deducting year*) in respect of a payment.
- 16 (2) The neutralising amount is so much of the *Australian income
- 17 reduction amount as does not exceed the amount of the *hybrid
- 18 mismatch.

Subdivision 832-C—Neutralising hybrid mismatches (non-including entities)

832-160 What this Subdivision is about

22 This Subdivision neutralises a hybrid mismatch if it involves

23 non-inclusion in Australia.

24 The types of mismatch covered are deduction/non-inclusion

25 mismatches (other than reverse hybrid mismatches).

26 However, this Subdivision does not apply if the primary response

27 country has neutralised the hybrid mismatch by denying the

28 deduction (see subsection 832-935(2)).

Table of sections

29

30 **Operative provisions**

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| 1 | 832-165 | Hybrid mismatch rule for amounts not included in assessable income |
| 2 | 832-170 | Working out the neutralising amount |
| 3 | 832-175 | Relationship between section 832-165 and other charging provisions in this |
| 4 | | Act |

5 Operative provisions

6 **832-165 Hybrid mismatch rule for amounts not included in** 7 **assessable income**

8 (1) This section applies to an entity if the entity is the recipient of a
9 payment that gives rise to any of the following:

10 (a) a *hybrid financial instrument mismatch (see
11 Subdivision 832-I);

12 (b) a *hybrid payer mismatch (see Subdivision 832-J).

13 (2) This subsection neutralises the *hybrid mismatch by including in
14 the entity's assessable income the amount worked out under
15 section 832-170. The assessable income is taken to have been
16 derived from the same source as the payment mentioned in
17 subsection (1).

18 *Income year in which amount is to be included*

19 (3) The income year (the *inclusion year*) in which the entity is taken to
20 have derived the amount is:

21 (a) if the *foreign tax period in which the *foreign income tax
22 deduction mentioned in paragraph 832-920(1)(a) is allowed
23 falls wholly within an income year of the entity—that income
24 year; or

25 (b) if the foreign tax period in which the foreign income tax
26 deduction mentioned in paragraph 832-920(1)(a) is allowed
27 straddles 2 income years of the entity—the earlier of those
28 income years.

29 *Exception if entity not a party to structured arrangement*

30 (4) However, this section does not apply to an entity in respect of a
31 payment if:

32 (a) the *scheme under which the payment is made is a
33 *structured arrangement; and

34 (b) if the scheme were not a structured arrangement, this section
35 would not apply; and

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1 (c) the entity is not a *party to the structured arrangement.

2 *Relationship with section 230-20*

3 (5) This section applies despite section 230-20 (financial
4 arrangements).

5 **832-170 Working out the neutralising amount**

6 (1) This section works out the amount (the *neutralising amount*) that
7 is treated as assessable income under subsection 832-165(2).

8 (2) The neutralising amount is an amount equal to the amount of the
9 *hybrid mismatch.

10 *Dual inclusion income of hybrid payers*

11 (3) In working out for the purposes of subsection (2) the amount of the
12 *hybrid mismatch, an amount of *dual inclusion income is not to be
13 applied under section 832-575 unless it is *subject to Australian
14 income tax in the inclusion year.

15 **832-175 Relationship between section 832-165 and other charging** 16 **provisions in this Act**

17 (1) This section applies if an amount is included in the assessable
18 income of an entity under section 832-165 in relation to a payment.

19 (2) An amount covered by subsection (3) is to be reduced to the extent
20 (if any) necessary to ensure that the total amount included in the
21 entity's assessable income in relation to the payment does not
22 exceed the amount of the payment.

23 (3) This subsection covers the following amounts:

24 (a) an amount in relation to the payment that is to be included in
25 the assessable income of the entity under a provision other
26 than section 832-165;

27 (b) an amount in relation to the payment that:

28 (i) is an element in the calculation of a net amount included
29 in the entity's assessable income (other than under
30 Division 5 or 6 of Part III of the *Income Tax Assessment*
31 *Act 1936*); and

32 (ii) has the effect of increasing the amount so included.

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1 Subdivision 832-D—Adjustments (deducting entities)

2 832-225 What this Subdivision is about

3 This Subdivision applies in a later income year to adjust the effect
4 of Subdivisions 832-B and 832-C.

5 The events that give rise to such an adjustment are:

- 6 (a) an inclusion that would have reduced the amount of a
7 hybrid financial instrument mismatch, if it had occurred
8 earlier, occurs in a later period; and
- 9 (b) an amount of dual inclusion income that would have
10 reduced the amount of a hybrid payer mismatch or
11 deducting hybrid mismatch, if it had been subject to tax
12 in Australia in an earlier income year, is subject to tax in
13 Australia in the income year.

14 Table of sections

15 Operative provisions

- 16 832-230 Adjusting if hybrid financial instrument payment is income in a later year
- 17 832-235 Adjusting if hybrid entity derives dual inclusion income in a later year

18 Operative provisions

19 832-230 Adjusting if hybrid financial instrument payment is income 20 in a later year

- 21 (1) There is an adjustment under this section for an entity in an income
22 year (the *adjustment year*) if:
 - 23 (a) an amount was disallowed, or disregarded, for the entity in an
24 earlier income year under subsection 832-105(2) in respect of
25 a payment that gave rise to a *hybrid financial instrument
26 mismatch; and
 - 27 (b) an amount (the *taxed amount*) of the payment is:
 - 28 (i) *subject to foreign income tax in a foreign country in a
29 *foreign tax period that is covered by subsection (2); or
 - 30 (ii) *subject to Australian income tax in an income year that
31 is covered by subsection (2).

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- 1 (2) For the purposes of subparagraphs (1)(b)(i) and (ii), a *foreign tax
2 period or income year is covered by this subsection if:
3 (a) it was not covered by subsection 832-920(2) in relation to the
4 *hybrid mismatch; and
5 (b) for an income year—it is the adjustment year; or
6 (c) for a foreign tax period—it ends within 12 months after the
7 end of the adjustment year.
- 8 (3) The taxed amount is an amount the entity can deduct in the
9 adjustment year.
- 10 (4) The total amounts deducted under this section in respect of a
11 payment must not exceed the amount disallowed, or disregarded, in
12 respect of the payment as mentioned in paragraph (1)(a).
- 13 *No adjustment for concessional taxes*
- 14 (5) This section does not apply if the *hybrid mismatch would not have
15 arisen apart from section 832-515.

16 **832-235 Adjusting if hybrid entity derives dual inclusion income in a** 17 **later year**

- 18 (1) There is an adjustment under this section for an entity in an income
19 year (the *adjustment year*) if:
20 (a) an amount was disallowed, or disregarded, for the entity in an
21 earlier income year under subsection 832-105(2) in respect of
22 a *hybrid payer mismatch or a *deducting hybrid mismatch;
23 and
24 (b) an amount of *dual inclusion income of the *hybrid payer or
25 *deducting hybrid is available to be applied by this section in
26 the income year.
- 27 (2) So much of the amount of *dual inclusion income that satisfies
28 paragraph (1)(b) as does not exceed the amount that was
29 disallowed or disregarded is an amount the entity can deduct in the
30 adjustment year.
- 31 (3) For the purposes of a later application of this section, treat the
32 amount that was disallowed, or disregarded, under
33 subsection 832-105(2) as being reduced by the amount deducted
34 under subsection (2) of this section.

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1 Subdivision 832-I—Hybrid financial instrument mismatch

2 832-485 What this Subdivision is about

3 A deduction/non-inclusion mismatch is a hybrid financial
4 instrument mismatch if it is attributable to hybridity in the
5 treatment of a financial instrument or an arrangement to transfer a
6 financial instrument, and either the relevant parties are related or
7 the mismatch arose under a structured arrangement.

8 There is also an integrity rule that covers payments, not involving
9 hybridity, that are made in lieu of hybrid payments.

10 This Subdivision has an extended application in relation to
11 payments that are subject to concessional tax rates in a foreign
12 country.

