

BANKING TAX UPDATE

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BANKING TAX UPDATE SEMINAR

Topics:

1. FCT v BHP Billiton Limited

- Professor Richard Vann

2. Hybrid Mismatch Rules

- Julian Pinson
- Andrew Hirst



FCT v BHP BILLITON LIMITED

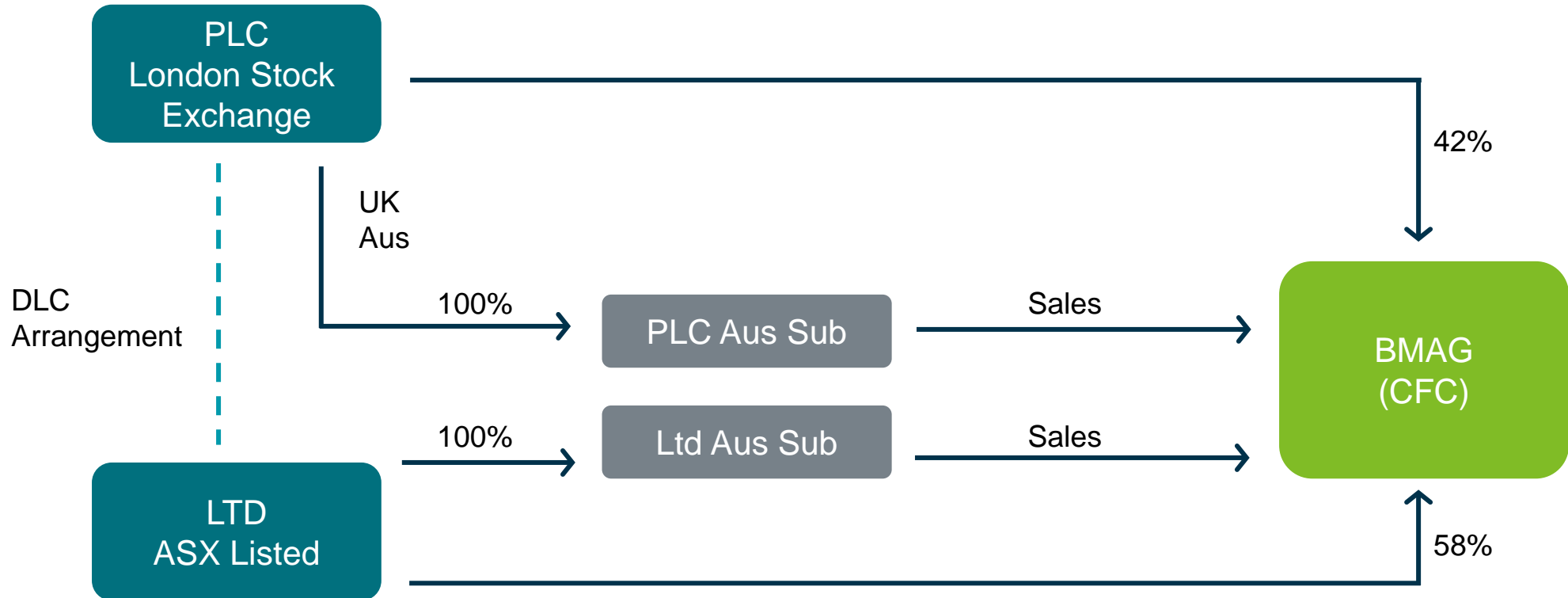
PROFESSOR RICHARD VANN



TOPICS

- Decision and reasoning on CFC rules
- Relevance to other uses of associate
- Relevance to stapled structures, joint ventures
- Role of Allsop CJ in resolving difficult cases or differences in opinion in Federal Court

PLC AND LTD – DLC STRUCTURE AND CFC ISSUE



Agreed: 58% CFC Attribution of BMAG sales of goods acquired from Ltd Aus Sub (s 447)

Dispute: 58% CFC Attribution of BMAG sales of goods acquired from PLC Aus Sub (need associate)

SUFFICIENT INFLUENCE

- A company is sufficiently influenced by an entity or entities if the company, or its directors:
 - are accustomed;
 - are under an obligation (whether formal or informal);
 - or might reasonably be expected,to act in accordance with the directions, instructions or wishes of the entity or entities.
- Coincidence between directions, etc. and action is not enough – must be more
- LTD and PLC acted (and were obliged by the terms of the DLC arrangements to act) with commonality of purpose, having regard to the interests of the shareholders in both entities, as if they were a single unified economic entity – does that comprise sufficient influence? Or does sufficient influence require the imposition of the will of one party on the operations of the other?

SUFFICIENT INFLUENCE

- All judges agree issue has to be decided in context of CFC regime
- Allsop CJ – do the provisions operate in a unidirectional way where one entity is the controlling entity, or a multidirectional way where separate entities may at once be the primary entity sufficiently influenced by the other (controlling) entity, and the controlling entity sufficiently influencing the other (primary) entity
- Thawley J focuses on specific aspects of the DLC voting and dividend arrangements, group policies influence on BMAG; general comments in critique of AAT give wide reading (company/directors, past present or future, etc)
- Davies J dissented, effectively agreeing with Logan J at first instance in the AAT

Without more, to act in concert with a common aim and mutuality of interest is not “to act in accordance with the directions, instructions or wishes of [another] entity”

- Distinction between “sufficient influence” and “control” (latter word only appears as part of descriptor)
- Appeal?

