TREASURER

Mr Michael Andrew AO
Chair
Board of Taxation
Department of the Treasury Building
Langton Crescent
Parkes ACT 2600

Dear Mr Andrew AO

REVIEW OF APPLICATION OF HYBRID MISMATCH RULES TO REGULATORY CAPITAL

I am writing to thank the Board of Taxation (Board) for its report on the review of Australia's implementation of the internationally agreed G20/OECD Base Erosion and Profits Shifting Project recommendations to neutralise the effects of hybrid mismatch arrangements (the OECD Hybrid Mismatch Recommendations).

As recommended by the Board, I ask that the Board undertake a subsequent review to examine how best to implement the OECD Hybrid Mismatch Recommendations to eliminate deductible/frankable hybrid mismatch arrangements that arise in relation to regulatory capital.

I ask that the Board report back by end of July 2016 to enable the commencement of the hybrid mismatch rules relating to regulatory capital to align with the proposed commencement date of the broader hybrid mismatch rules in Australia.

In undertaking this work, I request that the Board consult with relevant stakeholder groups and other relevant bodies as appropriate. I envisage that Treasury and the Australian Taxation Office will work directly with the Board as required.

The terms of reference for this further review is attached.

In recognition of the public interest in this issue, I will be publicly releasing this letter.

Yours sincerely

The Hon Scott Morrison MP
8 / 4 / 2016

ATTACHMENT – TERMS OF REFERENCE

1. The OECD released its final package of Base Erosion and Profit Shifting (BEPS) Action recommendations on 5 October 2015. As part of this package, the OECD released its Action 2 Report — *Neutralising the Effects of Hybrid Mismatch Arrangements* (Action 2 Report). The Action 2 Report sets out recommendations for countries to make changes to their domestic law to neutralise the effect of hybrid mismatch arrangements and includes changes to the OECD Model Tax Convention to address such arrangements.

2. The Board of Taxation (Board) provided their report to Government on the implementation of the OECD hybrid mismatch rules on 31 March 2016. This report identified that deductible/frankable arrangements that arise in relation to regulatory capital result in a hybrid mismatch and recommended a subsequent process to consider the appropriate policy response given the complexities and interactions involved.

3. Consistent with the Board's recommendation and the Government's commitment to implementing the Action 2 Report, the Board is asked to further examine how best to neutralise the hybrid mismatch arrangement identified in the Action 2 Report.

4. In determining how best to neutralise the hybrid mismatch arrangement involving regulatory capital, the Board should identify an implementation strategy that has regard to:

    4.1. Delivering on the objectives of eliminating double non-taxation;

    4.2. Capital regulatory requirements as enforced and set by Australian Prudential Regulation Authority;

    4.3. Fostering a level playing field internationally and within the Australian banking and insurance sector;

    4.4. Economic implications and potential market disruption;

    4.5. Compliance and administrative costs for taxpayers; and

    4.6. Interactions between Australia's existing domestic legislation, including with related tax laws.

5. The Board should conduct targeted consultation with relevant parties by drawing on its extensive links with tax professionals, key business groups and other relevant bodies. The Board should also work closely with Treasury and the Australian Taxation Office in finalising its advice.

6. Further, the Board's advice should utilise and build upon the work done as part of the Board's recent review of the broader Australian implementation of the hybrid mismatch rules.

7. The Board is requested to report to Government by end of July 2016 to enable the commencement of the hybrid rules to deductible/frankable arrangements to align with the proposed commencement date of the hybrid mismatch rules in Australia.