TD 2024/4EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – TD 2024/4

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Taxation Determination TD 2024/D1 *Income tax: hybrid mismatch rules – application of certain aspects of the 'liable entity' and 'hybrid payer' definitions*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997* (ITAA 1997).

Issue number	Issue raised	ATO response
1	To be a liable entity, an entity must be a liable entity under subsection 832-325(1) or (2) without the application of subsection 832-325(4) given subsection 832-325(4) starts with the expression 'to avoid doubt' and is thus only intended to clarify the operation of the liable entity definition, not expand it. *Karanfilov v Inghams Enterprises P/L* [2000] QCA 348 at [58] was cited as support for this proposition.	The term 'liable entity' has the meaning given by section 832-325 as a whole (see subsection 995-1(1)). Subsection 832-325(4) clarifies the interpretation of subsections 832-325(1) and (2) and must be considered in determining whether an entity is a liable entity. The general approach of the courts has been to regard expressions such as 'to avoid doubt' as adding little or nothing to the substantive text of the provision.[1] Following the guidance identified in the footnote, we consider that the expression 'to avoid doubt' could be removed from subsection 832-325(4) without effect. As noted by Barrett J in *Allen v Feather Products Pty Ltd* [2008] NSWSC 259[2]: … Precisely what the words "to avoid doubt" or "for the avoidance of doubt" add to the meaning of a statutory provision may itself be a matter of doubt. The operative enacted words should have the same effect whether or not the introductory or explanatory words are included.

[1] Pearce, D (2019) *Statutory Interpretation in Australia,* 9th edition, LexisNexis Australia, Chatswood, at [12.26] citing *Panochini v Jude* [1999] QCA 444; *Karanfilov v Inghams Enterprises P/L* [2000] QCA 348; *Allen v Feather Products Pty Ltd* [2008] NSWSC 259.

[2] At [25] and [29].

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		My strong inclination is to approach [the relevant provision] on the footing that the words "To avoid doubt" do not add meaning that would be absent if the words themselves were absent. Viewed in that way, [the relevant provision] is an interpretation provision like any other…
2	The note to subsection 832-325(4) should be considered in light of it being 'non-operative material'.[3]	While we accept that a note cannot govern the text of an Act, it cannot be disregarded.[4] We have used the note to appropriately aid the interpretation of subsection 832-325(4) in accordance with the directions and guidance on notes provided by the ITAA 1997.[5]
3	The assumption in the note to subsection 832-325(4) is a 'statutory deeming' provision and therefore should be 'construed strictly and only for the purpose for which [it is] resorted to'.[6] The purpose of the deeming is to hypothesise the potential taxation outcome of income or profits arising from the *actual activities* of the relevant entity. It does not allow for activities or connections with every potential jurisdiction that may impose tax to be hypothesised, as to do so would be to interpret section 832-325 divorced of its context.	We disagree that the purpose of the note is to direct the reader to hypothesise the potential taxation outcome of income or profits arising from the actual activities of the relevant entity. In fact, in determining whether an entity is a liable entity under section 832-325, the reader does not need to consider the activities (actual or hypothesised) of the relevant entity at all. The note to subsection 832-325(4) simply directs the reader to assume that income or profits within the tax base of the relevant jurisdiction exist. The object of section 832-325 is not to work out which entity will in fact pay tax in a particular period, but to work out whether an entity is of a type that could be liable to tax in a jurisdiction. Our interpretation of subsection 832-325(4) is also supported by paragraph 1.207 of the Revised Explanatory Memorandum to the Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018 (the Revised EM). Consistent with the guidance provided by the note, paragraph 1.207 of the Revised EM also demonstrates the clear intent of parliament for the reader to interpret subsection 832-325(4) as requiring an assumption that income or profits within the tax base of the relevant country exist (emphasis added):

[3] Sections 2-35 and 2-45.
[4] *Shuster v Minister for Immigration & Citizenship* [2008] FCA 215 at [11].
[5] Notes form part of the ITAA 1997 (section 950-100). While 'non-operative', notes provide context and assist readers understand the provisions (sections 2-35 and 2-45).
[6] The following cases were cited for this proposition: *Commissioner of Taxation v Comber, A. H.* [1986] FCA 92 at [25]; *Commissioner of Taxation v Douglas* [2020] FCAFC 220 at [161]; *Commissioner of Taxation v Glencore Investment Pty Ltd* [2020] FCAFC 187 at [155]; *Financial Synergy Holdings Pty Ltd v Commissioner of Taxation* [2016] FCAFC 31 at [34]; *Ellison v Sandini Pty Ltd* [2018] FCAFC 44.