RELEVANCE TO OTHER USES OF ASSOCIATE

- Associate provisions are contained in the CFC rules but are relevant for other parts of the Tax Act including:
 - thin capitalisation – determining outward investing entity status
 - debt equity – application of s 974-80
 - ‘associate-inclusive’ tests such as TAP and non-portfolio interest test in s 960-195
 - loss deferral on inter-associate asset transfers (Div 170)
 - deemed consideration in GST (Div 72 of GST Act)
- Prima facie decisions applies but can different context change/influence meaning?
- Thawley J quotes McHugh J suggesting this possibility:

the only proper course is to read the words of the definition into the substantive enactment and then construe the substantive enactment - in its extended or confined sense - in its context and bearing in mind its purpose and the mischief that it was designed to overcome. To construe the definition before its text has been inserted into the fabric of the substantive enactment invites error as to the meaning of the substantive enactment .

RELEVANCE TO STAPLED STRUCTURES, JVs

- Both DLC and stapled structures achieve economic unity
 - DLC achieves it at level of the legal entities in the structure
 - Stapled structure achieves it at level of members of legal entities
 - Will associate reasoning be the same (having regard to way “company or its directors” read by Thawley J)?
- Control in Div 6C
 - Thawley J suggests power of veto not enough on its own to produce sufficient influence, therefore also not control?
- Acceptance that joint ventures of otherwise independent parties do not (usually) produce associates?

ROLE OF ALLSOP CJ IN TAX CASES

- Allsop CJ recently appears in large and important tax cases
- At the end of the day his decision is not driven by technical analysis of language but by the apparent policy (or values) of measures
 - Channel Pastoral
 - Chevron
 - BHP Billiton
- Extra-judicial speeches suggest this is no accident
 - The Rule of Law is not a Law of Rules <http://www.fedcourt.gov.au/digital-law-library/judges-speeches/chief-justice-allsop/allsop-cj-20181101-2>

Law, at its very foundation, is conceived and derived from values. ... These values find expression in the rules, principles, precepts and norms developed by society and by the law. But the nature of these values is such as to make it necessary to recognise the limits of text in their expression, drawn ultimately, as they are, from the human condition, and the intuition and sensibility therein. They do not admit of minute definition. Words can often be inadequate to express the subtlety of human relations.



HYBRID MISMATCH RULES

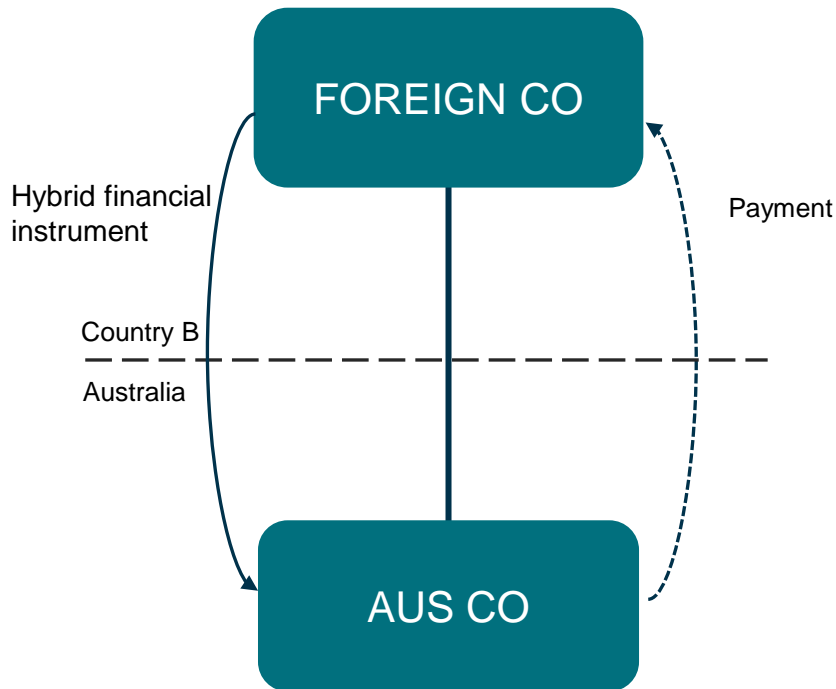
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STRUCTURED ARRANGEMENTS

- ‘Structured arrangement’ concept relevant to most hybrid rules: arrangement has to be either (i) within a control group, or (ii) a structured arrangement
- ‘Structured arrangement’ if:
 - mismatch ‘priced into the terms’ of scheme
 - design feature of scheme
- Must also be a ‘party to the structured arrangement’, which will be the case unless:
 - couldn’t reasonably have been expected to have known
 - hasn’t affected financial position
- ATO released draft LCR 2018/D9 and PCG 2018/D9 on structured arrangements
 - Link to OECD materials
 - Testing time
 - Indicators of ‘priced into’ and ‘design feature’

