Corporate Taxpayers Group

c/- Rebecca Osborn I Deloitte I PO Box 1990 I Wellington I +64 (0)4 470 3691

CTG

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

The Corporate Taxpayers Group (the "Group") is writing to submit on the discussion document "*Addressing hybrid mismatch arrangements*" (the "Discussion Document").

The Group is appreciative of the opportunity to submit on this Discussion Document and the time spent by Officials to date in discussing these proposals with us.

Summary of our submission

The key points in our submission are:

General comments

- New Zealand should not to proceed with the wholesale adoption of the OECD recommendations in relation to Hybrids, as:

    - the solutions proposed by the OECD are complex;
    - the number of instances of improper use of hybrid arrangements appears to be limited;
    - the proposed solution will often require taxpayers to seek foreign tax advice when applying the rules;
    - there is significant resource cost and opportunity cost involved in advancing these proposals.

  The better approach would be for New Zealand to consider targeted reform with rules addressing particular areas of concern.

- If it is not possible to apply a more targeted approach, the focus should be on making these rules as simple as possible and remove any unintended consequences. Further, if the rationale for a comprehensive solution is based on alignment with the OECD, then as a minimum we need to ensure that New Zealand aligns to the timing of adoption of other relevant jurisdictions, their transition periods and any grandfathering provisions.

- There are a number of ambiguities / unanswered questions with these proposals that are detailed in Appendix Two of this submission. Before proceeding further with these proposals, we suggest that these questions are considered further. We would like to arrange a meeting with Officials to discuss these further.

Economic analysis

- Some of the economic claims made in Chapter 3 of the discussion document appear questionable and we would be interested in seeing what economic analysis has taken place in relation to these claims. We would be interested in receiving clarification from Officials on this.

De-minimis threshold

- Given the complexity of the proposals, we believe it would be appropriate that a de-minimis threshold is introduced where transactions below a certain threshold are not subject to the hybrid rules. This will ensure that the rules are more appropriately targeted at transactions where the tax revenue at stake justifies the compliance costs imposed on the business.

Further consultation and timeframe

- This discussion document contains significant and complex tax proposals that require a lot of time to consider adequately. The timeframe for making submissions on the discussion document has not allowed sufficient time for the tax community to fully consider the wide-ranging impacts of the proposals.

- The current timeframe for advancing these proposals should be extended to enable sufficient time to properly consider and address the issues, compare New Zealand's position with other countries and reduce the risk of unintended consequences.

- In addition, as submitted below, these proposals warrant the introduction of an active income exemption for branches, which requires an additional consultation process.

- While the discussion document attempts to articulate proposals, it is only once proposals are put into draft legislation that taxpayers can really begin to analyse and appreciate how the proposals may impact on their business arrangements. Therefore we strongly recommend that an exposure draft with draft legislation should be released for further consultation prior to including these proposals in a Tax Bill.

General rule for introduction

- We do not agree with the proposed application date for these proposals. It is important that New Zealand's implementation date is not in in advance of other OECD member nations, particularly Australia's.

- New Zealand should not be an early adopter of these proposals because if we do act early, we risk a material increase in compliance costs as taxpayers will need to analyse their arrangements and the current foreign tax treatment, monitor legislative changes in foreign jurisdictions, and adopt different treatments in New Zealand as changes progress overseas.

- We submit that 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 should consider delaying the implementation date until similar proposals are in force in Australia.

Grandparenting and transitional period

- In the Group's view, a grandparenting period of three years following date of enactment would be appropriate for existing arrangements, to enable a transition to the new rules.

- Even if Officials do not accept a grandparenting period for all existing arrangements, there is a good case for grandparenting in specific circumstances. Given our close ties to Australia, if Australia includes some form of grandparenting treatment for regulatory capital, in the Group's view it would be necessary for New Zealand to apply similar treatment.

Timing differences

- We agree with Officials that the Australian Board of Taxation approach would be preferable for New Zealand. This approach has advantages over the OECD approach as it is more certain by providing objective criteria for determining when there is a timing mismatch. In addition, it is a more reasonable approach as it allows denied deductions to be carried forward.

- The discussion document does not consider how the rules may apply in situations where NZ recognises the treatment of interest and foreign exchange as a single item of Financial Arrangement income under our Financial Arrangement rules, as compared to other countries that might treat these amounts separately. We submit that further consideration needs to be given to this issue, and Officials need to provide further guidance on this in any further consultation on these proposals.

Taxation of FIF interests

- Our primary submission is that FDR, cost and DRR methods should not be altered in response to the hybrid proposals. This goes beyond the scope of the core policy concern and should not be an area of focus.

- If the proposals in this area, do proceed we suggest that the preferred approach should be to deny the ability to use the FDR, cost and DRR methods for shares on which any dividend would be deductible to the payer and simply tax the dividend. This appears to be the least complex and most straightforward to apply. However, we have not considered these options in detail.

Regulatory capital

- At a minimum, given our close ties to Australia, if Australia either excludes regulatory capital or regulatory capital is subject to grandfathering treatment, New Zealand should follow a similar approach.

- Even if Australia does not adopt grandfathering treatment for regulatory capital, there are good reasons for adopting grandfathering treatment to provide financial institutions with a transitionary period to adapt to the new rules.

- There should be a grandparenting period of 5 years from the effective date (assuming the proposals are enacted in 2018). In addition, grandparenting treatment should apply to all regulatory capital issued prior to the release of this discussion document as prior to this date, there was no certainty on the position that Officials would take in respect of regulatory capital.

Carry-forward of denied deductions

- We do not support the existing loss carry forward rules being used as a basis for allowing the carry forward of disallowed deductions under the hybrid rules. This is because the policy behind the existing loss carry forward rules is different to those applying to the hybrid rules. In addition, the Group has concerns around the continued appropriateness of the existing loss carry-forward continuity threshold.

- To prevent double taxation, if excess dual inclusion income is returned in a subsequent year, and deductions have been denied in a prior period, it is appropriate that this be offset to prevent double taxation, regardless of changes in ownership in excess of 51% during the total period.

Dual inclusion income

- As dual inclusion income is a fundamental concept to these proposals, we believe that further consideration needs to be given to what is and what is not dual inclusion income. Officials need to provide further guidance on this concept in any further consultation on these proposals.

- We do not agree with the proposal to depart from the OECD's recommendations in relation to CFC income as dual inclusion income.

Carry forward / reversal of defensive rule income

- We agree that there should be some carry forward of defensive rule income. A "reversal" rule for the application of the defensive rule is the most straightforward and least complex approach. Despite this, we submit that the best way forward would be to allow taxpayers a choice of options.