13 Table of sections

14 Operative provisions

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|----|---------|--|
| 15 | 832-490 | Hybrid financial instrument mismatch |
| 16 | 832-495 | Hybrid mismatch |
| 17 | 832-500 | Hybrid requirement—payments under financial instruments |
| 18 | 832-505 | Hybrid requirement—payments under transfers of certain financial 19 instruments |
| 20 | 832-510 | Hybrid mismatch—integrity rule for substitute payments |
| 21 | 832-515 | Extended operation of Subdivision in relation to concessional foreign taxes |

22 Operative provisions

23 832-490 Hybrid financial instrument mismatch

- 24 (1) A payment gives rise to a *hybrid financial instrument mismatch*
25 if:
- 26 (a) the payment gives rise to a *hybrid mismatch under
27 section 832-495 or 832-510; and
 - 28 (b) subsection (2) or (5) applies.

29 Note: This Subdivision only identifies the hybrid financial instrument
30 mismatch. The neutralising of the mismatch takes effect as follows:

- 31 (a) if Australia is the deducting element of the mismatch,
32 Subdivision 832-B neutralises it;

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- 1 (b) if Australia is the non-including element of the mismatch, and the
2 secondary response is required (see subsection 832-935(2)),
3 Subdivision 832-C neutralises it;
4 (c) if both deducting and non-including elements are offshore, the
5 mismatch might give rise to an imported hybrid mismatch (see
6 Subdivision 832-M) which Subdivision 832-B neutralises.

- 7 (2) This subsection applies if the following entities are related for the
8 purposes of subsection (3):
9 (a) the entity that made the payment;
10 (b) an entity that is a *liable entity in respect of the income or
11 profits of the recipient of the payment.

12 Note: For the definition of *liable entity*, see Subdivision 832-Q.

13 *Related persons*

- 14 (3) Two entities are related for the purposes of this subsection if any of
15 the following apply:
16 (a) the entities are in the same *Division 832 control group;
17 (b) one of the entities holds a *total participation interest of 25%
18 or more in the other entity;
19 (c) a third entity holds a total participation interest of 25% or
20 more in each of the entities.
- 21 (4) For the purposes of subsection (3), treat the *direct participation
22 interest of an entity (the *holding entity*) in another entity (the *test*
23 *entity*) as being the sum of the direct participation interests held by
24 the holding entity and its *associates in the test entity.

25 *Structured arrangement*

- 26 (5) This subsection applies if the *scheme under which the payment is
27 made is a *structured arrangement.

28 **832-495 Hybrid mismatch**

- 29 (1) A payment gives rise to a *hybrid mismatch* if:
30 (a) the payment is made under any of the following:
31 (i) a *debt interest;
32 (ii) an *equity interest;
33 (iii) a *derivative financial arrangement;
34 (iv) an *arrangement covered by subsection (2); and

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- 1 (b) the payment might be expected to give rise to a
2 *deduction/non-inclusion mismatch; and
3 (c) the mismatch that might be expected to arise, or a part of that
4 mismatch, meets a hybrid requirement in section 832-500 or
5 832-505.

Transfers of financial instruments

- 6
- 7 (2) An *arrangement is covered by this subsection if:
- 8 (a) the arrangement is any of the following:
- 9 (i) a reciprocal purchase agreement (otherwise known as a
10 repurchase agreement);
- 11 (ii) a securities lending arrangement;
- 12 (iii) a similar arrangement; and
- 13 (b) an entity acquires any of the following under the
14 arrangement:
- 15 (i) a *debt interest;
- 16 (ii) an *equity interest;
- 17 (iii) a *derivative financial arrangement.

Amount of the hybrid mismatch

- 18
- 19 (3) The amount of a *hybrid mismatch is:
- 20 (a) the amount of the *deduction/non-inclusion mismatch, unless
21 paragraph (b) applies; or
- 22 (b) if only a part of the deduction/non-inclusion mismatch meets
23 a hybrid requirement mentioned in paragraph (1)(c)—the
24 amount of that part of the deduction/non-inclusion mismatch.

832-500 Hybrid requirement—payments under financial instruments

- 25
- 26
- 27 (1) A *deduction/non-inclusion mismatch, or a part of such a
28 mismatch, meets the hybrid requirement in this section if:
- 29 (a) the payment that gives rise to the mismatch is made under
30 any of the following:
- 31 (i) a *debt interest;
- 32 (ii) an *equity interest;
- 33 (iii) a *derivative financial arrangement; and
- 34 (b) the mismatch, or the part of the mismatch, is attributable to
35 differences in the treatment of the debt interest, equity
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1 interest or derivative financial arrangement, arising from the
2 terms of the interest or arrangement; and

3 (c) the exception in subsection (2) does not apply.

4 Example: Redeemable preferences shares that are treated under this Act as a
5 debt interest, and in a foreign country as an equity interest.

6 *Exception for deferrals not exceeding 3 years*

7 (2) This exception applies if:

8 (a) the difference in treatment mentioned in paragraph (1)(b)
9 primarily relates to a deferral in the recognition of income or
10 profits under the *debt interest, the *equity interest or the
11 *derivative financial arrangement; and

12 (b) the term of the interest or arrangement is 3 years or less.

13 **832-505 Hybrid requirement—payments under transfers of certain** 14 **financial instruments**

15 (1) A *deduction/non-inclusion mismatch, or a part of such a
16 mismatch, meets the hybrid requirement in this section if:

17 (a) the payment that gives rise to the mismatch is made under an
18 *arrangement covered by subsection 832-495(2); and

19 (b) the mismatch, or the part of the mismatch, is attributable to
20 differences in the treatment of the arrangement; and

21 (c) the exception in subsection (2) does not apply.

22 *Exception for deferrals not exceeding 3 years*

23 (2) This exception applies if:

24 (a) the difference in treatment mentioned in paragraph (1)(b)
25 primarily relates to a deferral in the recognition of income or
26 profits under the *arrangement; and

27 (b) the term of the arrangement is 3 years or less.

28 **832-510 Hybrid mismatch—integrity rule for substitute payments**

29 (1) A payment also gives rise to a *hybrid mismatch* if:

30 (a) the payment gives rise to a *deduction/non-inclusion
31 mismatch; and

32 (b) the payment is made under an *arrangement under which any
33 of the following is transferred:

34 (i) a *debt interest;

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- 1 (ii) an *equity interest;
2 (iii) a *derivative financial arrangement; and
3 (c) the payment, or a part of the payment, (the *substitute*
4 *payment*) could reasonably be regarded as having been
5 converted into a form that is in substitution for a *return
6 (however described) on the interest or arrangement; and
7 (d) the return is covered by subsection (2).
- 8 (2) This subsection covers a *return (however described) on a *debt
9 interest, an *equity interest, or a *derivative financial arrangement,
10 that is transferred if any of the following apply:
11 (a) the return is made to the payer of the substitute payment, and
12 is not *subject to foreign income tax or *subject to Australian
13 income tax;
14 (b) the return is not made to the payer of the substitute payment,
15 but if it had been it would not have been subject to foreign
16 income tax or subject to Australian income tax;
17 (c) if the return were instead made to the payee of the substitute
18 payment:
19 (i) it would be subject to foreign income tax or subject to
20 Australian income tax; or
21 (ii) it would give rise to a *hybrid mismatch under
22 section 832-495.

23 *Amount of the hybrid mismatch*

- 24 (3) The amount of the *hybrid mismatch is the amount of the
25 *deduction/non-inclusion mismatch.

26 **832-515 Extended operation of Subdivision in relation to** 27 **concessional foreign taxes**

- 28 (1) This Subdivision also has the effect it would have if an amount of
29 income or profits covered by subsection (2) was taken *not* to be
30 *subject to foreign income tax.
- 31 (2) This subsection covers an amount of income or profits of an entity
32 if:
33 (a) apart from this section, the amount would be *subject to
34 foreign income tax; and
35 (b) the rate of *foreign income tax (except *credit absorption tax,
36 *unitary tax or a withholding-type tax) (the *lower rate*) on the
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1 amount under the law of the relevant foreign country is lower
2 than the rate (the *ordinary rate*) that would ordinarily be
3 imposed on interest income derived by an entity of that kind
4 in the foreign country.

5 *Applying hybrid requirements*

- 6 (3) Subsection (4) applies in working out, under a provision of this
7 Division, whether a *deduction/non-inclusion mismatch that would
8 not arise apart from this section is attributable to a difference in the
9 treatment of a thing.
- 10 (4) The *deduction/non-inclusion mismatch is taken to be attributable
11 to a difference in the treatment of the thing if the application of the
12 lower rate mentioned in paragraph (2)(b), instead of the ordinary
13 rate, to the relevant amount of income or profits is attributable to a
14 difference in the treatment of the thing.