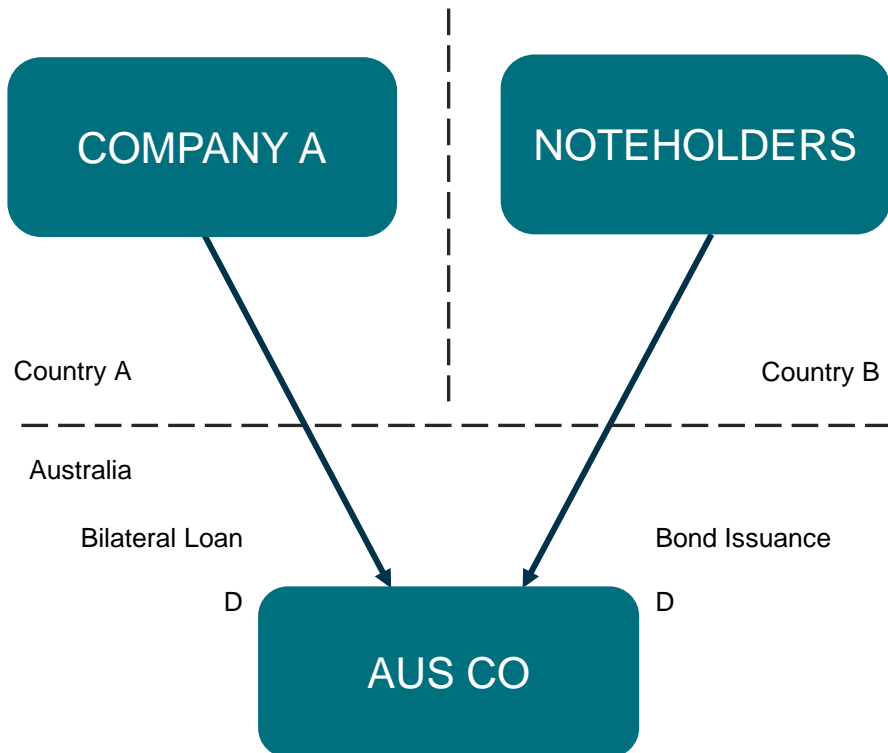
STRUCTURED ARRANGEMENT: EXAMPLE 1



Facts/Analysis

- Aus Co issues HFI to Foreign Co: tax debt in Australia; tax equity in Country B
- Payments give rise to a D/NI outcome
- As unrelated parties, hybrid rules only apply if Aus Co is party to a structured arrangement
 - Priced into terms?
 - Design feature?

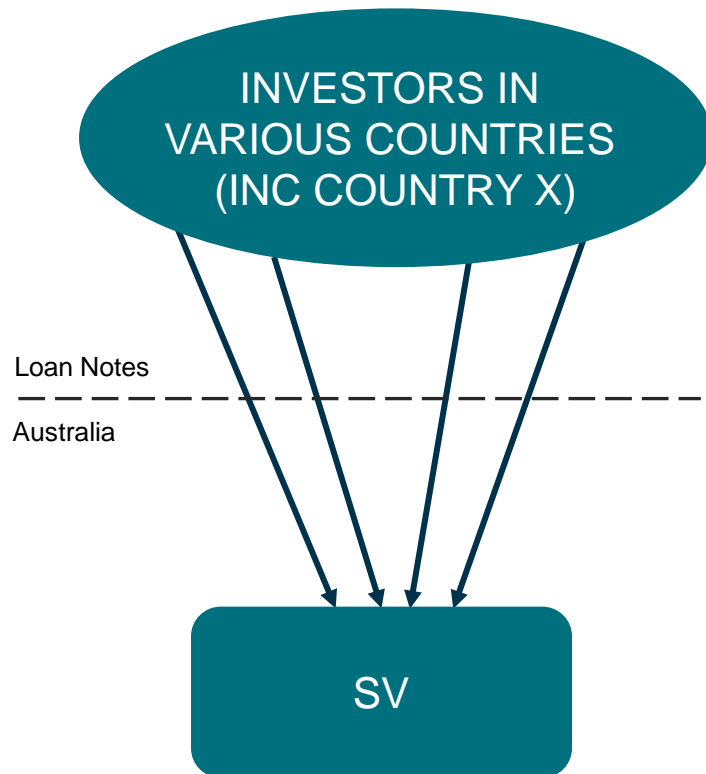
STRUCTURED ARRANGEMENT: EXAMPLE 2



Facts/Analysis

- Bilateral Loan - to Company A but market pricing
- Bond - offered widely but all subscribers in Country B (pricing 70bp lower than expected)
- Is there a HFI / structured arrangement?

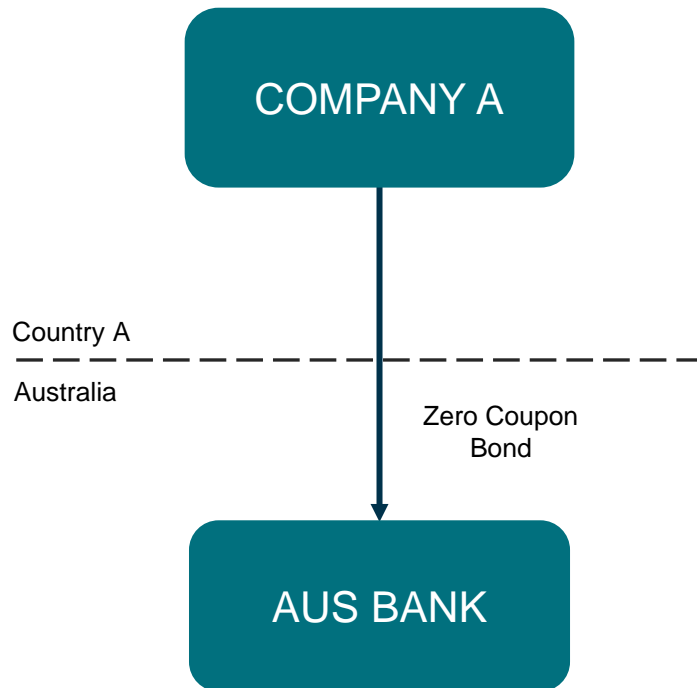
STRUCTURED ARRANGEMENT: EXAMPLE 3 (IN PCG)