Reverse Hybrids

- In relation to Recommendation 4, the Group strongly submits that CFC income should be respected as income of the payee to ensure there is no denial of a deduction where the income is recognised in the parent of the reverse hybrid as CFC income.

- We do not consider that the suggested changes to the CFC regime in paragraph 7.19 (Recommendation 5.1) in the Discussion Document are required given the breadth of New Zealand's CFC regime and the complexity this will give rise to.

Deductible hybrid payments – Application to branches

- If the proposal to deny a deduction for foreign branch losses, do proceed it is critical that this is balanced by an active income exemption for foreign branch income.

- Further, aspects of these rules will be need to be clarified. In particular, clarification of when a loss offset by a foreign branch is "not possible" to enable losses to be offset against the income of a NZ entity.

Further detail on these submission points are included at Appendix One to this submission. A list of questions regarding the Discussion Document proposals are included at Appendix

Two. As noted above, we would like to arrange a meeting with Officials to discuss these questions.

Please contact us if you wish to discuss any of the matters raised in our submission further with us.

For your information, the members of the Corporate Taxpayers Group are:

1. Air New Zealand Limited
2. Airways Corporation of New Zealand
3. AMP Life Limited
4. ANZ Bank New Zealand
5. ASB Bank Limited
6. Auckland International Airport Limited
7. Bank of New Zealand
8. Chorus Limited
9. Contact Energy Limited
10. Downer New Zealand Limited
11. Fisher & Paykel Healthcare Limited
12. Fletcher Building Limited
13. Fonterra Cooperative Group Limited
14. General Electric
15. Genesis Energy Limited
16. IAG New Zealand Limited
17. Infratil Limited
18. Lion Pty Limited
19. Meridian Energy
20. Methanex New Zealand Limited
21. New Zealand Post Limited
22. New Zealand Racing Board
23. New Zealand Steel Limited
24. New Zealand Superannuation Fund
25. Opus International Consultants Limited
26. Origin Energy New Zealand Limited
27. Pacific Aluminium (New Zealand) Limited
28. Powerco Limited
29. Shell New Zealand (2011) Limited
30. SKYCITY Entertainment Group Limited
31. Sky Network Television Limited
32. Spark New Zealand Limited
33. T & G Global Limited
34. The Todd Corporation Limited
35. Vodafone New Zealand Limited
36. Westpac New Zealand Limited
37. Z Energy Limited
38. ZESPRI International Limited

We note the views in this document are a reflection of the views of the Corporate Taxpayers Group and do not necessarily reflect the views of individual members.

Yours sincerely

John Payne

John Payne
For the Corporate Taxpayers Group

APPENDIX ONE: DETAILED SUBMISSION POINTS

1. General comments

Scope of proposals

1.1 The Group agrees that some changes to the rules may be necessary, as the world in which businesses operate has evolved – and so must New Zealand's tax settings. However, we question whether the proposed solution to the issue of hybrid mismatch arrangements is proportionate with the problem. We understand why it may be difficult to estimate the impact hybrid arrangements are having on the New Zealand tax base, but in absence of such evidence, there is no justification for the complexity that these proposals would introduce.

1.2 Paragraph 3.26 of the Discussion Document notes that "*any new rules addressing hybrid mismatch arrangements should be effective from a policy perspective, but be as simple as possible to comply with and administer*". By their very nature, given these proposals are so complex (even for experienced tax professionals) and require taxpayers to consider the tax treatment in another jurisdiction in order to determine the New Zealand tax treatment, this will be very difficult to achieve. This complexity is likely to give rise to unintended or adverse outcomes that are not subject to the same policy concerns as hybrid mismatch arrangements.

1.3 There is a good case for New Zealand not to proceed with the wholesale adoption of the OECD recommendations in this area, given that:

- the solutions proposed by the OECD are complex;
- the number of instances of improper use of hybrid arrangements appears to be limited;
- the proposed solution will often require taxpayers to seek foreign tax advice when applying the rules
- There is significant resource and opportunity costs involved in advancing these proposals.

The Group is not advocating for double non-taxation. However, in the Group's view, a better approach would be for New Zealand to consider targeted reform with rules addressing particular areas of concern. Officials should identify particular arrangements or structures they find offensive from a New Zealand revenue protection and welfare maximising point of view (as they have done in the discussion document, for example Australian limited partnerships) and design rules to combat those, using the OCED recommendations as a framework.

1.4 If it is not possible to apply a more targeted approach, the focus should be on making these rules as simple as possible and remove any unintended consequences. This is the focus of our submission points on the detailed proposals.

1.5 We consider that there are a number of unanswered questions with these proposals which are detailed in Appendix Two of this submission. These arise from the complexity of the discussion document proposals. Before proceeding further with these proposals, we suggest that these questions will need to be considered further before proceeding to the draft legislation stage. We would welcome a meeting with Officials to discuss these further.

Consideration of foreign tax rules

1.6 It is clear that taxpayers will need to seek foreign tax advice when applying the hybrid rules. We consider that it is a troubling development that in order to determine NZ tax treatment, a taxpayer will be forced to obtain tax advice in a foreign jurisdiction. The cost of obtaining tax advice in other jurisdictions can be excessive compared to New Zealand, and this will place an additional burden and increased compliance costs on businesses. In particular, tax advice will need to be sought on many cross border instruments or entities, as it may not be until the tax treatment in both jurisdictions is fully known, that a NZ taxpayer will know whether the instrument or entity is a hybrid and in the scope of the rules.

1.7 The burden placed on New Zealand businesses to obtain foreign tax advice is another reason for NZ not to adopt the full suite of hybrid proposals. It is also unclear how the IRD would plan to audit such transactions unless they also obtain their own foreign tax advice.

De-minimis threshold

1.8 As noted above, the complexity of proposals are likely to add significant compliance costs for impacted taxpayers. We submit that given this, there is merit in a de-minimis threshold being introduced so that transactions below a certain value would be exempt from the rules.

1.9 In the Group's view, the compliance costs of applying the hybrid rules are likely to be much higher than the potential revenue collected by IRD in many instances. Given that the risk to the tax base is lower on smaller transactions, it makes sense that the hybrid rules would be targeted only at higher-value transactions. We envisage that if the transaction value was below a particular level (e.g. $1 million), the hybrid rules would not apply. This will ensure that the rules are more appropriately targeted at transactions where the tax revenue at stake justifies the compliance costs imposed on the business.

