

11 November 2016

Addressing hybrid mismatch arrangements
C/- David Carrigan, Acting Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear David

Addressing hybrid mismatch arrangements – Government discussion document

We are writing in respect of the Government discussion document, *Addressing hybrid mismatch arrangements* (herein referred to as "the Paper"). We appreciate the opportunity to comment on the Paper.

Executive summary

From a policy perspective, our primary submission points are the following.

- A de minimis rule should be included to ensure that the proposals (and the resulting compliance costs) are correctly targeted.
- We are not supportive of the proposals to deny a deduction for a New Zealand business' foreign branch losses. This proposal would likely discourage the use of a common structure utilised by New Zealand businesses when expanding overseas.
- The denial of an immediate deduction for a New Zealand business' foreign branch losses would be untenable without an active income exemption.

In addition to the above, we also have the following general submission points.

- The Paper is long, complicated and technical in nature.
- The Paper should include an executive summary to assist readers in understanding the proposals.
- We endorse submissions made by the Corporate Taxpayer Group and support the detail included in their submission, particularly comments in relation to the proposal's application date and grandparenting.
- The consultation period for the Paper overlapped with a number of other outputs from Inland Revenue which required more immediate analysis.
- Further consultation should take place with respect to refining the proposals (including draft legislation).
- Separate consultation should take place in relation to the inclusion of a de minimis rule and an active income exemption (if Officials agree with our submissions).

Given the complexity of the Paper we have only provided high level submission points and have not submitted on the detail.

General comments

The Paper is an 83 page document discussing New Zealand's implementation of the OECD's recommendations included in their 454 page paper entitled *Neutralising the Effects of Hybrids Mismatch Arrangements*. The Paper is long, complicated and technical in nature. The Paper does not include an executive summary to assist readers in understanding proposals recommended by Officials. A summarised table of the proposals and common examples of where they could impact would be useful.

De minimis rule

The complexities of the proposals are likely to add significant compliance costs for affected taxpayers. Compliance costs will be incurred up-front in understanding the proposals and how they affect the taxpayer's business, and then on an on-going basis in ensuring continued compliance. Given their complexity, if the proposals are to proceed, we do not agree that all taxpayers should be subject to the proposals.

To ensure the proposals and the resulting compliance costs are correctly targeted, we submit that Officials should consider a de minimis rule. We recommend a rule to carve-out smaller sized taxpayers or small transactions that do not pose a material risk to New Zealand's tax base. We recommend that the de minimis rule is based on the taxpayer's overall turnover for smaller taxpayers (e.g. under \$80 million) and based on transaction value for larger taxpayers (e.g. under \$1 million of relevant income or expenditure).

Deductible hybrid payments

Foreign branches of New Zealand businesses

Chapter 8 (Deductible hybrid payments) proposes to deny a deduction for a New Zealand business' foreign branch losses (except against dual inclusion income from the same country). This proposal may detrimentally affect New Zealand businesses with foreign branches given the compliance costs that they will face, the change in the ability to use foreign losses against New Zealand income and the risk that certain losses will never be able to be used. We consider that this proposal, in the absence of an active income exemption, would not serve New Zealand's best interest. The use of foreign branches by a New Zealand business is common practice in the initial stage of operating in another country, particularly for SMEs who have a greater tendency to expand to another country via a branch structure due to lower compliance costs. The use of the foreign branches by a New Zealand business would therefore be discouraged by this proposal. This would be detrimental to New Zealand as, with the New Zealand market being so small, businesses must be able to easily expand offshore to grow the New Zealand economy.

Accordingly, we are not supportive of the proposals to deny a deduction for a New Zealand business' foreign branch losses.

Active income exemption

On page 65 of the Paper, Officials specifically call for submissions on whether the denial of a deduction for foreign branches losses against New Zealand income should be matched by an exemption for active income earned through foreign branches. We are strongly supportive of an exemption for active income earned through a foreign branch, especially if the

proposals in relation to foreign branches proceeds and our de minimis rule submission is not accepted by Officials.

We consider that an exemption for active income earned through a foreign branch would alleviate some of the issues caused by the deductible hybrid payment proposals. Despite this, we note that the proposals would still increase the overall compliance costs faced by New Zealand businesses using the foreign branch structure.

Based on this, it is our view that the denial of an immediate deduction for a New Zealand business' foreign branch losses would be untenable without an active income exemption.

Corporate Taxpayer Group

During the process of reviewing the Paper, we have liaised with the Corporate Taxpayer Group ("the Group"). While submission points included in our submission are limited, we endorse submissions made by the Group and support the detail included in their submission.

In particular, we are supportive of the following submissions made by the Group.

- A grandparenting period of three years following the date of enactment would be appropriate for existing arrangements, to enable a transition to the new rules.
- New Zealand should at a minimum have a similar implementation date for the hybrid rules to Australia and, if there is a delay in their hybrid rules being enacted, New Zealand could consider delaying the implementation date until similar proposals are in force in Australia.

Other comments

Deadline extension

We are appreciative that Officials have considered it appropriate to extend the Paper's submission deadline, however we note that the consultation period for the Paper overlapped with a number of other outputs from Inland Revenue which required more immediate analysis.

For example, the Supreme Court's judgement in *Trustpower v Commissioner of Inland Revenue* was released on 27 July 2016 and the updated draft interpretation statement on the deductibility of feasibility expenditure was released on 14 October 2016. The Commissioner's case impact statement on the Supreme Court case provides that tax positions taken after the date of the judgement should take into account the *Trustpower* decision. As a result, the analysis of feasibility expenditure for income tax returns currently being prepared has been prioritised by many taxpayers over hybrid mismatch arrangements proposals which are not expected to affect income tax returns currently being filed (i.e. hybrid mismatch arrangements are expected to apply to payments made after the taxpayer's first tax balance date following enactment).

Further consultation

The Paper is inherently complex, which means not all scenarios can be modelled for. We consider that further work is required to determine the impact of proposals on all likely scenarios. We therefore submit that further consultation should take place with respect to refining the proposals (including draft legislation).

Additionally, if Officials agree with our submissions points, we submit that separate consultation should take place in relation to the inclusion of a de minimis rule and active income exemption.

For any queries in relation to this submission, please don't hesitate in contacting Robyn Walker (04 4703615 or robwalker@deloitte.co.nz) or Brad Bowman (09 303 0885 or bbowman@deloitte.co.nz).

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Robyn Walker', is positioned above the typed name and title.

Robyn Walker
National Technical Director
for Deloitte Limited (as trustee of the Deloitte Trading Trust)