Facts/Analysis

- Securitisation vehicle issues loan notes which may give rise to D/NI
- Structured arrangement? Is D/NI:
 - Priced into terms?
 - Design feature?
- Relevant facts and circumstances include:
 1. the choice of instrument;
 2. the terms;
 3. tax residency and legal form of the SV;
 4. tax residency of each investor;
 5. the pricing of the different tranches of notes; and
 6. manner in which the notes have been marketed

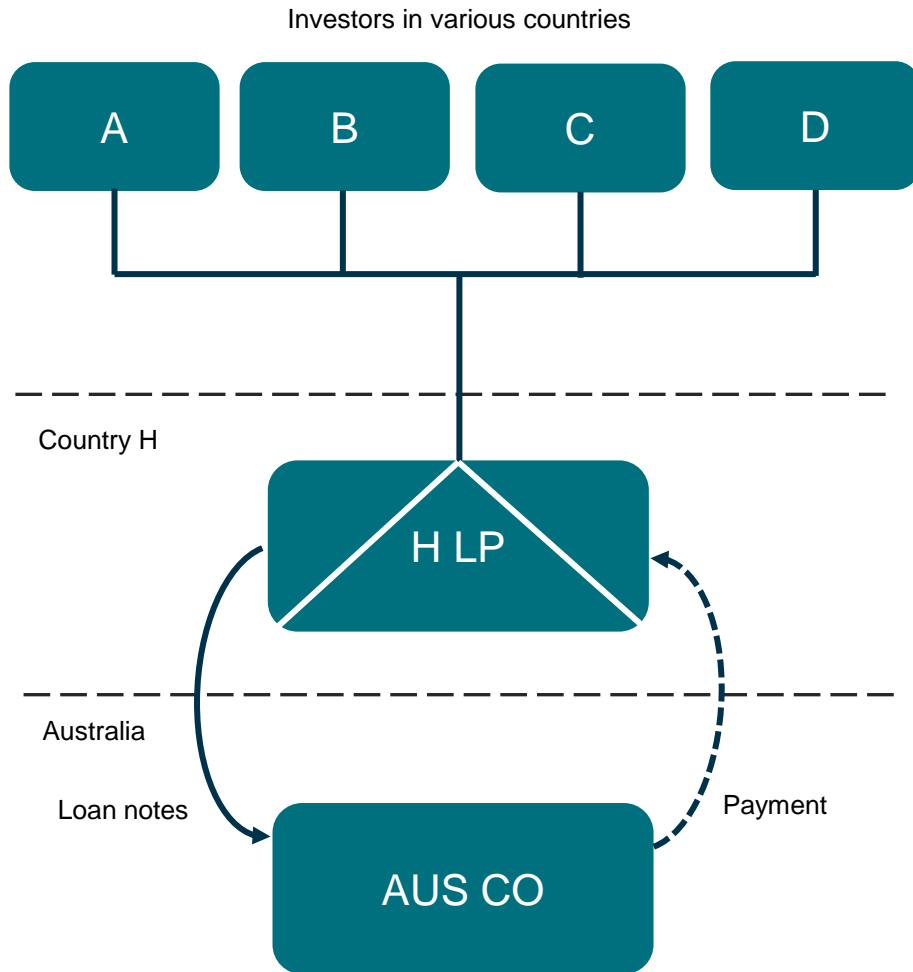
STRUCTURED ARRANGEMENT: EXAMPLE 4



Facts/Analysis

- Aus Bank receives request from Company A for a 10 year zero coupon bond
- Features:
 - issued for \$50
 - \$100 face value payable on maturity
 - pricing – market standard
- Should Aus Bank consider whether the zero coupon bond is a HFI?
- If yes, what enquiries should Aus Bank make?

STRUCTURED ARRANGEMENT: EXAMPLE 5 (IN PCG)