Economic analysis

1.10 Some of the economic claims made in Chapter 3 of the discussion document appear questionable and we would like to see what economic analysis has taken place in relation to these claims. Examples of these economic claims are:

- Paragraphs 3.4 and 3.5 note that organisations taking advantage of hybrid mismatch opportunities may lead to "welfare losses" and a "sub-optimal allocation of capital". Given it is widely acknowledged by economists that payment of tax gives rise to a deadweight (welfare) loss to society, it is questionable whether paying less tax actually gives rise to a welfare loss.

- Likewise, paragraph 3.8 suggests the current situation "reduces worldwide welfare". However, if tax on the whole results in a deadweight loss, how can increasing corporate tax be a good thing in terms of increasing worldwide welfare? The only way to reduce the impact on NZ's overall economic welfare would be to introduce tax cuts to compensate for the increased tax collected in respect of hybrid entities or mismatch arrangements (if these proposals proceed), is this what paragraph 3.8 infers we should do?

- Paragraph 3.19 hypothesises that investors using hybrids may be crowding out investors who would have otherwise invested via equity (and paid more NZ tax) so NZ may be currently missing out on additional tax through the use of hybrids. However, it is likely that foreign investors will be seeking a certain after-tax hurdle return from their investment in NZ. If the NZ tax increases, they may pass this cost on to NZ consumers/customers or even pull out of NZ altogether if the hurdle is not met. This is the flip side to welcoming more foreign investment by keeping taxes on foreign investors lower (given NZ is a capital importing country).

- Para 3.27 seems to wrap all of the preceding analysis into a conclusion that companies that exploit hybrid mismatch rules are "subsidised" currently and that eliminating this misallocation (i.e. taxing more) will "increase worldwide efficiency", leading to "higher worldwide incomes – which NZ will likely share in". It is not clear how increasing the NZ tax take will lead to an increase in NZ's share of worldwide income.

Further consultation and timeframe

1.11 It is the Group's view that the current timeframe for advancing these proposals should be extended. Given the complexity of the proposals, more time should be invested into the policy development process to ensure that Officials and taxpayers can properly consider the implementation of the proposals. As noted above, this is particularly important given that the exact implications of the proposals are yet to be fully understood and fleshed out. In the Group's view, it is crucial that time is taken to properly consider and address the issues and compare New Zealand's position with that of other countries and debate some of the more complex issues associated with these proposals.

1.12 It is worth noting that the original draft UK legislation on hybrids, was 69 pages long. Even though the UK rules are not effective until 1 January 2017, we understand that the draft legislation has already been amended several times to fix holes in it. This illustrates that the devil will be in the detail and it will be really hard to gauge the impact of rules in absence of draft legislation.

1.13 In light of this, we **strongly recommend** that an exposure draft with draft legislation should be released for further consultation prior to including these proposals in a Tax Bill. It is only once the exact parameters of the proposals are understood that taxpayers can properly test the proposals in their own factual scenarios and understand whether they give rise to appropriate outcomes. Releasing an exposure draft will increase the likelihood that any unintended consequences/issues can be fixed before the proposals are introduced into parliament. It is very difficult to effect material change in legislation through the select committee process.

1.14 Consultation of this nature is not unprecedented in respect of tax legislation and will often occur with other types of legislation. In respect of tax legislation, Officials consulted with the Group and other stakeholders on the rules for accommodation allowances introduced in the Taxation (Annual Rates, Employee Allowances and Remedial Matters) Act. The Group would be pleased to provide feedback on an exposure draft (in confidence), prior to inclusion in a Tax Bill. However, our first preference would be for the exposure draft to be released publically for all to consult on, particularly given the wide reaching impact of these proposals to all taxpayers with foreign branches.

2. General rule for introduction

Effective date

2.1 The proposed application date is noted in paragraph 11.22 of the Discussion Document:

> *"The impact of the proposals will in most cases be able to be established now, by reference to the Final Report. We consider that the period from introduction of the relevant legislation to its enactment should give taxpayers sufficient time to determine the likely impact and accordingly the effective date of the legislation should be its enactment date. In accordance with the OECD recommendation, the provisions would then apply to payments made after a taxpayer's first tax balance date following enactment."*

2.2 We do not agree that it is appropriate that these proposals should be effective from the date of enactment and apply to payments made after a taxpayer's first tax balance date following enactment. In particular, we do not agree with the conclusion reached by Officials that the impact of the proposals is well established by now. Given the overload of policy reform in the past couple of years, it is an inappropriate conclusion to expect taxpayers to have considered the OECD reports in any great detail (given the reports in are many hundreds of pages long), particularly before there was any indication of how they may be adopted in New Zealand.

2.3 If the Government considers that New Zealand must implement these rules, it is important that New Zealand's implementation date does not occur before other OECD member nations, particularly Australia's. New Zealand does not need to act fast as these is little to be gained from being the first to adopt these proposals. If New Zealand does act early, we risk a material increase in compliance costs as taxpayers will need to analyse their arrangements and the current foreign tax treatment, monitor legislative changes in foreign jurisdictions, and adopt different treatments in New Zealand as changes progress overseas.

2.4 For example, consider a trans-Tasman hybrid mismatch arrangement with a D/NI outcome where a New Zealand entity is the payer and an Australian entity is the recipient. Under existing rules, payments are treated as deductible interest in New Zealand but a non-taxable dividend in Australia. The tax treatment of this arrangement would change over the life cycle of the financial instrument. In Year 1, if the hybrid rules are in force in New Zealand but not Australia, New Zealand would deny the deduction. In Year 3, if Australia moves to tax the dividend, the payment would be deductible in New Zealand.

2.5 In addition, some of the proposed rules are not applicable if the overseas jurisdiction has implemented hybrid rules (i.e. the imported mismatch rule). Adopting before other countries could therefore significant increase compliance costs in New Zealand in the years before other countries adopt that would not otherwise arise.

2.6 These examples illustrate that having rules come into effect in New Zealand ahead of other jurisdictions will result in significant changes in outcomes and unnecessary complexity and uncertainty. Given this, it is important that New Zealand aligns itself with other jurisdictions, in particular Australia, both in respect of key issues such as regulatory capital (the Group understands this issue is causing delay of these proposals in Australia) and the implementation date.

2.7 The current intended start of the hybrid measures in Australia is 1 January 2018 or 6 months after legislation has been passed. We suggest that Officials monitor developments in Australia and if there are delays in their hybrid rules being enacted, consider delaying the implementation date for the hybrid proposals in New Zealand until similar proposals are in force and bedded down in Australia.

Grandparenting and transitional period

2.8 We do not agree with the general proposition that there should be no grandparenting for these proposals. Significant investment decisions have been made based on existing settings and a lot of these arrangements involve external commitments (not necessarily internal group arrangements) that cannot be easily unwound. In the Group's view, a minimum grandparenting period of three years following date of enactment would be appropriate for existing arrangements (with potentially a longer grandparenting period for regulatory capital), to enable a transition to the new rules.