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		In [applying subsection 832-325(4)], in determining whether an entity is a liable entity in such a situation, **it must be assumed** that income or profits within the tax base of the country exist.
4	The interpretation of the liable entity definition in the draft Determination is too broad as the circumstances in which an entity should be regarded as a liable entity in a country should be narrowed to where the entity: • is a tax resident in the country, or • normally derives income or profits within the tax base of the country. That is, an entity must have a *connection* with a country before the entity can be considered a liable entity in the country.	The liable entity definition in section 832-325 makes no reference to connections to a country. The liable entity definition is directed at determining whether an entity is of a type that is a taxable entity in a country. This is irrespective of whether: • the entity is a tax resident of the country • activities are proposed to be carried on in the country • activities are in fact, or were historically, carried on in the country, or • income or profits within the tax base of the country are normally, or were historically, derived.
5	Paragraph 1.209 of the Revised EM suggests that the policy intent of subsection 832-325(4) is to address circumstances where an entity *usually subject to tax* in a country is not taxed for a year. Rather than an entity that has no connection to the country and is not 'normally' taxed in the country.	Paragraph 1.209 of the Revised EM refers to '…an entity of a *type* that is normally subject to tax…' We consider that this is a reference to an entity that has the *characteristics* of a taxpayer under the relevant jurisdiction's income tax laws (regardless of the entity's connection to the jurisdiction). Note 2 to subsection 832-325(1) supports this view. Note 2 states that '[a]n example is an entity that is *a company* (and is not a subsidiary member of a consolidated group or MEC group). In Australia, a company is the liable entity in respect of its income or profits.' The company referred to in Note 2 to subsection 832-325(1) could be an Australian or foreign resident company.

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6	Section 882 of the United Sates (US) Internal Revenue Code should not result in X Co being a liable entity in the US in respect of its own or Y Co's income or profits in the absence of X Co or Y Co actually undertaking activities in the US that may produce income or profits within the scope of section 882.	An entity may be a liable entity in a country in respect of its own or another entity's income or profits irrespective of an actual connection to the country (including actual activities being undertaken in the country which may produce income or profits within the tax base of the country). For Examples 2 and 3 of the Determination, it is sufficient that: • X Co is a foreign corporation for US federal income tax purposes, and • the US taxes foreign corporations (via sections 11 and 882 of the US Internal Revenue Code). X Co is a liable entity in the US in respect of its own and Y Co's income or profits because, if income or profits within the scope of section 882 of the US Internal Revenue Code existed, US federal income tax would be imposed on X Co.
7	The expression '*in respect of*' in subsection 832-320(3) (also used in subsections 832-325(1) and (2)) directs that there be a *link* between the actual income or profits of Y Co and X Co in determining whether X Co is a liable entity in the US in respect of its own and Y Co's income or profits. The 'in respect of' language would be unnecessary if subsection 832-325(4) permitted any assumed income or profits to be taken into account irrespective of whether the assumed income or profits relate to the actual income or profits Y Co or X Co might derive based on their actual activities.	The words 'in respect of' in subsection 832-320(3) allow the reader of the provision to identify the income or profits of the entity that is being considered (that is, 'the test entity' and 'the recipient of the payment'). The 'in respect of income or profits' language in section 832-320 follows the text of the liable entity definition which refers to an entity being a liable entity in a country in respect of its own or another entity's income or profits (see subsections 832-325(1) and (2)). Division 832 is a set of mechanical rules. Once the relevant liable entities are identified under section 832-325 (which can be based wholly on hypothetical income or profits irrespective of an actual connection to a country), this is then applied to the hybrid payer definition in section 832-320.