Facts/Analysis

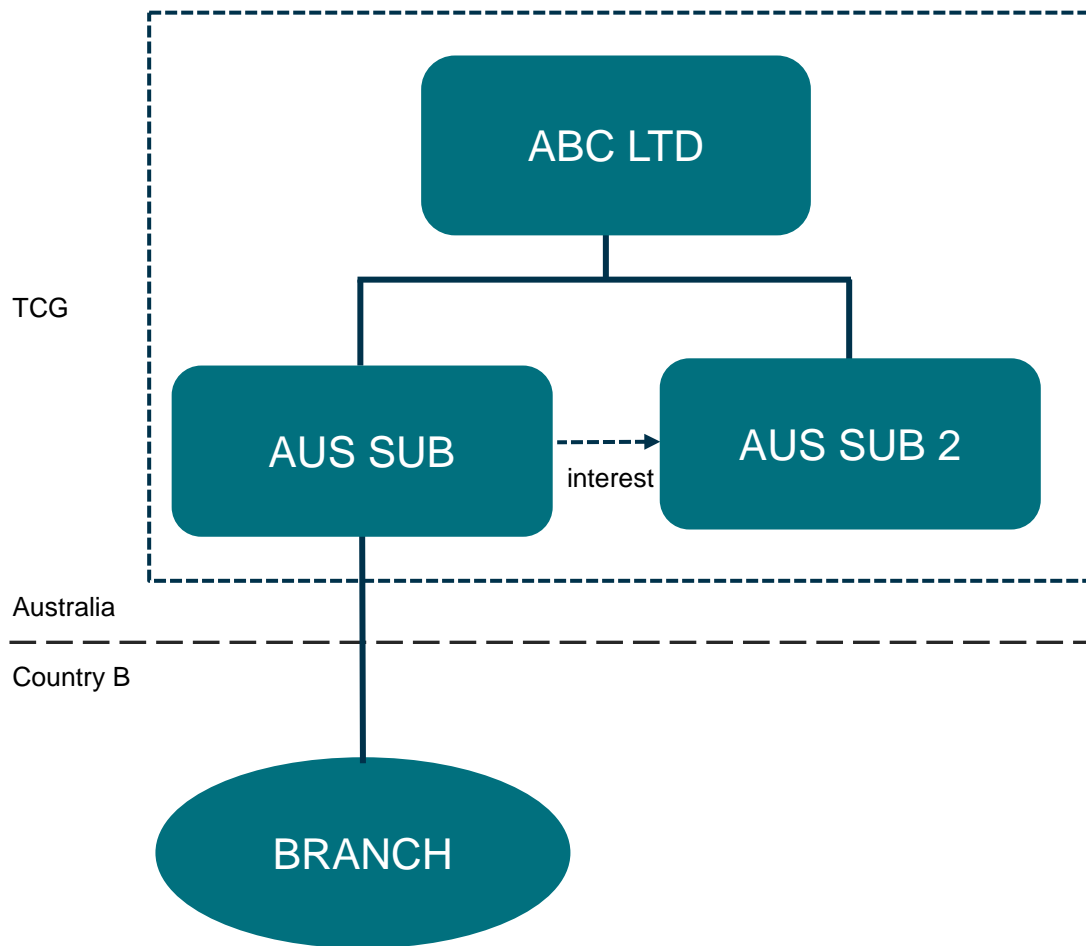
- H LP established as collective investment vehicle
- Tax transparent in Country H, opaque in each investor country
- Marketed to investors as a tax hybrid (reverse hybrid)
- Post-establishment, H LP acquires loan notes issued by Aus Co, an otherwise unrelated entity. Standard market rate/terms
- Gives rise to D/NI outcome
- May be structured arrangement (if scheme involving acquisition of loan notes)
- However, PCG concludes that Aus Co not a “party” to the structured arrangement (no knowledge/involvement)

TRANSACTIONS INVOLVING BRANCHES

- A myriad of ways in which hybrid rules can affect branches:
 - hybrid payer (Div 832-D)
 - branch hybrid (Div 832-F)
 - amendments to s.23AH
 - deducting hybrid – double deductions (Div 832-G)
 - Part IIIB amendments
- First 3 – all still require group relationship or structured arrangement. In relation to 4 and 5:
 - deducting hybrid – payment by a single entity
 - Part IIIB – payments within a single entity (head office/branch)

BRANCHES

EXAMPLE 6: HYBRID PAYER (DIV 832-D)

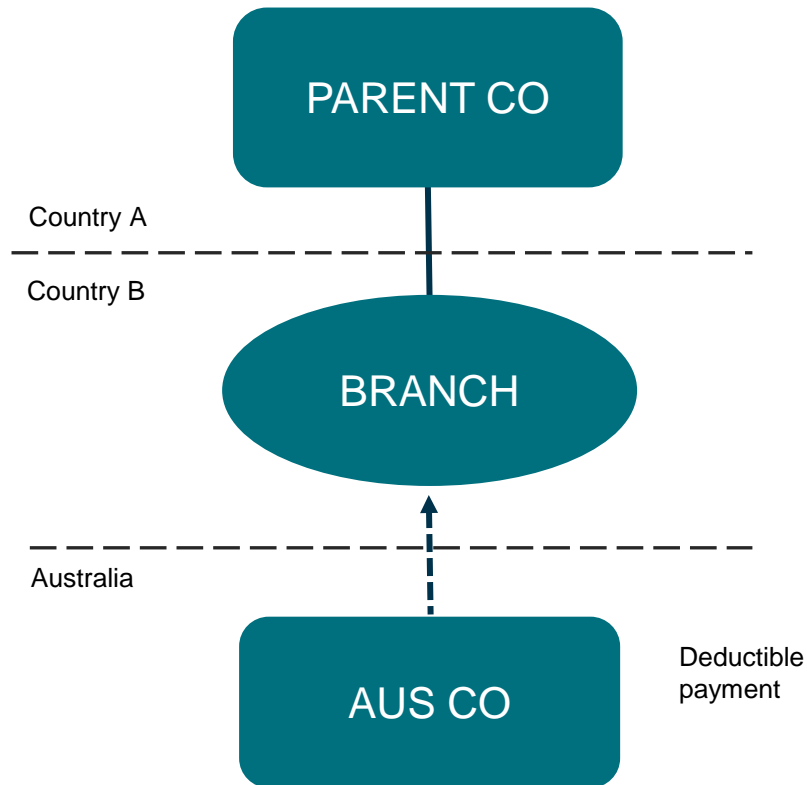


Facts/Analysis

- Aus Sub pays interest to Aus Sub 2
- Australia – ignore interest as within TCG
- Country B – recognises deduction for interest as funding branch
- Hybrid payer rules enlivened – include as assessable income in Australia

BRANCHES

EXAMPLE 7: BRANCH HYBRID REGIME (DIV 832-F)