15 *Amount of a deduction/non-inclusion mismatch*

- 16 (5) However, for the purposes of working out the amount of a
17 *deduction/non-inclusion mismatch that would not arise apart from
18 this section, the amount of a payment that is treated as being
19 *subject to foreign income tax only because of this section is to be
20 discounted by multiplying it by the following fraction:

$$\frac{\text{Lower rate}}{\text{Ordinary rate}}$$

21 where:

22 *lower rate* means the lower rate mentioned in paragraph (2)(b).

23 *ordinary rate* means the ordinary rate mentioned in
24 paragraph (2)(b).
25

26 **Subdivision 832-J—Hybrid payer mismatch**

27 **832-565 What this Subdivision is about**

28 A deduction/non-inclusion mismatch is a hybrid payer mismatch if
29 it is attributable to a hybrid payer, and either the relevant parties
30 are in the same control group or the mismatch arose under a
31 structured arrangement.

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1 An entity is a hybrid payer if a payment it makes is disregarded for
2 the purposes of the tax law of one country (resulting in
3 non-inclusion), but is deductible for the purposes of the tax law of
4 another country.

5 The amount of the hybrid payer mismatch is reduced by dual
6 inclusion income.

7 Table of sections

8 Operative provisions

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| 9 | 832-570 | Hybrid payer mismatch |
| 10 | 832-575 | Hybrid mismatch |
| 11 | 832-580 | Hybrid requirement—hybrid payer makes payment |
| 12 | 832-585 | Hybrid payer |

13 Operative provisions

14 832-570 Hybrid payer mismatch

- 15 (1) A payment gives rise to a *hybrid payer mismatch* if:
- 16 (a) the payment gives rise to a *hybrid mismatch under
17 section 832-575; and
- 18 (b) subsection (2) or (3) applies.

19 Note 1: A payment does not give rise to a hybrid mismatch under this section
20 if it gave rise to a hybrid mismatch under Subdivision 832-I: see
21 section 832-50.

22 Note 2: This Subdivision only identifies the hybrid payer mismatch. The
23 neutralising of the mismatch takes effect as follows:

24 (a) if Australia is the deducting element of the mismatch,
25 Subdivision 832-B neutralises it;

26 (b) if Australia is the non-including element of the mismatch, and the
27 secondary response is required (see subsection 832-935(2)),
28 Subdivision 832-C neutralises it;

29 (c) if both deducting and non-including elements are offshore, the
30 mismatch might give rise to an imported hybrid mismatch (see
31 Subdivision 832-M) which Subdivision 832-B neutralises.

32 *Control group*

- 33 (2) This subsection applies if the following entities are in the same
34 *Division 832 control group:
- 35 (a) the *hybrid payer;

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-
- 1 (b) each entity that is a *liable entity in respect of the income or
2 profits of the hybrid payer.

3 *Structured arrangement*

- 4 (3) This subsection applies if the *scheme under which the payment is
5 made is a *structured arrangement.

6 **832-575 Hybrid mismatch**

- 7 (1) A payment gives rise to a *hybrid mismatch* if:
8 (a) the payment gives rise to a *deduction/non-inclusion
9 mismatch; and
10 (b) the mismatch, or a part of the mismatch, meets the hybrid
11 requirement in section 832-580.
- 12 (2) The amount of a *hybrid mismatch is:
13 (a) the amount of the *deduction/non-inclusion mismatch, unless
14 paragraph (b) applies; or
15 (b) if only a part of the deduction/non-inclusion mismatch meets
16 the hybrid requirement in section 832-580—the amount of
17 that part of the deduction/non-inclusion mismatch.

18 *Effect of dual inclusion income of hybrid payer*

- 19 (3) However, for the purposes of subsection (2), subsection (4)
20 modifies the amount of the *deduction/non-inclusion mismatch if
21 the *hybrid payer has an amount of *dual inclusion income that is
22 available to be applied by this section.

23 Note: For *dual inclusion income*, and when it is available to be applied by a
24 provision, see section 832-1020.

- 25 (4) The amount of *dual inclusion income is applied in reduction (but
26 not below nil) of the *Australian income reduction amount or
27 *foreign income tax deduction mentioned in
28 paragraph 832-920(1)(a) of the definition of
29 *deduction/non-inclusion mismatch*.

30 **832-580 Hybrid requirement—hybrid payer makes payment**

31 A *deduction/non-inclusion mismatch, or a part of such a
32 mismatch, meets the hybrid requirement in this section if the
33 mismatch, or the part of the mismatch, is attributable to the

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1 payment that gives rise to the mismatch being made by a *hybrid
2 payer.

3 **832-585 Hybrid payer**

4 (1) An entity (the *test entity*) is a *hybrid payer* at a time if:

5 (a) there are *tax base purposes, for 2 or more countries, for one
6 or more entities that are *liable entities in respect of the
7 income or profits of the test entity; and

8 (b) for one such tax base purpose (the *first purpose*), the income
9 or profits of the test entity for a period, or a part of those
10 income or profits, are taken into account together with
11 income or profits of one or more other entities (the *combined*
12 *entities*); and

13 (c) for another such tax base purpose, for a different country,
14 (the *second purpose*), the income or profits of the test entity
15 for a period, or a part of those income or profits, are:

16 (i) not taken into account together with income or profits of
17 any other entity; or

18 (ii) taken into account together with income or profits of
19 one or more other entities, but those entities are not the
20 same as the combined entities; and

21 (d) as a result, a payment made at the time by the test entity to
22 one or more of the combined entities would be:

23 (i) disregarded for the first purpose; and

24 (ii) taken into account for the second purpose.

25 Note: For the meaning of *tax base purpose* and *liable entity*, see
26 Subdivision 832-Q.

27 *Effect of CFC regimes*

28 (2) For the purposes of this section, income or profits of an entity (the
29 *test entity*) are not taken into account together with income or
30 profits of another entity merely because all or part of the income or
31 profits of the test entity are:

32 (a) included under section 456 or 457 of the *Income Tax*
33 *Assessment Act 1936* in the assessable income of the other
34 entity; or

35 (b) included under a corresponding provision of a law of a
36 foreign country in working out the tax base of the other
37 entity.

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1 Subdivision 832-K—Reverse hybrid mismatch

2 832-635 What this Subdivision is about

3 A deduction/non-inclusion mismatch is a reverse hybrid mismatch
4 if it is attributable to a reverse hybrid.

5 An entity is a reverse hybrid if it is transparent for the purposes of
6 the tax law of the country in which it is formed, but
7 non-transparent for the purposes of the tax law of the country in
8 which investors in it are subject to tax (resulting in non-inclusion).

9 Table of sections

10 Operative provisions

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| 11 | 832-640 | Reverse hybrid mismatch |
| 12 | 832-645 | Hybrid mismatch |
| 13 | 832-650 | Hybrid requirement—payment made directly or indirectly to a reverse 14 hybrid |
| 15 | 832-655 | Reverse hybrid |

16 Operative provisions

17 832-640 Reverse hybrid mismatch

- 18 (1) A payment gives rise to a *reverse hybrid mismatch* if:
- 19 (a) the payment gives rise to a *hybrid mismatch under
 - 20 section 832-645; and
 - 21 (b) subsection (2) or (3) applies.

22 Note 1: A payment does not give rise to a hybrid mismatch under this section
23 if it gave rise to a hybrid mismatch under Subdivision 832-I or 832-J:
24 see section 832-50.

25 Note 2: This Subdivision only identifies the reverse hybrid mismatch. The
26 neutralising of the mismatch takes effect as follows:

- 27 (a) if Australia is the deducting element of the mismatch,
28 Subdivision 832-B neutralises it;
- 29 (b) if both deducting and non-including elements are offshore, the
30 mismatch might give rise to an imported hybrid mismatch (see
31 Subdivision 832-M) which Subdivision 832-B neutralises.

32 (Because of the nature of the mismatch, non-inclusion is not
33 neutralised).