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8	Paragraph 48 of Taxation Determination TD 2009/2 *Income tax: when is 'foreign income tax... imposed... on the partners, not the partnership' under paragraph 830-10(1)(b) of the Income Tax Assessment Act 1997 for the purpose of determining whether a foreign limited partnership is a foreign hybrid limited partnership under Division 830 of that Act?* suggests that there must be a nexus or a discernible and rational link between the actual income or profits of an entity and the tax base of the jurisdiction in which the entity is said to be a liable entity. Where no nexus or link exists, the entity should not be considered a liable entity in that jurisdiction.	We do not consider that TD 2009/2 affects our interpretation of the liable entity definition. It is acknowledged that paragraph 830-10(1)(b) uses similar language to subsections 832-325(1) and (2). To the extent it matters, there are similarities in how we have interpreted paragraph 830-10(1)(b) in TD 2009/2 and the liable entity definition in the Determination. Both approaches: • refer to the importance of determining the status of the entity as a taxable entity in the relevant country, and • do not rely on actual income or profits within the tax base of the relevant country. Further, Example 6 in TD 2009/2 concludes that Country Z imposes income tax on the partners of the limited partnership even though the limited partnership does not engage or propose to ever engage in activities that produce income or profits within the tax base of Country Z.
9	Substituting US Parent in Example 3 of the draft Determination with a UK Parent exposes why the interpretation of the liable entity definition is too broad. This is because, despite no apparent US connection to the revised structure, under our interpretation X Co would still be regarded as a liable entity in the US.	Under the revised structure, X Co would still be a liable entity in the US because, if X Co derived income or profits within the tax base of the US, US federal income tax would be imposed on X Co. There is no anomaly in respect of this outcome. The royalty payments made by Y Co to X Co under the revised structure should not give rise to hybrid payer mismatches. The hypothetical deduction/non-inclusion (D/NI) outcome under subparagraph 832-315(3)(b)(i) should be the same as the actual D/NI outcome. This is because: • there would not be a hypothetical subpart F income inclusion in respect of the royalties (because there is no US shareholder in respect of X Co), and • any non-inclusion under the UK's controlled foreign corporation (CFC) regime is unlikely to be caused by hybridity.
10	Subsection 832-325(5) operates to exclude CFC income non-inclusions from the operation of Division 832.	We disagree. Subsection 832-325(5) does not reflect a policy that non-inclusion under a foreign CFC regime is outside the scope of Division 832. Broadly, subsection 832-325(5) only provides that a shareholder in a CFC is not a liable entity in respect of the income or profits of the CFC merely because all or part of the income or profits of the CFC are attributed to the shareholder under certain corresponding CFC provisions.

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11	Further to Issue 10 of this Compendium, there is a misalignment in the approach to address the mischief contemplated by the draft Determination. This is because the mischief contemplated by the draft Determination is non-inclusion under the *US CFC regime*. However, in Examples 2 and 3 in the draft Determination, X Co's status as a liable entity in the US is determined by reference to the US *'regular income tax regime'*.	We disagree that there is any misalignment. Determining that X Co is a liable entity in the US is one step in concluding whether the royalty payments made by Y Co to X Co give rise to hybrid payer mismatches. It is permissible to identify X Co as a liable entity in the US based on sections 11 and 882 of the US Internal Revenue Code. Subsection 832-325(5) does not prevent this. It is also permissible to take into account the non-inclusion of the royalties in US Parent's tax base in determining the overall D/NI mismatch in respect of the royalties. At first sight, it is Y Co's classification as a disregarded entity of X Co for US federal income tax purposes that causes the royalties to not be included in US Parent's tax base under subpart F of the US Internal Revenue Code. The hybrid requirement in subparagraph 832-315(3)(b)(i) then tests the extent to which the overall D/NI mismatch in respect of the royalties is caused by Y Co being a hybrid entity.
12	A similar comment to Issue 11 of this Compendium is raised about perceived inconsistencies. Namely: • the draft Determination '*does not rely* on attribution under a CFC regime' to determine if Y Co in Example 3 is a hybrid payer, but rather 'an assumed scenario that X Co and Y Co had a taxable presence in the US', and • the hybrid requirement in subparagraph 832-315(3)(b)(i) '*entirely relies*' on hypothetical attribution under the US CFC regime.	Also refer to our response to Issue 11 of this Compendium. The liable entity concept and the hybrid requirement in subparagraph 832-315(3)(b)(i) are separate concepts which should not be conflated. X Co can be identified as a liable entity in the US based on sections 11 and 882 of the US Internal Revenue Code irrespective of whether X Co or Y Co has an actual taxable presence in the US. Hypothetical attribution under the US subpart F regime can be taken into account under subparagraph 832-315(3)(b)(i) to reveal whether the actual D/NI mismatch in respect of the royalties is caused (or partly caused) by the hybridity of the payer.
13	A third country[7] can be a non-including country for the purpose of the hybrid payer definition. However, the third country should be limited to the country in which the liable entity for the purpose of subsection 832-320(3) is established or resident in. The word *'in'* immediately before the words 'the non-including country' in paragraphs 832-320(3)(a) and (b) support this proposition. Accordingly,	The language 'is a liable entity in the non-including country' in subsection 832-320(3) of the hybrid payer definition follows the language 'is a liable entity in a country' in subsections 832-325(1) and (2) of the liable entity definition. Division 832 is a set of mechanical rules. Once the relevant liable entities are identified, this is then applied to the hybrid payer definition in section 832-320. Nothing in section 832-320 restricts a third country non-

[7] That is, a jurisdiction other than the country where the payer or payee of the relevant payment is located or resides.