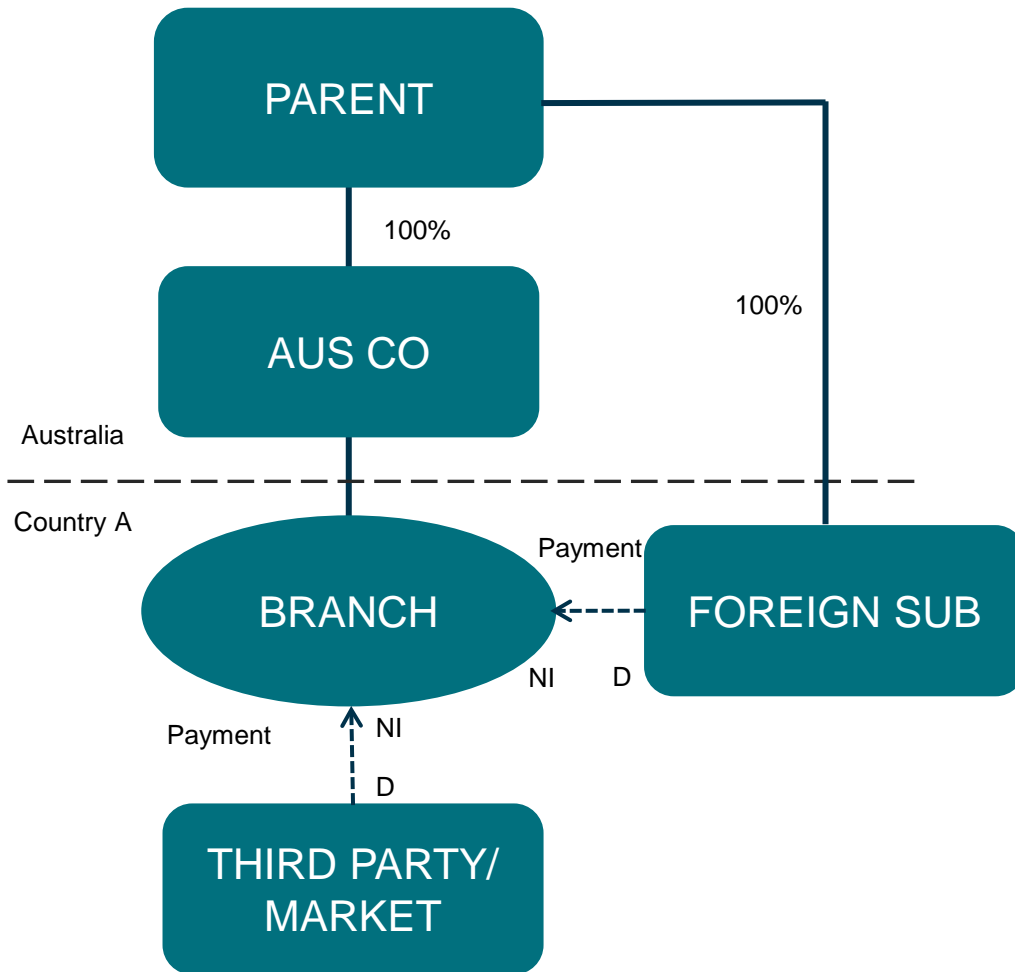


Facts/Analysis

- Aus Co – deductible payment to branch
- Country A – treats payment as attributable to branch and has a branch profits exemption
- Country B – does not recognise the income as attributable to branch
- Australia – will deny deduction if either:
 - group/related party relationship; or
 - structured arrangement
- Note: effectively a type of reverse hybrid

BRANCHES

EXAMPLE 8: AMENDMENTS TO s.23AH



Facts/Analysis

- Branch in Country A receives payments from third parties and Foreign Sub. Payments are D/NI (assume Country A is a listed country).
- Exemption in s.23AH switched-off if there is a branch hybrid:
 - Foreign Sub – group relationship so a branch hybrid
 - Third Party – only a hybrid if there is a structured arrangement
- Structured arrangement – same analysis should apply?
- What if Country A is an unlisted country?