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Control group

- 1
- 2 (2) This subsection applies if the following entities are in the same
3 *Division 832 control group:
- 4 (a) the entity that made the payment;
 - 5 (b) the *reverse hybrid;
 - 6 (c) each entity that is an investor identified in
7 paragraph 832-655(b) in relation to the reverse hybrid.

Structured arrangement

- 8
- 9 (3) This subsection applies if the *scheme under which the payment is
10 made is a *structured arrangement.

832-645 Hybrid mismatch

- 11
- 12 (1) A payment gives rise to a *hybrid mismatch* if:
- 13 (a) the payment gives rise to a *deduction/non-inclusion
14 mismatch; and
 - 15 (b) the mismatch, or a part of the mismatch, meets the hybrid
16 requirement in section 832-650.

Amount of the hybrid mismatch

- 17
- 18 (2) The amount of a *hybrid mismatch is:
- 19 (a) the amount of the *deduction/non-inclusion mismatch, unless
20 paragraph (b) applies; or
 - 21 (b) if only a part of the deduction/non-inclusion mismatch meets
22 the hybrid requirement in section 832-650—the amount of
23 that part of the deduction/non-inclusion mismatch.

832-650 Hybrid requirement—payment made directly or indirectly to a reverse hybrid

24

25

26 A *deduction/non-inclusion mismatch, or a part of such a
27 mismatch, meets the hybrid requirement in this section if the
28 mismatch, or the part of the mismatch, is attributable to the
29 payment that gives rise to the mismatch being made directly, or
30 indirectly through one or more interposed entities, to a *reverse
31 hybrid.

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1 832-655 Reverse hybrid

2 An entity (the *test entity*) is a *reverse hybrid*, in relation to a
3 payment, if:

- 4 (a) for the country in which it was formed (the *formation*
5 *country*), the test entity is:
6 (i) not a *liable entity; and
7 (ii) for Australia—not a *member of a *consolidated group;
8 and
9 (b) for the formation country, another entity (an *investor*) is a
10 liable entity in respect of income or profits of the test entity,
11 but the payment is not taken into account for the *tax base
12 purpose for that liable entity; and
13 (c) for another country (the *investor country*), either:
14 (i) the investor is a liable entity in respect of the investor’s
15 income or profits; or
16 (ii) another entity is a liable entity in respect of the
17 investor’s income or profits; and
18 (d) for the investor country, the liable entity identified in
19 subparagraph (c)(i) or (ii) is *not* a liable entity in respect of
20 the income or profits of the test entity, and so the payment is
21 also not taken into account for the tax base purpose for that
22 liable entity; and
23 (e) for the investor country, if the payment were instead made
24 directly to the liable entity identified in subparagraph (c)(i) or
25 (ii):
26 (i) it would be subject to foreign income tax or subject to
27 Australian income tax; or
28 (ii) it would give rise to a *hybrid mismatch under
29 section 832-495 (about hybrid financial instruments),
30 section 832-575 (about hybrid payers), or
31 section 832-645.

32 Subdivision 832-L—Deducting hybrid mismatch

33 832-705 What this Subdivision is about

34 A deduction/deduction mismatch is generally a deducting hybrid
35 mismatch if it is attributable to a deducting hybrid.

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1 An entity is a deducting hybrid if a payment it makes is deductible
2 for the purposes of the tax law of 2 countries.

3 However, unless the deducting hybrid is a dual resident, there are
4 rules identifying which country is the primary response country. If
5 Australia is *not* the primary response country, a deducting hybrid
6 mismatch will not arise unless:

- 7 (a) the primary response country does not have hybrid
8 mismatch rules; and
- 9 (b) the relevant parties are in the same control group, or the
10 mismatch arose under a structured arrangement.

11 The amount of the deducting hybrid mismatch is reduced by dual
12 inclusion income.

13 Table of sections

14 Operative provisions

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| 15 | 832-710 | Deducting hybrid mismatch |
| 16 | 832-715 | Hybrid mismatch |
| 17 | 832-720 | Hybrid requirement—deducting hybrid makes payment |
| 18 | 832-725 | Deducting hybrid |
| 19 | 832-730 | Extended operation of Subdivision in relation to non-payment deductions |

20 Operative provisions

21 832-710 Deducting hybrid mismatch

- 22 (1) A payment gives rise to a *deducting hybrid mismatch* if:
- 23 (a) the payment gives rise to a *hybrid mismatch under
24 section 832-715; and
 - 25 (b) if a primary response country is identified in the applicable
26 item of the table in subsection 832-725(2), and that country is
27 not Australia:
 - 28 (i) the exception in subsection (2) does not apply; and
 - 29 (ii) subsection (3) or (4) applies.

30 Note 1: A payment does not give rise to a hybrid mismatch under this section
31 if it gave rise to a hybrid mismatch under Subdivision 832-I, 832-J or
32 832-K: see section 832-50.

33 Note 2: There is no primary response country if the deducting hybrid is a dual
34 resident: see item 3 of the table in subsection 832-725(2).

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-
- 1 Note 3: This Subdivision only identifies the deducting hybrid mismatch. The
2 neutralising of the mismatch takes effect as follows:
3 (a) if Australia is the deducting element of the mismatch,
4 Subdivision 832-B neutralises it;
5 (b) if both deducting elements are offshore, the mismatch might give
6 rise to an imported hybrid mismatch (see Subdivision 832-M)
7 which Subdivision 832-B neutralises.

8 *Exception if primary response is in a country with hybrid mismatch*
9 *rules*

- 10 (2) The exception in this subsection applies if:
11 (a) a *liable entity in respect of the income or profits of the
12 *deducting hybrid satisfies the residency test in
13 subsection 832-725(3) in the primary response country; and
14 (b) the primary response country has *foreign hybrid mismatch
15 rules, or another law that has substantially the same effect as
16 foreign hybrid mismatch rules.

17 *Control group*

- 18 (3) This subsection applies if the following entities are in the same
19 *Division 832 control group:
20 (a) the *deducting hybrid;
21 (b) each entity that is a *liable entity in respect of the income or
22 profits of the deducting hybrid.

23 *Structured arrangement*

- 24 (4) This subsection applies if the *scheme under which the payment is
25 made is a *structured arrangement.

26 **832-715 Hybrid mismatch**

- 27 (1) A payment gives rise to a **hybrid mismatch** if:
28 (a) the payment gives rise to a *deduction/deduction mismatch;
29 and
30 (b) the mismatch, or a part of the mismatch, meets the hybrid
31 requirement in section 832-720.

32 *Amount of the hybrid mismatch*

- 33 (2) The amount of a *hybrid mismatch is:

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-
- 1 (a) the amount of the *deduction/deduction mismatch, unless
2 paragraph (b) applies; or
3 (b) if only a part of the deduction/deduction mismatch meets the
4 hybrid requirement in section 832-720—the amount of that
5 part of the deduction/deduction mismatch.

6 *Effect of dual inclusion income of deducting hybrid*

- 7 (3) However, for the purposes of subsection (2), subsection (4)
8 modifies the amount of the *deduction/deduction mismatch if the
9 *deducting hybrid has an amount of *dual inclusion income that is
10 available to be applied by this section.

11 Note: For *dual inclusion income*, and when it is available to be applied by a
12 provision, see section 832-1020.

- 13 (4) Subject to subsection (5), the amount of *dual inclusion income is
14 applied in reduction (but not below nil) of any *Australian income
15 reduction amount or *foreign income tax deduction to which the
16 payment gave rise.
- 17 (5) If a *foreign income tax deduction to be reduced under
18 subsection (4) represents a share of a net loss of the *deducting
19 hybrid for a *foreign tax period, the amount of *dual inclusion
20 income is instead applied in reduction (but not below nil) of that
21 net loss, and the foreign income tax deduction is reduced
22 accordingly.

23 **832-720 Hybrid requirement—deducting hybrid makes payment**

24 A *deduction/deduction mismatch, or a part of such a mismatch,
25 meets the hybrid requirement in this section if the mismatch, or the
26 part of the mismatch, is attributable to the payment that gives rise
27 to the mismatch being made by a *deducting hybrid.