2.9 Even if Officials do not accept a grandparenting period for all existing arrangements, there is a good case for grandparenting in specific circumstances. One such instance where grandparenting treatment is warranted is regulatory capital. Again given our close ties to Australia, if Australia includes some form of grandparenting treatment for regulatory capital, in the Group's view it would be necessary for New Zealand to apply similar treatment.

3. Implementation of OECD recommendations in New Zealand

3.1 The next section in our submission considers the more technical aspects of the proposals. Given the sheer scope of these proposals, we do not comment on all the submission points in the discussion document, but focus on those that are of greater interest to our members.

4. Timing differences

4.1 As summarised in paragraph 5.22 and 5.23 of the Discussion Document, the OECD Final Report suggested approach for timing differences is:

> *"The Final Report suggests that a deduction should not be denied if the payment giving rise to the deduction is included in income in an accounting period that begins within 12 months of the end of the period in which the deduction is claimed. If this test is not met, the payer should still be entitled to a deduction if it can satisfy the tax authority that there is a reasonable expectation that the payment will be made within a reasonable period of time, and once made will be included in ordinary income. A reasonable period is one that might be expected to be agreed between arm's length parties. Final Report Example 1.21 applies these principles.*
>
> *The Final Report does not provide for any denied deductions to be carried forward and allowed if and when the payee does recognise income."*

4.2 The Australian Board of Taxation approach for timing differences is (as summarised in paragraph 5.25 of the Discussion Document):

> *The Australian Board of Taxation Report recommends a different approach. It suggests that a gap of up to three years between deduction and inclusion should not attract operation of the rule, whereas a longer*

gap should mandatorily do so. It also suggests that any deduction denial should reverse when and if the payee recognises the corresponding income. This is essentially a carry-forward loss proposal. The proposal seems to mirror what would happen in the case of inclusion under the defensive rule. If the amount of a deduction in a payer jurisdiction were included in the payee's income under the defensive rule, and the payment giving rise to the income inclusion was later received, it would not be appropriate to tax the payment again, and rules against double taxation would generally achieve this. This supports the Board of Taxation carry-forward proposal in relation to the primary rule.

4.3 The Discussion Document seeks submissions on (Submission point 5C, page 42):

- *Whether the approach recommended by the Australian Board of Taxation would be an acceptable one for New Zealand;*
- *What alternatives might be better to deal with timing mismatches;*
- *What thresholds should apply to determine when the rule would apply to a difference caused by different income and expenditure rules."*

4.4 We agree with Officials that the Australian Board of Taxation approach would be preferable for New Zealand. This approach has advantages over the OECD approach as it is more certain by providing objective criteria for determining when there is a timing mismatch. In addition, it is a more reasonable approach as it allows denied deductions to be carried forward. It also seems sensible that a gap of up to three years between deduction and inclusion should not attract operation of the rule (particularly factoring in time delay between deductions being incurred, tax returns being filed, assessments being made of returns filed and any adjustments required being factored into required New Zealand provisional tax payments). For these reasons we support the Australian approach being adopted in relation to timing mismatches.

4.5 We comment later in the submission on the rules for carrying forward a deduction that has previously been denied.

4.6 The discussion document does recognise that the payee and payer countries may recognise income and expenditure from a financial instrument on a different basis (e.g. accrual or cash basis). However, it does not appear to consider how the rules may apply in situations where NZ recognises the treatment of interest and foreign exchange as a single item of Financial Arrangement income under our Financial Arrangement rules, as compared to other countries that might treat these amounts separately. We submit that further consideration needs to be given to this issue, and Officials need to provide further guidance on this in any further consultation on these proposals.

5. Taxation of FIF interests

5.1 Paragraph 5.48 and 5.49 of the Discussion Document notes:

"If a New Zealand resident holds shares subject to the FIF regime, and accounts for those shares using the fair dividend rate (FDR), cost or deemed rate of return (DRR) method, the dividends on those shares are not taxable. Instead the resident returns an amount of deemed income. Dividends are only taxable if the holder uses the comparative value (CV) or attributable foreign interest (AFI) method (note that when those two methods are being used, if the dividend is deductible in the

foreign country it will not be exempt in New Zealand even if the shareholder is a company).

FIF taxation therefore presents at least two problems for applying Recommendation 1.

- *The non-resident payer of a deductible dividend to a New Zealand payee, if resident in a country with the hybrid rules, will not know how a New Zealand taxpayer of ordinary status would treat the dividend, and therefore will not know whether, or to what extent, it is denied a deduction for the dividend by the primary response in its own country.*

- *When the New Zealand payee is applying the defensive rule (in a case where the non-resident payer of a deductible dividend has not been denied a deduction), if the payee is not applying the CV or AFI method, the payee will need to determine how much of the dividend has not been taxed, in order to know how much additional income to include."*

5.2 Paragraph 5.50 of the Discussion Document notes the possible solutions:

- *deny the FDR, cost and DRR methods to shares on which any dividend would be deductible to the payer. This would be similar to the existing requirement to use the CV method for a non-ordinary (generally, debt-like) share (section EX 46(8));*

- *include a deductible dividend in the holder's income, in addition to income already recognised under the FDR, cost or DRR method. This would be similar to the exclusion of deductible dividends from the general exemption for foreign dividends received by New Zealand companies in section CW 9 (though this exclusion does not apply to interests accounted for under the FDR, DRR or cost method);*

- *include a deductible dividend in the holder's income only to the extent that it exceeds the income otherwise recognised on the shares. This is somewhat similar to the concept of a top-up amount (defined in section EX 60) that applies when a person uses the DRR method.*

5.3 Submission point 5E notes (at page 42):

"Submissions are sought on which of these FIF approaches would be preferable and why, and whether there is another better approach."

5.4 Our primary submission is that these FIF methods should not be altered in response to the hybrid proposals. This goes beyond the scope of the core policy concern and should not be an area of focus.

5.5 We note that there are a number of issues Officials will need to consider if they are to advance any of the proposed solutions noted above. In particular, ensuring that these rules do not inadvertently capture portfolio investments, including those held by PIEs and other widely held investment vehicles.

5.6 If one of these options does proceed, we suggest that the preferred approach should be the one that is the least complex and most straightforward to apply. Our preliminary view is that the first option appears to best meet this criteria however we would welcome further discussion with Officials on this if it is to be advanced.