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	Country B in Example 1.14 of the Revised EM is an acceptable non-including country because B Co (the liable entity for the purpose of subsection 832-320(3)) is established or resident in Country B. However, the US in Example 3 in the draft Determination should not be considered a non-including country because X Co (the liable entity for the purpose of subsection 832-320(3)) is not established or resident in the US.	including country to the country in which the liable entity for the purpose of subsection 832-320(3) is established or resident in.
14	Appropriate regard should be given to the royalty payments in Example 3 in the draft Determination when determining the non-including country for the purpose of subsection 832-320(3). The royalties provide the 'nexus' to the appropriate non-including country. The assessment should be whether the royalties and the nature of the activities surrounding the royalties gives rise to X Co being a liable entity in the US.	The royalties and the nature of the activities surrounding the royalties do not determine whether X Co is a liable entity in the US in respect of its own or Y Co's income or profits. What matters is X Co's status as a taxable entity in the US in respect of its own and Y Co's income or profits if income or profits within the tax base of the US existed. Because of the language used in subsection 832-320(3), more than one country can be considered in identifying the non-including country. The US is a natural non-including country in the context of Example 3 of the draft Determination because US Parent is a US shareholder of X Co and there is in fact a non-inclusion in the US in respect of the royalties. At first sight, it is the grouping of X Co and Y Co for US federal income tax purposes which causes the royalties to be disregarded and not included in US Parent's tax base under the US CFC regime.
15	Tax imposed under section 881 of the US Internal Revenue Code appears to be a 'withholding-type tax'.[8] Therefore, section 881 should not be a basis for characterising a foreign corporation as a liable entity in the US.	References to section 881 of the US Internal Revenue Code have been removed from the final Determination. Section 882 of the US Internal Revenue Code remains relevant. References to section 11 of the US Internal Revenue Code have been added.
16	Identifying a liable entity in a country, based on hypothetical income or profits within the tax base of the country, creates an additional compliance burden because (in effect) you would need to consider the liable entity definition with respect to every entity in a multinational group.	We disagree. The facts and circumstances surrounding a payment will dictate the logical jurisdictions to consider. A payment cannot give rise to a hybrid payer mismatch if the payment does not give rise to a D/NI mismatch. We would expect multinational groups to be aware of their payments that give rise to material D/NI mismatches. This exposes and narrows down the relevant entities in respect of which the liable entity definition must be applied. The view expressed in the draft Determination should not require the

[8] See paragraph 832-130(7)(c).

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		liable entity definition to be applied to every entity within a multinational group.
17	The hypothetical calculation required by subparagraph 832-315(3)(b)(i) is difficult and ultimately there may be no (or an immaterial) hypothetical subpart F income inclusion under the hypothetical. It may be difficult to engage relevant US based tax teams to assist with performing the hypothetical subpart F income calculation.	It is acknowledged that there may be complexities in the operation of the subpart F rules in the context of a hypothetical scenario posed by subparagraph 832-315(3)(b)(i). The degree of complexity will depend on the relevant facts and circumstances.
18	It would be helpful if guidance could be provided on the application of subparagraph 832-315(3)(b)(i) to arrangements contemplated by the draft Determination.	The application of the hybrid requirement in subparagraph 832-315(3)(b)(i) is outside the scope of this Determination. We invite taxpayers to engage with us to discuss what product may be appropriate for their circumstances.
19	Neither the OECD Action 2 Report, Division 832, or the Revised EM explicitly refer to non-inclusions under a CFC regime as an arrangement that is being targeted. Therefore, this indicates that non-inclusions under a CFC regime were not intended to be captured by Division 832.	We consider that the views expressed in the Determination are consistent with the purpose of Division 832. That is, the prevention of tax advantages arising from the exploitation of differences in the tax treatment of entities under the laws of 2 or more tax jurisdictions. Division 832 (along with the OECD Action 2 Report and Revised EM) does not specifically list or refer to all of the arrangements and structures it may target. In addition, in construing Subdivision 832-D, the task must begin (and end) with a consideration of the text itself, and extrinsic material (including the OECD Action 2 Report and the Revised EM) cannot be relied on to displace the clear meaning of that text.[9]
20	CFC regime taxation should only be considered in a favourable manner under Division 832. That is, CFC *inclusions* should be recognised to avoid economic double taxation. However, CFC *non-inclusions* should not be recognised or addressed.	We disagree. Addressing CFC non-inclusions where the non-inclusion is attributable to hybridity is consistent with the purpose of Division 832. We cannot comment on matters of policy, to the extent the issue is raising a point about the scope of the policy represented by Division 832.