28 **832-725 Deducting hybrid**

- 29 (1) An entity (the *test entity*) is a *deducting hybrid* at a time if:
30 (a) there are *tax base purposes, for 2 or more countries, for one
31 or more entities that are *liable entities in respect of the
32 income or profits of the test entity; and
33 (b) the test entity satisfies the duplication test in subsection (2);
34 and

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(c) as a result, a payment made at the time by the test entity would be taken into account for a tax base purpose for 2 or more different countries.

Duplication test

(2) An entity (the *test entity*) satisfies the duplication test in this subsection if, having regard only to countries for which there are *tax base purposes for *liable entities in respect of the income or profits of the test entity, the condition in column 2 of an applicable item of the following table is satisfied in relation to the entity.

Duplication test

| Item | Column 1 If: | Column 2 Condition: |
|------|--|---|
| 1 | there are different *liable entities in 2 or more countries in respect of the income or profits of the test entity | (a) in one country the test entity is either: (i) the same entity as the liable entity; or (ii) a *member of a *consolidated group; and (b) in another country (the <i>primary response country</i>), the liable entity is a different entity to the test entity. |
| 2 | the only *liable entity is the test entity | (a) in one country, the liable entity does not satisfy the residency test in subsection (3); and (b) in another country (the <i>primary response country</i>), the liable entity satisfies the residency test in subsection (3). |
| 3 | the only *liable entity is the test entity | in all countries, the liable entity satisfies the residency test in subsection (3). |

Residency test

(3) An entity that is a *liable entity in a country satisfies the residency test in this subsection in relation to the country, if:

- (a) if the country is Australia—the entity is an *Australian entity; or
- (b) if the country is a foreign country—for the *tax base purpose for the liable entity for the foreign country:
 - (i) the entity is a resident of the foreign country; or
 - (ii) the tax base includes income from worldwide sources.

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832-730 Extended operation of Subdivision in relation to non-payment deductions

- (1) This Division applies in relation to the following amounts in the same way as it applies in relation to a payment:
- (a) an amount representing the decline in value of an asset;
 - (b) an amount representing a share in the net loss of a partnership, trust or other transparent entity.
- (2) However, such an amount does not give rise to a *hybrid financial instrument mismatch, *hybrid payer mismatch or *reverse hybrid mismatch.
- (3) For the purposes of the extended application of this Division mentioned in subsection (1), a reference in this Division to the *scheme under which a payment is made is taken to be a reference to:
- (a) if paragraph (1)(a) applies—the scheme under which the asset is held; or
 - (b) if paragraph (1)(b) applies—the scheme under which the net loss arose.

Subdivision 832-M—Imported hybrid mismatch

832-780 What this Subdivision is about

This Subdivision defines the concept “imported hybrid mismatch”. This mismatch is an integrity rule aimed at stopping arrangements that seek to avoid hybrid mismatch rules by interposing one or more entities between the hybrid mismatch and a country that has hybrid mismatch rules.

Identifying an imported hybrid mismatch involves testing whether a hybrid mismatch involving 2 foreign countries has been “imported” into Australia by a deduction or other amount that reduces assessable income. If so, there are priority rules that allocate the neutralisation of the mismatch between countries that have hybrid mismatch rules.

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| 1 | 832-785 | Imported hybrid mismatch |
| 2 | 832-790 | Meaning of <i>offshore hybrid mismatch</i> |
| 3 | 832-795 | Meaning of <i>importing payment</i> |
| 4 | 832-800 | When an importing payment is eligible to neutralise an offshore hybrid mismatch |
| 5 | | |
| 6 | 832-805 | Working out the amount of the imported hybrid mismatch |
| 7 | 832-810 | Carry forward of residual offshore hybrid mismatches |

8 Operative provisions

9 832-785 Imported hybrid mismatch

- 10 (1) A payment gives rise to an *imported hybrid mismatch* if:
- 11 (a) apart from section 832-105, the payment would give rise to
- 12 an *Australian income reduction amount for an entity in an
- 13 income year; and
- 14 (b) the payment is an *importing payment in relation to an
- 15 *offshore hybrid mismatch; and
- 16 (c) the importing payment is eligible to neutralise the offshore
- 17 hybrid mismatch (see section 832-800).
- 18 Note 1: A payment does not give rise to a hybrid mismatch under this section
- 19 if it gave rise to a hybrid mismatch under Subdivision 832-I, 832-J,
- 20 832-K or 832-L: see section 832-50.
- 21 Note 2: This Subdivision only identifies the mismatch. Subdivision 832-B
- 22 neutralises the mismatch.
- 23 (2) The amount of the *imported hybrid mismatch is worked out under
- 24 section 832-805.
- 25 (3) An *imported hybrid mismatch is also a *hybrid mismatch*.

26 832-790 Meaning of *offshore hybrid mismatch*

- 27 (1) A payment an entity (the *offshore deducting entity*) makes gives
- 28 rise to an *offshore hybrid mismatch* if:
- 29 (a) the payment gives rise to any of the following:
- 30 (i) a *hybrid financial instrument mismatch (see
- 31 Subdivision 832-I);
- 32 (ii) a *hybrid payer mismatch (see Subdivision 832-J);
- 33 (iii) a *reverse hybrid mismatch (see Subdivision 832-K);
- 34 (iv) a *deducting hybrid mismatch (see Subdivision 832-L);
- 35 and

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-
- 1 (b) the payment gave rise to a *foreign income tax deduction for
2 an entity for a *foreign tax period (the *deducting period*); and
3 (c) the payment did not give rise to an *Australian income
4 reduction amount for any entity; and
5 (d) no amount was included in an entity's assessable income
6 under section 832-165 (which is about neutralising
7 mismatches for non-including entities) in respect of the
8 *hybrid mismatch.

- 9 (2) In working out for the purposes of paragraph (1)(c) whether a
10 payment gives rise to an *Australian income reduction amount,
11 disregard the effect of Subdivision 832-B (which is about
12 neutralising mismatches for deducting entities).

13 *Amount of the offshore hybrid mismatch*

- 14 (3) The amount of the *offshore hybrid mismatch is the amount of the
15 *hybrid mismatch to which the payment gives rise.

16 **832-795 Meaning of *importing payment***

- 17 (1) A payment an entity (the *payer*) makes is an *importing payment* in
18 relation to an *offshore hybrid mismatch if the payment is made
19 directly, or indirectly through one or more interposed entities, to
20 the offshore deducting entity.

- 21 (2) However, a payment is *not* an *importing payment* if the income or
22 profits of the offshore deducting entity, or an interposed entity, are:
23 (a) *subject to Australian income tax; or
24 (b) *subject to foreign income tax in a country that has *foreign
25 hybrid mismatch rules.

26 *Indirect importations*

- 27 (3) For the purposes of determining whether a payment is made
28 indirectly through one or more interposed entities to the offshore
29 deducting entity:
30 (a) it is not necessary to demonstrate that each payment in a
31 series of payments funds the next payment, or is made after
32 the previous payment; and
33 (b) it is sufficient if payments exist between each interposed
34 entity, and each of the payments gives rise to a *foreign

EXPOSURE DRAFT

1 income tax deduction (but not a *deduction/non-inclusion
2 mismatch).

3 **832-800 When an importing payment is eligible to neutralise an** 4 **offshore hybrid mismatch**

- 5 (1) An *importing payment an entity makes is eligible to neutralise an
6 *offshore hybrid mismatch if:
- 7 (a) the payment, or a part of the payment, gives rise to any of the
8 following:
 - 9 (i) an *Australian income reduction amount in an income
10 year covered by subsection (2);
 - 11 (ii) a *foreign income tax deduction, in a foreign country
12 that has *foreign hybrid mismatch rules, in a *foreign
13 tax period covered by subsection (2); and
 - 14 (b) an item in the table in subsection (3) applies to the importing
15 payment.

16 *Period within which mismatch may be neutralised*

- 17 (2) For the purposes of paragraph (1)(a), a *foreign tax period or
18 income year is covered by this subsection if (and only if):
- 19 (a) it ends at or after the end of the deducting period mentioned
20 in paragraph 832-790(1)(b); and
 - 21 (b) it has at least one day in common with the deducting period.