6. Regulatory capital

6.1 Submission point 5H notes (at page 45):

> *"Submissions are sought on whether there are any issues with providing no exclusion for regulatory capital."*

6.2 On this issue, paragraphs 5.59 and 5.60 of the Discussion Document note:

> *"The UK proposes to take up the option to exclude bank regulatory capital instruments from its regime in certain circumstances (see discussion at Chapter 8 of Tackling aggressive tax planning (HM Treasury and HMRC, December 2014). However, we understand that the UK has existing anti-hybrid rules that apply to bank regulatory capital. The Australian Board of Taxation Report sought an extension of time to report on this issue.*
>
> *It is not proposed that bank regulatory capital is excluded from the implementation of hybrid mismatch rules in New Zealand."*

6.3 It is disappointing that Officials have provided no rationale for the proposed position in respect of regulatory capital. It makes it very difficult for stakeholders to consider the appropriateness of the position without understanding the rationale for such. We believe it would be in New Zealand's best interests to exclude regulatory capital from the scope of these proposals, as the inclusion of such is likely to increase the cost of capital in New Zealand.

6.4 We submit that in this area, New Zealand should closely monitor what Australia is doing. At a minimum, given our close ties to Australia, if Australia either excludes regulatory capital or regulatory capital is subject to grandfathering treatment, New Zealand should follow a similar approach.

6.5 Even if Australia does not adopt grandfathering treatment for regulatory capital, there are good reasons for adopting grandfathering treatment to provide financial institutions with a transitionary period to adapt to the new rules. We understand that it can be difficult to wind up regulatory capital arrangements and that to do so will often require Reserve Bank approval (and there can be a number of hurdles to be met before such approvals are granted).

6.6 In light of this, we submit that there should be a grandfathering period of at least 5 years from the likely effective date (assuming these proposals are enacted in 2018). This would allow an orderly unwind of existing instruments, supporting investor confidence. This would ensure that the cost of capital is not pushed up through the need for multiple issuers to withdraw their issues and go to market for replacement funding at a similar time.

6.7 Any grandparenting treatment should apply to all regulatory capital issues prior to the date IRD released this discussion document. Prior to this date there was no certainty about how the IRD would land on regulatory capital, particularly since other jurisdictions are actively considering or applying carve outs for regulatory capital from their hybrid proposals.

6.8 In summary, we submit that at the very least, there should be some grandfathering treatment for regulatory capital, subject to any further developments in Australia.

7. Carry-forward of denied deductions

7.1 Submission point 6A notes (at pages 50-51):

> *"Submissions are sought on whether there are any issues with using the rules for the carrying forward of tax losses as a basis for the treatment of carrying forward disallowed deductions."*

7.2 We do not support the existing loss carry forward rules being used as a basis for allowing the carry forward of disallowed deductions under the hybrid rules. In the Group's view, there are deficiencies with our existing loss carry forward rules and these operate in some instances to reduce the incentive for businesses to innovate and take risks and restricts the ability to introduce new capital into a business. Arguably, the loss carry forward rules should be more generous and should be not be used as the basis for loss carry forward for hybrid mismatch arrangements.

7.3 In addition, the purpose of our existing loss carry forward rules are designed to ensure that the same ultimate owner who bears the loss is ultimately able to utilise it.

7.4 In the context of hybrid mismatch arrangements, the same policy concerns are not as evident. If excess dual inclusion income is returned in a subsequent year, and deductions have been denied in a prior period, it is appropriate that this be offset to prevent double taxation, regardless of changes in ownership in excess of 51% during the total period. If Officials have concerns about loss trading, an anti-avoidance rule could be included in the rules to specifically combat this.

8. Carry-forward / reversal of defensive rule income

8.1 Paragraphs 6.25 to 6.27 of the Discussion Document note:

> *"The Final Report does not propose a carry-forward rule for the application of the defensive rule. This creates a potential for over-taxation in a scenario where the defensive rule is applied to include extra income in the payee country and excess dual inclusion income arises in a later year.*
>
> *A solution to this problem may be to provide for a "reversal" rule whereby the application of the defensive rule in the payee country could be reversed (through an allowable deemed deduction) in a later year where there is excess dual inclusion income.*
>
> *Alternatively, the defensive rule could be limited so that income is only included to the extent that the disregarded payment deduction is offset against non-dual inclusion income in the payer jurisdiction. In the event that there is no non-dual inclusion income that the payment can be offset against, the income inclusion could be suspended until non-dual inclusion income is present. Unlike the reversal approach, this option would require the payee country tax authority and payee jurisdiction taxpayers to be aware of the level of non-dual inclusion income being earned in the payer country."*

8.2 Submission point 6C notes (at pages 52-53):

> *Submissions are sought on whether it is appropriate to depart from the OECD's recommendations in this regard, and which approach would be best to take."*

8.3 We agree that there should be some carry forward of defensive rule income. A "reversal" rule for the application of the defensive rule is the most straightforward and least complex approach. Despite this, we submit that the best way forward would be to allow taxpayers a choice of options. Where the taxpayer is aware of the level of non-dual inclusion income being earned in the payer country, they could elect to limit the application of the defensive rule. This ensures that the taxpayer is not forced to report income in the payee country which they know will ultimately be reversed.

8.4 However, taxpayers may not have the information to identify the level of non-dual inclusion income in the payer country or choose not to apply this approach due to the greater complexity involved. In this instance, taxpayers should be able to elect to apply the "reversal rule" to reverse the application of the defensive rule in a later period. Allowing an election of options will provide the most flexibility to ensure that taxpayers are not subject to double taxation.

9. Dual inclusion income

General comments

9.1 Dual inclusion income is a fundamental concept in the context of hybrid entities and branches. We believe this requires further consideration as to what would be and would not be dual inclusion income. While this appears to be a simple concept, there are some complexities such as foreign exchange gains/losses on loans which is unclear how this would be treated.

9.2 We believe that further consideration needs to be given to what is and what is not dual inclusion income. Officials need to provide further guidance on this concept in any further consultation on these proposals. Until there is clarity on key concepts such as this, taxpayers face difficulties in understanding how these proposals might apply to their existing structures.

CFC income as dual inclusion income

9.3 Paragraph 6.28 of the Discussion Document notes:

> *"As with Recommendation 1, it is proposed that CFC income is not able to be included as dual inclusion income. This will avoid drafting a large amount of very detailed and targeted legislation, aimed at situations that are unlikely to arise, and that in all likelihood will not deal appropriately with the peculiarities of such situations when they do arise."*

9.4 Submission point 6D notes:

> *"Submissions are sought on whether it is appropriate to depart from the OECD's recommendations in relation to CFC income as dual inclusion income."*

9.5 We do not agree with the proposal to depart from the OECD's recommendations in relation to CFC income as dual inclusion income. Just because it is difficult and/or complex to include CFC income as dual inclusion income is not an excuse to depart from the OECD proposals, especially since the OECD recommendations are likely to achieve a more appropriate outcome.