BRANCHES – STRUCTURED ARRANGEMENT

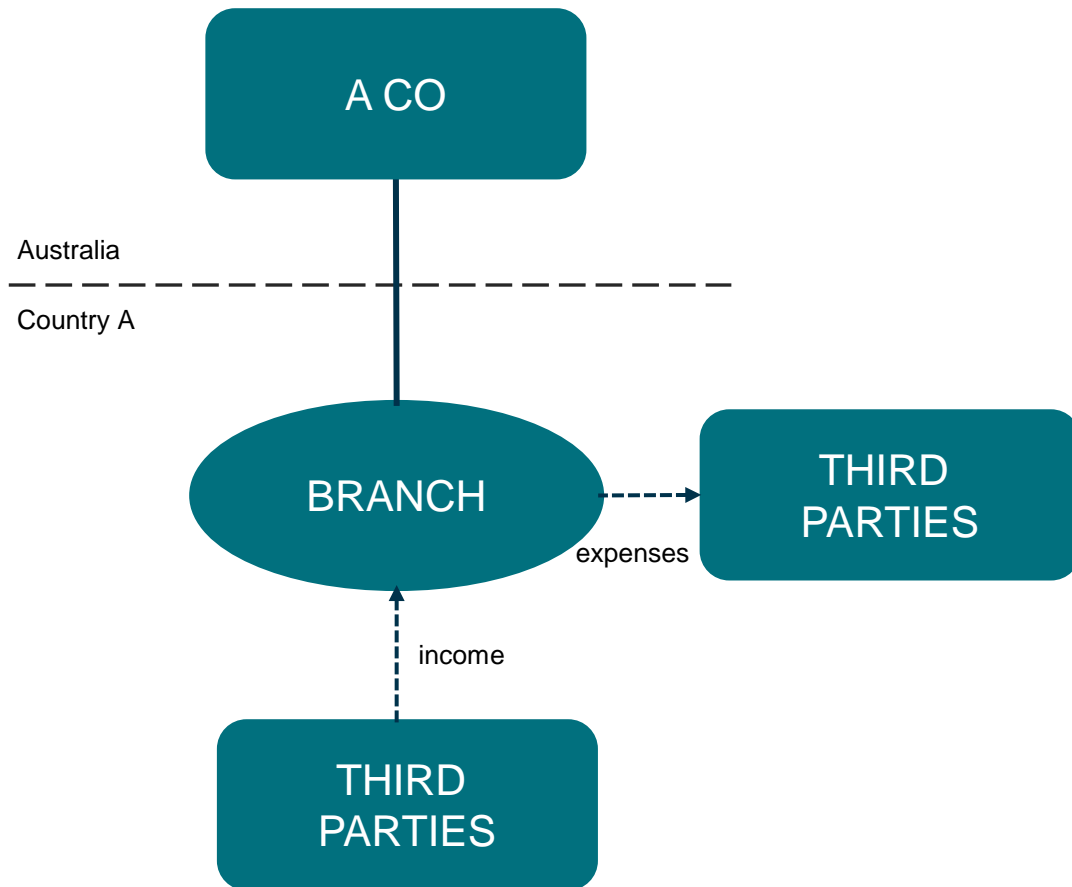
- EM – paragraphs 1.261 and 1.262

1.261 The branch hybrid mismatch rules apply only to payments made between members of the same Division 832 control group or under a structured arrangement. In this regard, as pointed out in paragraph 59 of the OECD Branch Mismatch Arrangements Report, a taxpayer may enter into a number of on-market transactions with unrelated parties that give rise to deduction/non-inclusion outcomes and the payer may not have the capacity to undertake due diligence on the transaction to determine whether there is a mismatch (or the reason for it).

1.262 However, on market transactions between unrelated parties will not generally fall within the scope of the branch hybrid mismatch rules as the payer would generally be expected to enter into these transactions on arm's length terms and could not be expected to make enquiries as to a counterparty's tax position in the context of these type of trades. This is because in these circumstances the payer would not be a party to any structured arrangement.

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EXAMPLE 9: DEDUCTING HYBRID (DIV 832-G)

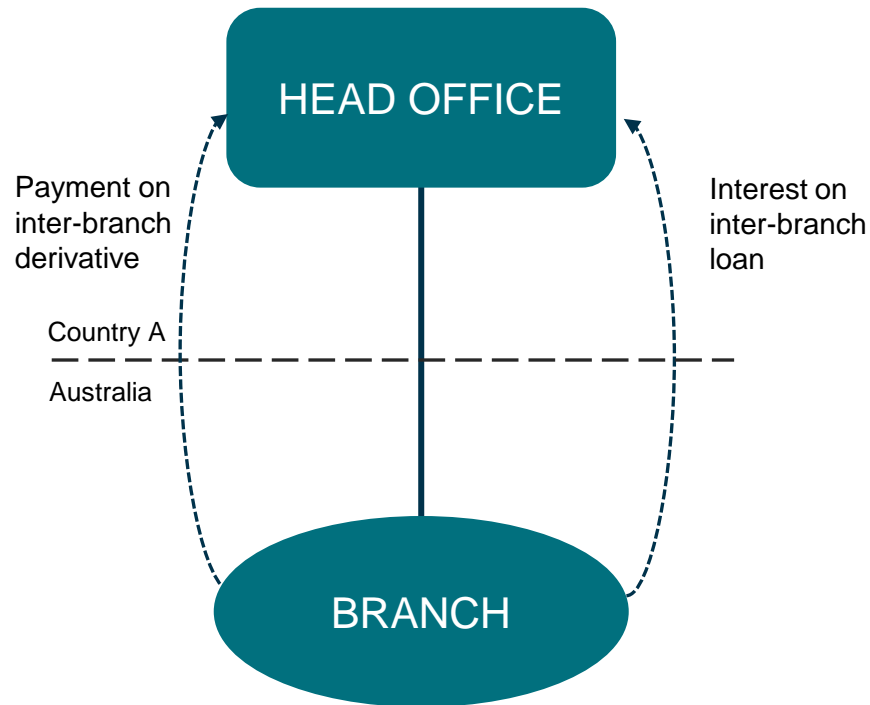


Facts/Analysis

- A Co has a branch in Country A (an unlisted country)
- Double deduction being claimed for expenses paid by branch – in Country A and Australia (as s.23AH does not make the income NANE)
- Deducting hybrid provisions – no requirement for group relationship or structured arrangement. As such, deny D unless there is dual inclusion income