[9] *Alcan (NT) Alumina Pty Ltd v Commissioner of Territory Revenue* [2009] HCA 41 at [47].

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21	The draft Determination conflicts with the OECD Action 2 Report recommendation that a D/NI outcome should not arise in respect of a payment received by an entity resident in a no-tax jurisdiction.	As noted at Issue 19 of this Compendium, in construing Subdivision 832-D the task must begin (and end) with a consideration of the text itself, and extrinsic material (including the OECD Action 2 Report) cannot be relied on to displace the clear meaning of that text. Division 832 does not exclude D/NI outcomes on the basis that the recipient of the payment is established or resident in a no-tax jurisdiction. This is an example of a departure from the OECD Action 2 Report. It is a feature of Division 832 that jurisdictions beyond the payer and payee countries can be considered when determining whether a D/NI outcome arises under section 832-105. In Example 3 of the Determination, while it is relevant that the payment is not subject to foreign income tax in Country X (a no-tax jurisdiction) or elsewhere, the overall D/NI outcome also arises because the US treats Y Co as a disregarded entity. The issue is whether the non-inclusion in the US is caused by the hybridity of Y Co. This is tested by the application of subparagraph 832-315(3)(b)(i).
22	Under the hypothetical scenario set by subsection 832-315(4), there may be *no **overall** net increase* in attributable subpart F income. Therefore, there may be no *overall* subpart F income mischief in relation to the structures contemplated by the draft Determination.	This issue considers the hypothetical outcome in respect of payments in addition to the payment that gave rise to the D/NI mismatch. This is not how subparagraph 832-315(3)(b)(i) operates. Subparagraph 832-315(3)(b)(i) only compares the actual amount of a particular D/NI mismatch with what the amount of that D/NI mismatch would have been under the hypothetical scenario set by subsection 832-315(4). For arrangements contemplated by the Determination, subparagraph 832-315(3)(b)(i) does not compare a multinational group's actual *overall* subpart F income inclusion with the multinational group's hypothetical *overall* subpart F income inclusion under the hypothetical scenario set by subsection 832-315(4). In any case, it is not possible to generalise what the outcome may be under the hypothetical scenario set by subsection 832-315(4). The outcome will vary based on the relevant facts and circumstances of each arrangement.

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23	The application of Subdivision 832-H to arrangements contemplated by the draft Determination effectively results in double taxation when considered in conjunction with the US global intangible low-taxed income regime.	We acknowledge that the Australian tax payable may increase if Subdivision 832-H applies to arrangements contemplated by the Determination. However, the essence of the issue raised is the interaction of Division 832 with the US global intangible low-taxed income regime, not the views expressed in the Determination on elements of the liable entity and hybrid payer definitions.
24	The final Determination should only apply prospectively from the date it is finalised. This is because: • the draft Determination is the first guidance provided by us on the issues since the enactment of Division 832 in August 2018 • our view on the issues hasn't been adequately communicated to the market prior to the release of the draft Determination, and • multinational groups may be overly penalised by the carry forward rule in section 832-635 even where they restructure out of arrangements contemplated by the draft Determination.	The final Determination will apply both before and after its date of issue. It is appropriate to apply the view in the final Determination retrospectively as the view has been consistently applied by us since the commencement of the relevant provision. We have not previously issued any publications or demonstrated any conduct that could reasonably be seen as conveying a different view of the law. Refer to our policy on retrospective and prospective views as set out in Law Administration Practice Statement PS LA 2011/27 *Determining whether the ATO's views of the law should be applied prospectively only*. Section 832-635 may apply to some arrangements contemplated by the Determination, where the relevant facts and circumstances exist. It is our expectation that the application of section 832-635 should be appropriate in these cases.