9.6 If the Government proceeds with the full suite of hybrid proposals, it is important that we have a comprehensive regime that seeks to get the right overall outcomes, and not draw a line in a taxpayer unfavourable manner. While it could be argued that taxpayers who are impacted by this proposal could simply use an alternative structure, in many instances structures are locked in or simply cannot be re-structured.

10. Reverse hybrid rule

10.1 Chapter 7 of the Discussion Document deals with reverse hybrids which is an entity whose income is treated as:

- Derived by its investors in its establishment country;
- Derived by the entity in the investor country.

Recommendation 4

10.2 Recommendation 4 is described in paragraphs 7.6 to 7.7 of the Discussion Document:

> *"Recommendation 4 is when a D/NI payment is made to a reverse hybrid, and the payment would have been included in income if it were made directly to the investor; the payer country should deny a deduction for the payment. The Recommendation also applies if the payment would have given rise to a hybrid mismatch under the hybrid financial instrument rule if made directly to the investor. As with the disregarded payments rule, this rule can apply to any deductible payment.*
>
> *Taxation of an investor in its home country on a subsequent distribution by the reverse hybrid of the income does not prevent a payment being subject to disallowance under this Recommendation (Final Report, paragraph 156)."*

10.3 Submission point 7A notes (at page 56):

> *"Submissions are sought on whether there are any issues relating to implementing Recommendation 4 in New Zealand"*

10.4 These rules are extremely complex and we would question whether such a rule is a proportionate response to the issue. However, the Group strongly submits that CFC income should be respected as income of the payee to ensure there is no denial of a deduction where the income is recognised in the parent of the reverse hybrid as CFC income.

Recommendation 5.1 and 5.2

10.5 Chapter 7 of the Discussion Document includes Recommendations 5.1 and 5.2 which consider "CFC and other offshore investment regimes" and "taxation of reverse hybrids established in New Zealand" respectively.

10.6 According to paragraph 7.17 of the Discussion Document, recommendation 5.1 involves:

> *"This recommendation is for New Zealand to ensure that a payment to a CFC that is fiscally transparent in its establishment country with respect to the payment is caught by the CFC regime, that is, that it is taxed to New Zealand investors in the CFC, if those investors are subject to tax under the CFC regime. In this way, the CFC regime would be used to turn the reverse hybrid into an ordinary fiscally transparent entity, at least insofar as it allocates income to New Zealand investors."*

10.7 We understand that recommendation 5.1 is focused on D/NI outcomes and the proposals in para 7.19 are targeted at CFCs that are not recognising income in their own jurisdiction because they are treated as fiscally transparent, however a deduction has been taken in another jurisdiction for the payment to the CFC. We consider that payments giving rise to a D/NI outcome are likely to be passive income rather than active income. Given the breadth of New Zealand's CFC regime, passive income is likely to be taxed to the New Zealand parent of a reverse hybrid CFC under the current rules. We also consider that any active income is also likely to be taxed in the jurisdiction in which it is earned, meaning that any rule applied in this area is likely to have limited application. There could be situation where the reverse hybrid is largely active and the minor passive income is not taxed in jurisdiction or as New Zealand CFC income. However such cases are likely to be minor and are the result of a deliberate policy decision that income of a CFC will not be attributed to New Zealand where passive income is less than 5% of total income.

10.8 Given the complexity in drafting such a rule and its limited application, the Group submits that it should not be advanced as it is not considered required.

10.9 If the rule is adopted, the UK approach suggested at para 7.24 should be available to taxpayers that are able to ascertain whether a deduction has been denied in a payer jurisdiction. That is, taxpayers that can ascertain this information should not be disadvantaged.

11. Deductible hybrid payments – Application to branches

11.1 Submission point 8 (at page 65) notes:

> *"Submissions are sought on whether the denial of a deduction for foreign branch losses against New Zealand income should be matched by an exemption for active income earned through a foreign branch. This would put foreign branches of New Zealand companies in a similar New Zealand tax position to foreign subsidiaries.*
>
> *Submissions are also sought on any other aspect of the proposals relating to the implementation of the OECD's Recommendation 6 in New Zealand."*

11.2 If the proposal to deny a deduction for a foreign branch loss does proceed, we believe that an active income exemption for foreign branch income is critical to remove the complexity that will otherwise arise for those taxpayers that cannot simply restructure out of the use of a foreign branch.

11.3 Further, if these proposals do proceed, aspects of these will be need to be clarified. In relation to foreign branch losses, Paragraph 8.6 of the Discussion Document is not entirely clear on how these proposals will apply in practice. It is noted that "unless it can be shown that such an offset is not possible", losses will have to be carried forward.

11.4 The question that arises is: When is an offset not possible? If we take an example of a New Zealand company with a branch in Australia, presumably this will be when there is no other Australian income to offset against. This could occur when the New Zealand resident entity does not have any other business operations in the other jurisdiction. However, what if the New Zealand entity later acquires a business in the other jurisdiction which it can offset the loss against? For example, consider an example where in Year 1, a New Zealand entity has no income in Australia to offset the loss incurred by its Australian branch. In Year 2, the New Zealand entity now has Australian income due to acquisition of another business. In Year 1, the NZ entity would not have known that it would have income in Australia in Year 2. Would this situation meet the criteria of being "not possible" for those losses to be offset against other Australian income? We require further clarification of how the Discussion Document proposals are intended to apply in this scenario.

APPENDIX TWO: FURTHER QUESTIONS

Para	Discussion Document extract	Issue
4.11	So, for example, a cross-border lease payment by a resident under an operating lease is not subject to this rule, even if the lessor country treats the lease as a finance lease.	Assume the same position if: • the lessee treats as a finance lease • both countries treat as a finance lease?
4.14	This rule only applies to payments between related parties (broadly, 25 percent or more common ownership) or under structured arrangements.	When investing into listed entities there are various rules prohibiting disclosure of information, even when greater than 50% is owned. How is this addressed? Also, when you own less than 50% outside the listed company scenario, how are restrictions of information to be addressed? How is 25% test to be measured (voting, dividend or some other basis?)
4.18	So, for example, if a hybrid entity makes a deductible payment to its foreign parent, and that payment is disregarded in the parent country because it treats the hybrid entity as a part of the parent, then *prima facie* the country where the hybrid is resident should deny a deduction for the payment. If it does not, the parent country should tax the payment. Neither response is required if the hybrid entity in the same year derives an equal amount of income which is taxed in both countries (that is, is dual inclusion income).	What happens if the branch is in losses, this seems to suggest that must have an equal amount of income?
5.12	Subject to two exceptions (considered below), countries only need to apply this rule to payments under financial instruments as characterised under their own domestic law. So, for example, a cross-border lease payment by a New Zealand-resident	If there is a finance lease in NZ, could this be a hybrid instrument?