22 *Priority rules for importing payments*

- 23 (3) If more than one item in the table covers an *importing payment,
24 apply the first item that covers it. However, an item does *not* apply
25 to an importing payment if:
- 26 (a) an item higher in the table applies to one or more other
27 importing payments in relation to the *offshore hybrid
28 mismatch; and
 - 29 (b) the offshore hybrid mismatch is, or will be, fully neutralised
30 by the application of this Subdivision, and equivalent
31 provisions of applicable *foreign hybrid mismatch rules, to
32 those other importing payments.
- 33

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Priority table for importing payments

| Item | Topic | An *importing payment is covered if: |
|------|------------------------|---|
| 1 | Structured arrangement | (a) the *importing payment, the payment made by the offshore deducting entity, and each payment made by an interposed entity (if applicable), are made under a *structured arrangement; and (b) the payer of the importing payment, the offshore deducting entity, and each interposed entity (if applicable) are all *parties to the structured arrangement |
| 2 | Direct payment | (a) the *importing payment is made directly to the offshore deducting entity; and (b) the payer of the importing payment and the offshore deducting entity are members of the same *Division 832 control group |
| 3 | Indirect payment | (a) the *importing payment is made indirectly through one or more interposed entities to the offshore deducting entity; and (b) the payer of the importing payment, the offshore deducting entity, and each interposed entity are members of the same *Division 832 control group |

1

2

Neutralising provisions to be disregarded

3

- (4) In working out, for the purposes of paragraph (1)(a), whether an *Australian income reduction amount or a *foreign income tax deduction arises, disregard the effect of this Subdivision and any equivalent provisions of *foreign hybrid mismatch rules.

4

5

6

7

832-805 Working out the amount of the imported hybrid mismatch

8

- (1) The amount of the *imported hybrid mismatch is the lesser of:

9

- (a) the importing deduction amount worked out under subsection (2) in relation to the *Australian income reduction amount; and

10

11

12

- (b) the amount worked out using the following formula:

13

$$\frac{\text{Importing deduction}}{\text{Total importing deductions of equal priority}} \times \text{Remaining offshore hybrid mismatch}$$

14

where:

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1 **importing deduction** means the amount of the importing deduction
2 amount worked out under subsection (2) in relation to the
3 *Australian income reduction amount.

4 **remaining offshore hybrid mismatch** means:

- 5 (a) unless paragraph (b) applies—the amount of the *offshore
6 hybrid mismatch; or
7 (b) if an item higher in the table in subsection 832-800(3) applies
8 to one or more other *importing payments in relation to the
9 offshore hybrid mismatch—the amount of the offshore
10 hybrid mismatch that is not, or will not be, neutralised by the
11 application of this Subdivision, and equivalent provisions of
12 applicable *foreign hybrid mismatch rules, in relation to
13 those other importing payments.

14 **total importing deductions of equal priority** means the amount
15 worked out by:

- 16 (a) identifying each *importing payment in relation to the
17 *offshore hybrid mismatch that is eligible to neutralise the
18 mismatch, and to which the same item in the table in
19 subsection 832-800(3) applies; and
20 (b) working out under subsection (2) the importing deduction
21 amount in relation to the *Australian income reduction
22 amount or *foreign income tax deduction to which each such
23 importing payment gives rise; and
24 (c) summing the results from paragraph (b) for each such
25 importing payment.

26 (2) The amount (the **importing deduction amount**) worked out under
27 this subsection in relation to an *Australian income reduction
28 amount or *foreign income tax deduction is:

- 29 (a) if the *importing payment is made directly to the offshore
30 deducting entity—the amount of the Australian income
31 reduction amount or foreign income tax deduction; or
32 (b) if the importing payment is made indirectly through one or
33 more interposed entities to the offshore deducting entity—the
34 lesser of:
35 (i) the amount of the Australian income reduction amount
36 or foreign income tax deduction; and
37 (ii) the smallest amount of any foreign income tax
38 deduction to which a payment to an interposed entity
39 gave rise.
-

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832-810 Carry forward of residual offshore hybrid mismatches

(1) Subsection (2) applies if:

- (a) a payment made in a particular *foreign tax period gave rise to an *offshore hybrid mismatch (the *original mismatch*); and
- (b) the original mismatch is only partly neutralised by the application of this Subdivision and equivalent provisions of applicable *foreign hybrid mismatch rules.

(2) This Subdivision applies as if:

- (a) the offshore deducting entity had made a payment in the next *foreign tax period; and
- (b) the payment gave rise to an *offshore hybrid mismatch (the *residual mismatch*); and
- (c) the amount of the residual mismatch was the amount of the original mismatch that was not neutralised by the application of this Subdivision and equivalent provisions of applicable *foreign hybrid mismatch rules.

Subdivision 832-P—Concepts relating to mismatches

832-910 What this Subdivision is about

This Subdivision sets out rules about identifying deduction/non-inclusion mismatches and deduction/deduction mismatches.

Table of sections

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EXPOSURE DRAFT

1 Operative provisions

2 832-915 Identifying mismatches

3 In working out whether a payment gives rise to a
4 *deduction/non-inclusion mismatch, or a *deduction/deduction
5 mismatch, disregard Subdivisions 832-B and 832-C.

6 832-920 Meaning of *deduction/non-inclusion mismatch*

- 7 (1) A payment gives rise to a *deduction/non-inclusion mismatch* if:
8 (a) the payment, or a part of the payment, gives rise to either:
9 (i) an *Australian income reduction amount in an income
10 year; or
11 (ii) a *foreign income tax deduction in a foreign country in
12 a *foreign tax period; and
13 (b) the amount of the Australian income reduction amount or
14 foreign income tax deduction exceeds the sum of the amounts
15 of the payment that are:
16 (i) *subject to foreign income tax in a foreign country in a
17 foreign tax period that is covered by subsection (2); or
18 (ii) *subject to Australian income tax for an income year
19 that is covered by subsection (2).

20 *Period within which payments must be subject to tax*

- 21 (2) For the purposes of subparagraphs (1)(b)(i) and (ii), a *foreign tax
22 period or income year is covered by this subsection if (and only if)
23 it ends no later than 12 months after the end of:
24 (a) if subparagraph (1)(a)(i) applies—the income year mentioned
25 in that subparagraph; or
26 (b) if subparagraph (1)(a)(ii) applies—the foreign tax period
27 mentioned in that subparagraph.

28 *Amount of the deduction/non-inclusion mismatch*

- 29 (3) The amount of the *deduction/non-inclusion mismatch is the
30 amount of the excess worked out under paragraph (1)(b).

EXPOSURE DRAFT

832-925 Meaning of *deduction/deduction mismatch*

- (1) A payment gives rise to a *deduction/deduction mismatch* if the payment, or a part or share of the payment:
- (a) gives rise to a *foreign income tax deduction in a foreign country; and
 - (b) also gives rise to:
 - (i) an *Australian income reduction amount in an income year; or
 - (ii) a foreign income tax deduction in a foreign country (other than the country mentioned in paragraph (a)).

Amount of the deduction/deduction mismatch

- (2) The amount of the *deduction/deduction mismatch is the lesser of:
- (a) the amount of the *foreign income tax deduction mentioned in paragraph (1)(a); and
 - (b) the sum of the amounts of the *Australian income reduction amount, or foreign income tax deduction, mentioned in subparagraph (1)(b)(i) or (ii).

832-930 Meaning of *Australian income reduction amount*

Each of the following amounts is an *Australian income reduction amount* an entity has in an income year:

- (a) an amount the entity can deduct in an income year (other than a net amount that is deductible as mentioned in subparagraph (c)(i));
- (b) an amount that:
 - (i) is an element in the calculation of a net amount included in the entity's assessable income (other than under Division 102 of this Act or Division 5 or 6 of Part III of the *Income Tax Assessment Act 1936*) for the income year; and
 - (ii) has the effect of reducing the amount so included;
- (c) an amount that:
 - (i) is an element in the calculation of a net amount that is deductible (other than under Division 5 of Part III of the *Income Tax Assessment Act 1936*) for the entity for the income year; and
 - (ii) has the effect of increasing the amount so deducted.