BRANCHES

EXAMPLE 10: PART IIIB



Facts/Analysis

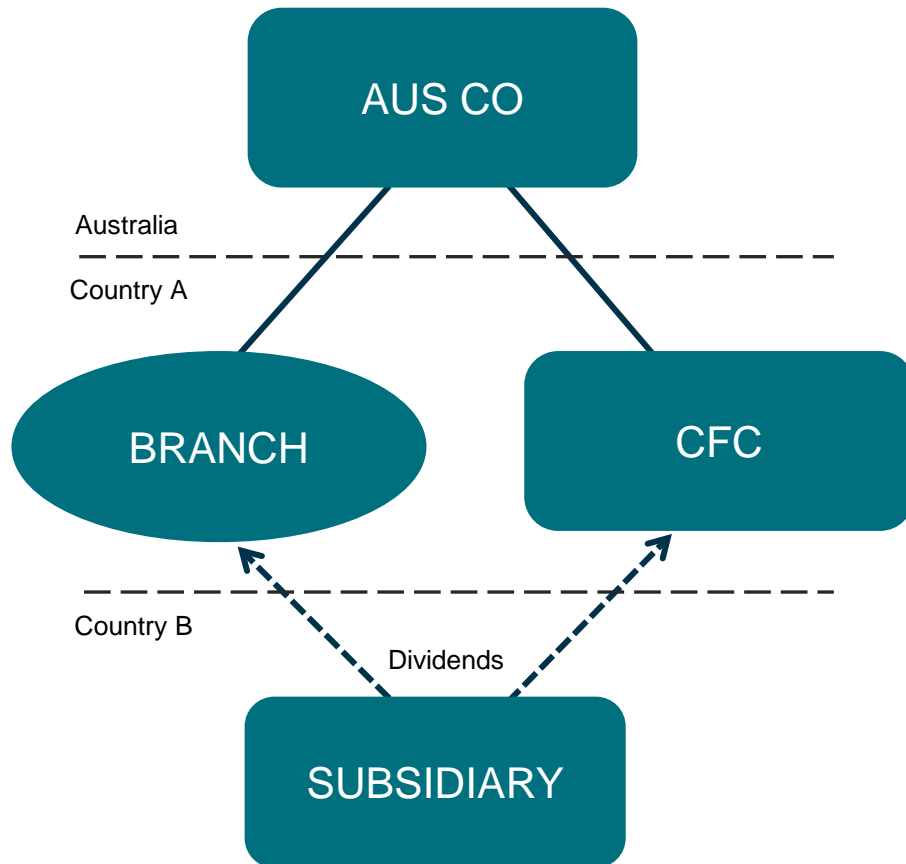
- “Internal” loan and derivatives recognised under Part IIIB
- Special hybrid rules (in s.160ZZZL) will apply to deny D unless either:
 - inclusion in Country A;
 - funded by non-deductible expenses in Country A; or
 - bank adopts a “recognised TP methodology in allocating expenditure and income between itself and foreign branches”
- Rules n/a to Australian banks or foreign banks that have elected out of Part IIIB

BRANCHES v CFCs

- Div 832 has great relevance for branches
- Div 832 does not apply to CFCs – switched-off in calculating attributable income of a CFC
- One exception – as s.768-5 (non-portfolio dividend exemption) applies to CFCs, hybrid related amendments to s.768-5 will apply in calculating attributable income of a CFC

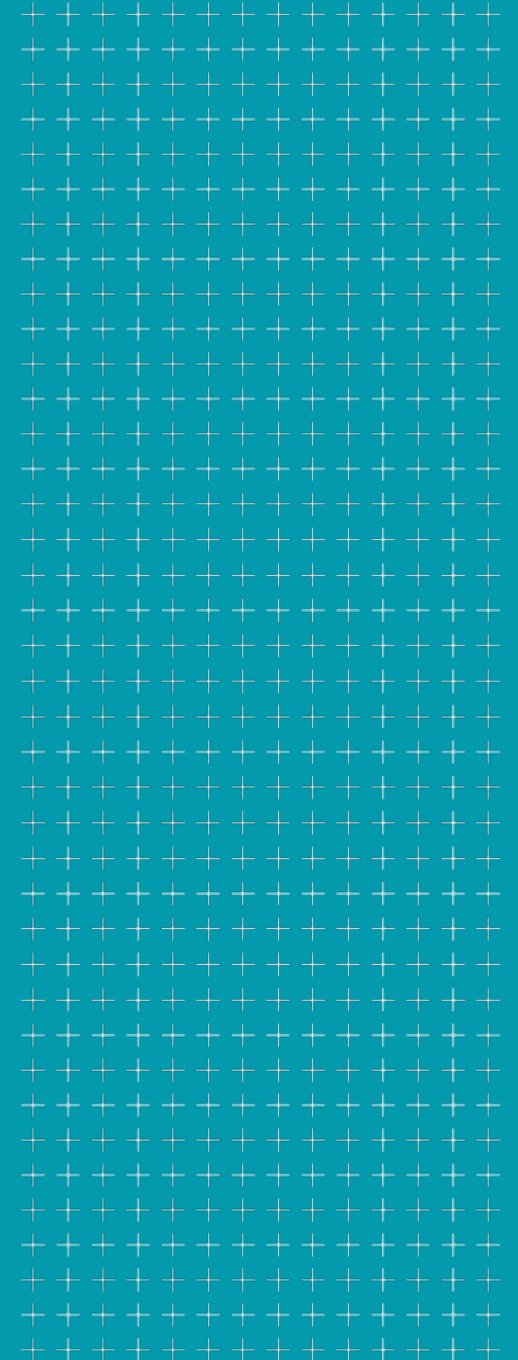
BRANCHES

EXAMPLE 11: BRANCHES v CFCs



Facts/Analysis

- Aus Co has a branch and a CFC in Country A
- Branch and CFC receive dividends from Subsidiary in Country B (non-portfolio interest)
- Outcomes:
 - CFC – attributable if deduction for Subsidiary (s.768 switched-off)
 - Branch – although s.768 n/a, s.23AH may still be switched-off if a HFI
- CFC – position different if Subsidiary located in Country A



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