Para	Discussion Document extract	Issue
	under a lease that is not a financial arrangement would not be subject to disallowance under this rule, even if the lessor country treats the lease payment as partially a return of principal under a finance lease.	
5.17	Only hybrid mismatches that arise as a result of the terms of an instrument are relevant. For example, if a New Zealand borrower pays interest to a related party who is tax-exempt, there will be no hybrid mismatch if the related party would have been taxable on the interest were it not tax-exempt. However, there will be a hybrid mismatch if the related party would not have been taxable on the interest if it were not tax-exempt (Final Report, Example 1.5).	How is this determined? How is the counterfactual established?. The tax treatment of an individual or a corporate or a trust or a collective investment vehicle (or various elections thereon) may all give different results. How is this addressed?
5.21/5.23 5.25	Where the payer and payee under a financial instrument are in different jurisdictions, it is not uncommon for them to recognise income/expenditure from the instrument on different bases. For example, a payer may be entitled to a deduction for a payment on an accrual basis, whereas a payee is taxable on a cash basis. In that case, there is a hybrid mismatch, which is *prima facie* subject to Recommendation 1. … The Final Report does not provide for any denied deductions to be carried forward and allowed if and when the payee does recognise income. … The Australian Board of Taxation Report recommends a different approach. It suggests that	What happens with the following: • Deduction is removed due to FX gains. • Deduction is accrual of a premium on the bond paid to another person (e.g. shareholder buys market debt for a premium, it will have deductions and no income to subsidiary company). • Deduction is due to capitalization of establishment costs. • Deduction reverses over life of instrument and is greater than 3 years?

Para	Discussion Document extract	Issue
	a gap of up to three years between deduction and inclusion should not attract operation of the rule, whereas a longer gap should mandatorily do so. It also suggests that any deduction denial should reverse when and if the payee recognises the corresponding income.	
5.37 & figure 5.3	The substitute payment is the premium portion of the amount paid by A Co to B Co for the transfer of the bond with accrued interest. The transfer is neither a financial instrument, nor a hybrid transfer. However, the premium is a payment in substitution for the payment of the accrued interest. It is deductible to A Co and treated as a capital gain to B Co, so it gives rise to a hybrid mismatch. On the facts of the example, the payment by A Co to B Co is a substitute payment because the payment of the coupon to the vendor would itself have given rise to a hybrid mismatch. The result would be the same if the coupon payment were taxable to the vendor. Accordingly, if the purchaser and vendor are related, or the sale is a structured arrangement, the payment of the premium will be subject to the hybrid mismatch rule.	What payment is taxable to B Co? How would B Co know, or the IRD know?
5.50	Possible solutions are to: • deny the FDR, cost and DRR methods to shares on which any dividend would be deductible to the payer. This would be similar to the existing requirement to use the CV method for a non-ordinary (generally, debt-like) share (section EX 46(8));	Is the CV treatment being proposed, or simply a move back to dividend only treatment? What happens if less than $50,000 FDR exemption applies? What if the NZ shareholder has no knowledge of the tax treatment of the dividend or whether the payer applied these rules?

Para	Discussion Document extract	Issue
5.50	• include a deductible dividend in the holder's income, in addition to income already recognised under the FDR, cost or DRR method. This would be similar to the exclusion of deductible dividends from the general exemption for foreign dividends received by New Zealand companies in section CW 9 (though this exclusion does not apply to interests accounted for under the FDR, DRR or cost method);	What is the logic to tax both FDR and the dividend? Why is the option of doing nothing not viable? What does the comment in Yellow highlight mean?
5.50	• include a deductible dividend in the holder's income only to the extent that it exceeds the income otherwise recognised on the shares. This is somewhat similar to the concept of a top-up amount (defined in section EX 60) that applies when a person uses the DRR method.	How are corporate restructures to be treated? What happens if the higher dividend does not occur each year?
5.52	Recommendation 1 could apply to an asset transfer involving a New Zealand party. For example, suppose a New Zealand resident purchases an asset from a related party on deferred payment terms, and is entitled to deduct a portion of the price as financial arrangement expenditure. If the vendor treats the entire amount as being from the sale of the asset, then there will be a hybrid mismatch, and the purchaser will be denied a deduction for the expenditure.	What if the vendor held the asset on revenue account (e.g. it was a significant item of trading stock) or was subject to capital gains tax in their jurisdiction? What if the asset is depreciable property? What if it is not known what the vendor's treatment is?
7.8/7.10	Many trusts – for example, most family trusts, do not have investors as such. For the purposes of this rule, an investor is any person to whom income is allocated by a reverse hybrid. So it	How is a control group determined for a Trust? (see also 7.30 below). How can a discretionary beneficiary have any control or exert any influence?

Para	Discussion Document extract	Issue
	would include any person who is allocated beneficiary income. …. The rule only applies if either: • the investor, the reverse hybrid and the payer are members of the same control group; or • the payment is under a structured arrangement to which the payer is a party.	Para 7.11 refers to the definitions in chapter 12, chapter 12 states that it needs to be defined?
7.9	The Recommendation will not apply if the reverse hybrid establishment country taxes as ordinary income the income allocated to the non-resident investor – for example, on the basis that the reverse hybrid is carrying on business in the establishment country.	How can a trustee always know what the foreign tax rules of a beneficiary is?
7.13	Countries should tax reverse hybrids established in their own country to the extent that their income is allocated to non-residents who are not taxable on the income because they are resident in a country that treats the reverse hybrid as fiscally opaque. This recommendation would only apply if the non-resident investor is in the same control group as the reverse hybrid.	If there is no control group, presumably there is no reverse hybrid?
7.16/12.5 /12.7	From the perspective of other jurisdictions making payments to New Zealand, we note that a foreign investor PIE would seem to be a reverse hybrid, depending on the treatment of the investors in their home countries (see Final Report, paragraphs 161 and 162). However, a payment to a foreign investor PIE would not be subject to disallowance in most cases, due to the scope limitation of Recommendation 4.	Why would a foreign investor PIE not have a purpose or effect of producing a hybrid mismatch?