EXPOSURE DRAFT

832-935 Meaning of *foreign income tax deduction*

- 1
2 (1) An amount of a loss or outgoing incurred by an entity is a *foreign*
3 *income tax deduction* in a foreign country in a *foreign tax period
4 to which an entity is entitled if:
5 (a) the amount is deducted in working out the tax base of the
6 entity under a law of the foreign country for the foreign tax
7 period; and
8 (b) as a result, the amount of *foreign income tax (except *credit
9 absorption tax, *unitary tax or a withholding-type tax)
10 payable under a tax law of the foreign country is reduced.

Effect of foreign hybrid mismatch rules

- 11
12 (2) In determining for the purposes of this section whether an amount
13 is deducted as mentioned in paragraph (1)(a):
14 (a) have regard to the effect of any provisions of *foreign hybrid
15 mismatch rules of a foreign country that correspond to the
16 provisions covered by subsection (3) (the *Australian primary*
17 *response provisions*); and
18 (b) disregard the effect of any provisions of foreign hybrid
19 mismatch rules of a foreign country that correspond to the
20 provisions covered by subsection (4) (the *Australian*
21 *secondary response provisions (for deductions)*).
- 22 (3) The Australian primary response provisions are:
23 (a) Subdivision 832-B, to the extent that Subdivision applies in
24 relation to a *deduction/non-inclusion mismatch or an
25 *imported hybrid mismatch; and
26 (b) Subdivision 832-B, to the extent that Subdivision applies in
27 relation to a *deduction/deduction mismatch, if a primary
28 response country is identified in the applicable item of the
29 table in subsection 832-725(2), and that country is Australia.
- 30 (4) The Australian secondary response provisions (for deductions) are
31 Subdivision 832-B, to the extent that Subdivision applies in
32 relation to a *deduction/deduction mismatch, if a primary response
33 country is identified in the applicable item of the table in
34 subsection 832-725(2), and that country is *not* Australia.

EXPOSURE DRAFT

832-940 Meaning of *subject to Australian income tax*

- 1
- 2 (1) An amount of income or profits is *subject to Australian income*
3 *tax* in an income year if the amount is:
- 4 (a) included in working out the taxable income of an entity
5 (other than a trust or partnership) for the income year; or
6 (b) included in working out:
- 7 (i) for a trust—the net income for the income year; or
8 (ii) for a partnership—the net income or partnership loss for
9 the income year.
- 10 (2) However, an amount of income or profits is not *subject to*
11 *Australian income tax* if an amount of *foreign income tax (except
12 *credit absorption tax, *unitary tax or a withholding-type tax) paid
13 in respect of the amount counts towards a *tax offset for an entity
14 under Division 770.

Effect of CFC regimes

- 15
- 16 (3) An amount of income or profits of an entity is *subject to*
17 *Australian income tax* if the amount is included under section 456
18 or 457 of the *Income Tax Assessment Act 1936* in the assessable
19 income of another entity.

832-945 Meaning of *subject to foreign income tax*

- 20
- 21 (1) An amount of income or profits is *subject to foreign income tax* in
22 a foreign country in a *foreign tax period if:
- 23 (a) the amount is included in the tax base of a law of the foreign
24 country for the foreign tax period; and
25 (b) as a result, the amount is taken into account in working out
26 the amount (including a nil amount) of *foreign income tax
27 (except *credit absorption tax, *unitary tax or a
28 withholding-type tax) payable by an entity for the foreign tax
29 period.
- 30 Note: Subdivision 832-I (Non-inclusion mismatches involving hybrid
31 financial instruments) has effect as if certain amounts that are subject
32 to a concessional rate of foreign income tax were not subject to
33 foreign income tax: see section 832-515.
- 34 (2) However, an amount of income or profits is not *subject to foreign*
35 *income tax* if an entity is entitled under the law of the foreign
36 country to a credit, rebate or other tax concession in respect of the

EXPOSURE DRAFT

1 amount for foreign tax (other than a withholding-type tax) payable
2 under a tax law of a different country (including Australia).

3 *Effect of CFC regimes*

- 4 (3) An amount of income or profits of an entity is ***subject to foreign***
5 ***income tax*** if the amount is included in working out the tax base of
6 another entity under a provision of a law of a foreign country that
7 corresponds to Part X of the *Income Tax Assessment Act 1936*.

8 *Effect of foreign hybrid mismatch rules*

- 9 (4) In determining for the purposes of this section whether a payment
10 is included in a tax base of a law of a foreign country as mentioned
11 in paragraph (1)(a), disregard provisions of *foreign hybrid
12 mismatch rules that correspond to the provisions covered by
13 subsection (5) (the ***Australian secondary response provisions (for***
14 ***non-inclusion)***).

- 15 (5) The Australian secondary response provisions (for non-inclusion)
16 are Subdivision 832-C.

17 **Subdivision 832-Q—Other concepts**

18 **832-995 What this Subdivision is about**

19 This Subdivision defines concepts used in this Division that do not
20 relate to mismatches, such as liable entity, tax base purpose and
21 dual inclusion income.

22 **Table of sections**

23 **Operative provisions**

24 832-1000 Meaning of *liable entity*
25 832-1005 Meaning of *tax base purpose*
26 832-1010 Meaning of *structured arrangement*
27 832-1015 Meaning of *Division 832 control group*
28 832-1020 Meaning of *dual inclusion income*

EXPOSURE DRAFT

1 Operative provisions

2 832-1000 Meaning of *liable entity*

3 (1) An entity is a *liable entity*, in a country, in respect of the income or
4 profits of an entity (the *test entity*) if:

- 5 (a) for Australia—*tax is imposed on the entity in respect of
6 income or profits of the test entity for an income year; and
7 (b) for a foreign country—*foreign income tax (except *credit
8 absorption tax, *unitary tax or a withholding-type tax) is
9 imposed under the law of the foreign country on the entity in
10 respect of income or profits of the test entity for a *foreign
11 tax period.

12 Note: Generally, a non-transparent entity such as a company is a liable
13 entity, while a transparent entity (such as a trust or partnership) or
14 disregarded entity (such as a member of a consolidated group) is not a
15 liable entity.

16 (2) To avoid doubt, there may be one or more interposed entities
17 between the test entity and an entity that is a *liable entity in
18 respect of the income or profits of the test entity.

19 832-1005 Meaning of *tax base purpose*

20 Each of the following purposes is a *tax base purpose*, for a
21 country, for a *liable entity:

- 22 (a) for Australia—working out, under this Act:
23 (i) the taxable income of the liable entity for an income
24 year; or
25 (ii) if *tax is imposed on the liable entity in respect of an
26 amount other than taxable income—that other amount;
27 (b) for a foreign country—working out, under the law of the
28 foreign country, the tax base of the liable entity for a *foreign
29 tax period.

30 832-1010 Meaning of *structured arrangement*

31 (1) A *scheme under which a payment is made is a *structured*
32 *arrangement* if:

- 33 (a) the payment gives rise to a *hybrid mismatch; and
34 (b) either:

EXPOSURE DRAFT

-
- 1 (i) the hybrid mismatch is priced into the terms of the
2 scheme; or
3 (ii) it is reasonable to conclude that the scheme has been
4 designed to produce a hybrid mismatch.
- 5 (2) The question whether a *scheme has been designed to produce a
6 *hybrid mismatch must be determined by reference to the facts and
7 circumstances that exist in connection with the scheme, including
8 the terms of the scheme.
- 9 (3) An entity that entered into or carried out the *scheme or any part of
10 the scheme is a *party* to the *structured arrangement unless:
11 (a) the entity could not reasonably have been expected to be
12 aware that the scheme gave rise to a *hybrid mismatch; and
13 (b) no other entity in the same *Division 832 control group as the
14 entity could reasonably have been expected to be aware that
15 the scheme gave rise to a hybrid mismatch; and
16 (c) the financial position of each entity in the Division 832
17 control group would reasonably be expected to have been the
18 same if the scheme had not given rise to the hybrid
19 mismatch.

20 **832-1015 Meaning of *Division 832 control group***

- 21 Two entities are in the same *Division 832 control group* if any of
22 the following apply:
23 (a) the entities are both members of a group of entities that are
24 consolidated for accounting purposes as a single group;
25 (b) one of the entities holds a *total participation interest of 50%
26 or more in the other entity;
27 (c) a third entity holds a total participation interest of 50% or
28 more in each of the entities.

