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28 May 2021

Shahzeb Panhwar
Assistant Commissioner
Australian Taxation Office

By Email: HybridMismatches@ato.gov.au

Dear Shahzeb,

DRAFT PCG 2021/D3 - IMPORTED HYBRID MISMATCH RULE - ATO'S COMPLIANCE APPROACH

CPA Australia represents the diverse interests of more than 168,000 members working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

We previously **commented** on the Exposure Draft of the hybrid mismatch rules, highlighting the significant compliance burden imposed on small and medium entities (**SMEs**) and their advisors by these rules and the challenges in ensuring compliance in the SME and individual markets.

Our suggestion for a carve-out based on deduction thresholds, akin to the thin capitalisation rules, was not included in the legislation passed by Parliament, however we consider that the **Practical Compliance Guideline 2021/D3 Imported hybrid mismatch rule – ATO's compliance approach** (**the draft PCG**) may be an appropriate product by which to achieve a similar outcome administratively. This is particularly important with respect to the imported hybrid mismatch rule which imposes the greatest compliance burden of all the hybrid mismatch rules.

However, we find that the draft PCG in its current form imposes a very high burden of proof on taxpayers who are required to prove a negative (i.e. no hybrid mismatches have occurred in the global group). The draft PCG takes the default position that all cross-border intra-group payments are treated prima facie as non-deductible with the onus placed on the taxpayer to prove beyond doubt their entitlement to deduct the amount.

For SMEs including smaller subsidiaries of multinational entities (**MNEs**), this approach by the ATO imposes an unreasonable expectation that the Australian entities and their advisers will annually undertake voluminous information gathering and detailed analysis to eliminate what is, in our view, a remote occurrence and a relatively low risk to the revenue.

Concepts such as "information that should have been known" (paragraph 19) and "adequate and complete responses" (paragraph 21) do not provide assurance to affected taxpayers, nor does the threat of the Commissioner imposing statement or scheme penalties even when reasonable care was taken (paragraph 22). We recommend that comments in the draft PCG about reasonable care are consistent with **MT 2008/1 Penalty relating to statements: meaning of reasonable care, recklessness and intentional disregard**.

We consider that eight risk zones are too many and consideration should be given to consolidating the Green and Blue zones as low risk and the Yellow and Amber zones as moderate risk. While the automatic 'Blue zone' rating for payments totalling less than $2 million provides some comfort for smaller taxpayers, we suggest that is more appropriate that they are classified as low risk. This is due to the comparatively small size of the payments and risk to revenue relative to the compliance costs of

undertaking a comprehensive analysis of all payments made within a global group in order to identify potential imported hybrid mismatches.

We also recommend that the ATO is more consistent in their approach for smaller taxpayers. For example, the chosen turnover threshold for transfer pricing record keeping purposes is $50 million (see **PCG 2017/2 Simplified transfer pricing record keeping options**). A similar simplified approach to hybrid mismatches would provide less onerous investigative and documentation requirements, enabling a streamlined annual process while managing the level of risk.

Our preference that smaller taxpayers, however defined, would be subject to a tailored administrative approach that is mindful of the different factors that can impact on their ability to meet the draft PCG's extraordinarily high expectations. In particular, we suggest that the draft PCG should be designed on the basis that the professional advisers, upon whom these taxpayers rely, can appropriately exercise their judgment in identifying the necessary information to request from overseas parties in order to correctly determine if there is an imported hybrid mismatch for Australian tax purposes. This will reduce the impost on the ATO to administer the draft PCG across all markets, reduce the volume of base-level documentation expected to be produced annually and provide greater assurance to taxpayers with respect to the likelihood of compliance action.

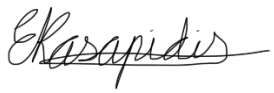
We support guidelines that result in simpler and more practical compliance approaches and refer the ATO to the New Zealand Inland Revenue Department's **draft guidance** on the imported mismatch rules as a good example.

Should the draft PCG retain its approach to all entities captured by the legislation, the ATO should publish further information such as the list of countries with foreign hybrid mismatch rules including comparative analysis of the regimes to assist the taxpayer minimise the time and cost of undertaking the review required by the ATO at paragraph 33.

On the detailed technical aspects of the draft PCG, we support the comments provided by Pitcher Partners in their separate submission to you.

If you have any queries, contact me at 0466 675 194 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,



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