Para	Discussion Document extract	Issue
	… The definition of a "structured arrangement" is set out in Recommendation 10 of the Final Report, and discussed in some detail. The core definition is that it is an arrangement where either: • the hybrid mismatch is priced into the terms of the arrangement; or • the facts and circumstances indicate that it has been designed to produce a hybrid mismatch. To incorporate this definition into New Zealand law, it is proposed to use the existing "arrangement" definition, and to define a structured arrangement as one where either: • the hybrid mismatch is priced into the terms of the arrangement; or • the arrangement has a purpose or effect of producing a hybrid mismatch.	
7.18	One way to address this would be to treat any person who has an interest in a CFC, as determined under subpart EX, to derive an amount of income from the CFC equal to the amount allocated to that person by the reverse hybrid for income tax purposes in its establishment country, and which is not taxed in the establishment country because of that allocation. This figure will already have been calculated by the CFC, and so should be readily available to the investor. In the case of an entity that is only partially transparent	What does this mean? How does this apply to ordinary dividends received by the reverse hybrid? Why will these amounts already have been calculated by the CFC and now available to the investor? Can we have a fully worked example what this is aimed at?

Para	Discussion Document extract	Issue
	only the untaxed income would be subject to the CFC regime.	
7.29	There is also an argument in favour of New Zealand taxing the foreign source trustee income of a New Zealand trust to the extent that that income is not taxed in any other country. The non-taxation of foreign-sourced trustee income of a New Zealand foreign trust is premised on the non-residence of the settlor. The trustee income is, in a sense, allocated to the non-resident settlor for the purpose of determining New Zealand's right to tax. Accordingly, if the settlor is in the same control group as the trust, it would seem logical to apply Recommendation 5.2 to tax the trustee income, if it is not taxed to the settlor or any other person.	What sense are we allocating income to a non-resident settlor? For example, if a foreign Trust has NZ sourced income, it is subject to NZ tax, there is no allocation to any settlor? How is a foreign trust a reverse hybrid when it gets a legislative tax exemption on foreign source income? When would the settlor be in the same control group as the Trust? What if the Trustee does not know how each beneficiary is taxed in each foreign jurisdiction where beneficiaries reside? What if beneficiaries do not reside in any country? What is the income? Is it dividend income, FIF income, or CFC income? For example, where foreign trust has FIF and CFC interests and the non-resident beneficiaries are only taxed on dividend income? What if the countries of the beneficiaries do not tax foreign sourced income? Why are these proposals overriding existing tax structures without consultation on why this is occurring? (Foreign Trusts and foreign PIEs)
7.30	The definition of a "control group" is discussed in more detail in Chapter 12. The definition is designed to apply to partnerships and trusts as well as to corporate groups. Example 11.1 of the Final Report demonstrates that:	Appointment of trustee gives rise to what percentage of voting interests? What else makes up voting interest in a foreign trust?

Para	Discussion Document extract	Issue
	• the power to appoint a trustee of a trust is treated as a voting interest in the trust; • where a settlor's immediate family are the beneficiaries of a trust, they will be treated as holding equity interests in the trust, and these equity interests will be deemed held by the settlor under the "acting together" test.	Family members will be deemed as holding equity interest in the trust. What does this mean? What percentage is this compared to all possible beneficiaries? What happens if there are multiple settlers, settlers who are deceased or do not exist? What are immediate family members?
8.6	The primary response means that in most cases a New Zealand resident will not be able to claim an immediate deduction for a foreign branch loss except against income from the same country. This is because in most cases it will be possible for those losses to be used to offset non dual-inclusion income in the branch country. Unless it can be shown that such an offset is not possible, those losses will have to be carried forward and used either: • to offset net income from the branch in future years; • without restriction, if the losses have become unusable in the branch country, for instance because the branch has been closed down before the losses have been used or because of an ownership change. In this case the losses are referred to as "stranded losses".	Why most cases? In most cases of a foreign branch, the only activity in that jurisdiction will be the foreign branch, i.e. there will be no other activity. Where there is only a single foreign branch operation, what is the other dual-inclusion income in the branch country? What is the definition of a branch?
Submission point 8	Submissions are sought on whether the denial of a deduction for foreign branch losses against New Zealand income should be matched by an exemption for active income earned through a	What is proposed in relation to the possible branch exemption? When would it apply from?

Para	Discussion Document extract	Issue
	foreign branch. This would put foreign branches of New Zealand companies in a similar New Zealand tax position to foreign subsidiaries.	What realizations would occur on moving from existing branch tax to exemption regime? Would trading stock gains, depreciation recoveries etc. be realized? What will be included as a branch? Will the existing active/passive rules apply to the branch? What is the FX treatment of investment into the branch?
10.7		
10.10	As it is part of the OECD recommendations, it is proposed that New Zealand should introduce an imported hybrid rule. Multinational groups with Australian or UK members will already need to be keeping track of uncorrected hybrid mismatches for the purpose of compliance with the rules in those countries, so the imposition of such a rule by New Zealand should not involve significant additional costs. This may require the New Zealand members of the group to have access to information held within the group but outside New Zealand. This should not be problematic, in a control group context.	Presumably Officials agree there are significant compliance costs for groups outside UK and Australian ownership? How is the IRD going to audit this?
11.4	In accordance with the OECD recommendations, we propose that denial of a deduction for a payment under any of the hybrid rules would not affect its withholding tax treatment.	Can you confirm the resulting tax payable would be treated as imputation credits for a company eligible to maintain an ICA? Will deductible payments be able to be fully imputed? If not, why not and how does the added layer of tax (28% plus additional withholding) be justified?
12.12-14	An investment in an entity can be a voting interest or an equity interest or both. A voting interest can	What is the proposed standalone definition?

Para	Discussion Document extract	Issue
	apply to non-corporate as well as corporate entities, and is a right to participate in decision making concerning distributions, changes in the person's constitution or the appointment of a director, broadly defined so that includes the persons who have management and control of an entity. A look-through test applies to trace interests through interposed entities. This approach is similar to that taken to determining whether or not two companies, two natural persons, and a company and a person other than a company, are associated under subpart YB 2 to YB 4 and YB 13 and YB 14, subject to the fact that for two companies, the test generally requires a 50 percent common ownership. However, the application to trusts and partnerships seems somewhat different. While it would make sense to build so far as possible on existing definitions, it is likely to be preferable to do so by using a stand-alone definition which combines existing concepts plus the modifications necessary to ensure that New Zealand's hybrid regime has the same scope as others enacted in accordance with Action 2.	What existing concepts will be used? How do you apply voting measurements to a discretionary structure where distributions and membership (i.e. beneficiaries) are totally discretionary?