29 **832-1020 Meaning of *dual inclusion income***

- 30 (1) An amount of income or profits of an entity that is a *hybrid payer
31 or *deducting hybrid is *dual inclusion income* of the entity if 2 or
32 more of the following apply to the amount:
33 (a) it is *subject to Australian income tax in an income year;
34 (b) it is *subject to foreign income tax in a foreign country in a
35 *foreign tax period;

EXPOSURE DRAFT

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- 1 (c) it is subject to foreign income tax in a foreign country (other
2 than the country mentioned in paragraph (b)) in a foreign tax
3 period.
- 4 (2) For the purposes of paragraph (1)(a), treat an amount of income or
5 profits of an entity as if it were *subject to Australian income tax in
6 an income year if:
- 7 (a) the entity is a *member of a *consolidated group; and
8 (b) the amount was a payment received from another member of
9 the consolidated group; and
10 (c) it is reasonable to conclude that the payment was funded by
11 another amount of income or profits of the other member (the
12 *funding payment*); and
13 (d) the funding payment was subject to Australian income tax
14 because it was included in the *head company's assessable
15 income for the income year.

16 *Period in which dual inclusion income is available to be applied*

- 17 (3) An amount of *dual inclusion income is available to be applied by
18 a provision of this Division to reduce an amount if:
- 19 (a) for an amount that is an *Australian income reduction amount
20 for an income year—the dual inclusion income is *subject to
21 Australian income tax in the income year; or
22 (b) for an amount that is a *foreign income tax deduction, or a
23 net loss mentioned in subsection 832-715(5), in a foreign
24 country for a *foreign tax period—the dual inclusion income
25 is *subject to foreign income tax in the foreign country in the
26 foreign tax period.
- 27 (4) An amount of *dual inclusion income is available to be applied by
28 section 832-235 to create an adjustment for an entity in an income
29 year if the dual inclusion income is *subject to Australian income
30 tax in the income year.

31 *Dual inclusion income not to be applied more than once*

- 32 (5) An amount of *dual inclusion income is not available to be applied
33 by a provision of this Division if the amount has already been
34 applied by a previous application of a provision of this Division.

EXPOSURE DRAFT

1 Part 2—Other amendments

2 *Income Tax Assessment Act 1997*

3 2 Subsection 995-1(1)

4 Insert:

5 *Australian income reduction amount* has the meaning given by
6 section 832-930.

7 *deducting hybrid* has the meaning given by section 832-725.

8 *deducting hybrid mismatch* has the meaning given by
9 section 832-715.

10 *deduction/deduction mismatch* has the meaning given by
11 section 832-925.

12 *deduction/non-inclusion mismatch* has the meaning given by
13 section 832-920.

14 *Division 832 control group* has the meaning given by
15 section 832-1015.

16 *dual inclusion income* has the meaning given by section 832-1020.

17 *foreign hybrid mismatch rules* means a *foreign law
18 corresponding to Division 832.

19 *foreign income tax deduction* has the meaning given by
20 section 832-935.

21 *foreign tax period*, in relation to an entity, in relation to a foreign
22 tax imposed by a tax law of a foreign country, means the
23 accounting period used by the entity for the purposes of
24 determining the tax base under that law.

25 *hybrid financial instrument mismatch* has the meaning given by
26 section 832-490.

27 *hybrid mismatch* has the meaning given by sections 832-495,
28 832-510, 832-575, 832-645, 832-715 and 832-785.

29 *hybrid payer* has the meaning given by section 832-585.

EXPOSURE DRAFT

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- 1 ***hybrid payer mismatch*** has the meaning given by section 832-570.
- 2 ***imported hybrid mismatch*** has the meaning given by
- 3 section 832-785.
- 4 ***importing payment***, in relation to an *offshore hybrid mismatch,
- 5 has the meaning given by section 832-795.
- 6 ***liable entity*** has the meaning given by section 832-1000.
- 7 ***offshore hybrid mismatch*** has the meaning given by
- 8 section 832-790.
- 9 ***party***, in relation to a *structured arrangement, has the meaning
- 10 given by section 832-1010.
- 11 ***reverse hybrid*** has the meaning given by section 832-655.
- 12 ***reverse hybrid mismatch*** has the meaning given by
- 13 section 832-640.
- 14 ***structured arrangement*** has the meaning given by
- 15 section 832-1010.
- 16 ***subject to Australian income tax*** has the meaning given by
- 17 section 832-940.
- 18 ***subject to foreign income tax*** has the meaning given by
- 19 section 832-945.
- 20 ***tax base purpose*** has the meaning given by section 832-1005.

EXPOSURE DRAFT

1 **Part 3—Application and transitional provisions**

2 *Income Tax (Transitional Provisions) Act 1997*

3 **3 After Division 830**

4 Insert:

5 **Division 832—Hybrid mismatch rules**

6 **Table of Subdivisions**

7 832-A Application of Division 832 of the Income Tax Assessment
8 Act 1997

9 **Subdivision 832-A—Application of Division 832 of the Income**
10 **Tax Assessment Act 1997**

11 **Table of sections**

12 832-10 Application of Division 832 of the *Income Tax Assessment Act 1997*

13 **832-10 Application of Division 832 of the *Income Tax Assessment Act***
14 ***1997***

15 (1) Division 832 of the *Income Tax Assessment Act 1997* applies to
16 payments made on or after the start day mentioned in
17 subsection (2).

18 (2) The start day is the last day of the period of 6 months beginning on
19 the day the *Treasury Laws Amendment (OECD Hybrid Mismatch*
20 *Rules) Act 2017* receives the Royal Assent.

21 **4 Application of Part 2**

22 A term that is defined in Part 2 of this Schedule applies in a provision of
23 an Act, regulation or instrument in the same way as that provision
24 applies.

EXPOSURE DRAFT

Schedule 2—Other effects of foreign income tax deductions

Part 1—Denial of imputation benefits

Income Tax Assessment Act 1997

1 After paragraph 207-145(1)(da)

Insert:

(db) the distribution is one to which section 207-158 (which is about foreign income tax deductions) applies;

2 After paragraph 207-150(1)(ea)

Insert:

(eb) the distribution is one to which section 207-158 (which is about foreign income tax deductions) applies;

3 After section 207-157

Insert:

207-158 Distributions entitled to a foreign income tax deduction

This section applies to a distribution if the entity that made the distribution was entitled to a *foreign income tax deduction in respect of all or part of the distribution.

EXPOSURE DRAFT

1 **Part 2—Foreign equity distributions**

2 *Income Tax Assessment Act 1997*

3 **4 At the end of subsection 768-5(1)**

4 Add:

5 ; and (d) the distribution is not one to which section 768-7 (which is
6 about foreign income tax deductions) applies.

7 **5 At the end of subsection 768-5(2)**

8 Add:

9 ; and (f) the distribution is not one to which section 768-7 (which is
10 about foreign income tax deductions) applies.

11 **6 After section 768-5**

12 Insert:

13 **768-7 Foreign equity distributions entitled to a foreign income tax**
14 **deduction**

15 This section applies to a *foreign equity distribution if the company
16 that made the distribution was entitled to a *foreign income tax
17 deduction in respect of all or part of the distribution.

EXPOSURE DRAFT

1 **Part 3—Application**

2 **7 Application—general**

- 3 (1) The amendments made by Part 1 of this Schedule apply in relation to
4 distributions made on or after the day that is 6 months after the day this
5 Act receives the Royal Assent.
- 6 (2) The amendments made by Part 2 of this Schedule apply in relation to
7 foreign equity distributions made on or after the day that is 6 months
8 after the day this Act receives the Royal Assent.

9 **8 Application—regulatory capital**

- 10 (1) Subitem (2) applies if:
- 11 (a) before 9 May 2017, an ADI issued an Additional Tier 1
12 capital instrument (within the meaning of the prudential
13 standards, as in force at the time this Schedule commences);
14 and
- 15 (b) the instrument is callable, and there is an available call date
16 of the instrument on or after 9 May 2017.
- 17 (2) Despite subitem 7(1), the amendments made by Part 1 of this Schedule
18 do not apply in relation to distributions on the instrument that are made
19 before the first available call date of the instrument that occurs on or
20 after 9 May 2017.

21