

HYBRIDS COMPLIANCE AND DISCLOSURE¹

As with all other provisions of the law, self-assessment requires taxpayers to determine their taxable income considering the potential application of the hybrid provisions. The following table should assist taxpayers to determine whether or not they are likely to need to consider the application of the hybrid provisions. The table also contains a reference to the relevant section, and some comments to assist in determining whether or not the section will in fact give rise to denial of a deduction or additional income. The last column identifies which item in the BEPS disclosure form the taxpayer should tick if the relevant section does in fact apply to them. Like the rest of this commentary, these questions do not replace the law, and cannot be relied on to identify every hybrid mismatch situation.

	Guidance question	Comment	Disclosure question
1.	<p>Are you claiming a deduction under a financial instrument for a payment to a <i>related</i> non-resident, where either:</p> <ul style="list-style-type: none"> the payment was not taxable income for the non-resident in another country in an accounting period beginning within 24 months of the end of the income year in which you are claiming a deduction; or you do not know whether (or when) the payment was taxable income in another country. <p>FH 3 – deductions on hybrid financial instrument rules</p>	<p>Any time you claim a deduction under a <i>financial instrument</i> (generally this will be a loan, derivative, or other financial arrangement, but for this purpose the definition is slightly broader) where the payee is non-resident and <i>related</i> to you, you should check the foreign tax treatment of the payment. Is the related party including the payment in its taxable income as interest, or as income taxable at the same rate as interest? If it is, is that inclusion expected to occur in an accounting period beginning within 24 months of the end of the income year in which you are claiming a deduction for the payment? If the answer to either question is no, you need to consider sections FH 3 of the hybrid rules before claiming a deduction.</p> <p>The definitions of “financial instrument” and “related” are in section FH 15.</p>	Hybrid payment disclosure

¹ This text and table were published in Inland Revenue’s Tax Information Bulletin, Volume 31, No 3 (April 2019) and reproduced for the special report on hybrid and branch mismatch rules (see <https://taxpolicy.ird.govt.nz/publications/2019-sr-beeps-final/overview>).

	Guidance question	Comment	Disclosure question
2.	<p>Do you hold shares in a foreign company where you have treated the dividend on those shares as exempt income, and either:</p> <ul style="list-style-type: none"> • the payment was deductible to the payer in another country, or otherwise gave rise to some form of tax relief; or • you do not know how the payment was treated by the payer. <p>CW 9(3) – deductible dividends</p>	<p>A dividend from a foreign country is not exempt from tax under section CW 9(1) if the payment is deductible to the payer or otherwise meets the definition of a “deductible foreign equity distribution” in section YA 1.</p>	<p>Hybrid receipt disclosure</p>
3.	<p>Have you received a payment under a financial instrument with a non-resident <i>related</i> person where either:</p> <ul style="list-style-type: none"> • that person is entitled to a deduction or equivalent tax relief for payments under the arrangement in tax periods that end more than two years before the beginning of the income year in which you expect to recognise the income from those payments; or • that person is entitled to a deduction or equivalent tax relief for payments under the arrangement which will not be included in your income • you do not know whether or not that is the case. <p>FH 4 –income on hybrid financial instruments rule</p>	<p>If a non-resident is entitled to a deduction (or equivalent tax relief) for a payment to a New Zealand <i>related party</i> in relation to a <i>financial instrument</i> in a tax period ending more than 24 months before the beginning of the income year in you treat the payment is treated as income in New Zealand, or you do not treat the payment as income at all, you must recognise the income at the same time it is deducted by the payer, under section FH 4.</p>	<p>Hybrid receipt disclosure</p>

	Guidance question	Comment	Disclosure question
4.	<p>Are you claiming a deduction for a payment to a non-resident member of your <i>control group</i> where any of the following applies:</p> <p>A. under a foreign tax law, the payment is not taxed because you and the payee are treated as the same person;</p> <p>B. the payee is treated as transparent by the tax law of the country where it is formed; or</p> <p>C. the payee is not taxable on the income because it is treated by the payee as received in a country where the payee is not resident.</p> <p>D. you do not know the answer to any of questions A to C.</p> <p>FH 5 hybrid entities primary and FH 7 reverse hybrids</p>	<p>Any time you make a payment to a non-resident member of your <i>control group</i>, you need to consider whether or not the payee is treating you as a separate entity for purposes of its tax law. For example, it may not be treating you as a separate entity if you and the payee are members of the same consolidated group in that country. If it is not treating you as a separate entity, you need to consider section FH 5 before deducting any expenditure you have incurred.</p> <p>You also need to consider whether the payee is not taxed on the amount because:</p> <ul style="list-style-type: none"> • it is fiscally transparent in the country where it is formed or operates; or • one country (generally the country where the payee is tax resident) exempts the income because it is treated as referable to activities in a third country, but the third country does not tax the income because it does not treat it as referable to such activities. <p>In these two cases, you need to consider section FH 7 before deducting any expenditure you have incurred.</p> <p>“Control group” is defined in section FH 15.</p>	<p>A & D Hybrid entity/Branch/Dual resident disclosure and Hybrid payment disclosure</p> <p>B-D. Hybrid payment disclosure</p>
5.	<p>Are you a branch of a non-resident, and claiming a deduction in relation to activities occurring outside New Zealand (“head office activities”)?</p> <p>FH 5 branches primary</p>	<p>If you are entitled to a deduction in New Zealand for amounts reflecting activities occurring outside New Zealand, and those amounts are more than an allocation of third party costs (eg they reflect a profit margin for the offshore activity), you need to consider section FH 5 of the Act before taking a deduction for those amounts. Generally, section FH 5 denies a deduction if the same profit margin is not income in the other country.</p>	<p>Hybrid entity /Branch/Dual resident disclosure and Hybrid Payment disclosure</p>

	Guidance question	Comment	Disclosure question
6.	<p>Are you a member of a tax consolidated group who has received a payment from another member of the group that relates to the offshore activities of the payer.</p> <p>FH 6 hybrid entities defensive</p>	<p>If yes, has the payer claimed a deduction in the other country for that payment? If yes, you are likely to be required by section FH 6 of the hybrid rules to include the payment in income. If the other country has hybrid rules, it should deny a deduction for the payment, so section FH 6 will not apply.</p>	<p>Hybrid receipt disclosure</p>
7.	<p>Do you have a foreign branch which is entitled under the tax law where it operates to a deduction for activities carried on by you in New Zealand.</p> <p>FH 6 branches defensive</p>	<p>If yes, is the deduction in the other country more than an allocation of your New Zealand costs (ie it reflects a profit margin for New Zealand)? If yes, you need to consider whether section FH 6 requires you to include the additional amount deducted in your New Zealand income (if you are not already doing so). If the other country has hybrid rules that apply to the payment, it should deny a deduction for any mismatch amount, so section FH 6 will not apply.</p>	<p>Hybrid receipt disclosure</p>
8.	<p>Do you have a foreign branch, or an interest in an entity in another country which is <i>related</i> to you and which you treat as fiscally transparent for New Zealand tax (for example a foreign partnership).</p> <p>FH 8 – double deduction primary rule</p>	<p>If the answer is yes, you need to determine whether there is another person in that country who for foreign tax purposes is able to offset your share of any branch or entity loss against its income. If there is, you need to consider whether section FH 8 denies you a deduction for the expenditure incurred through the branch or by the entity.</p>	<p>Double deduction disclosure</p>

	Guidance question	Comment	Disclosure question
9.	<p>Are you a branch of a non-resident, or is there a non-resident entity in your <i>control group</i>:</p> <ul style="list-style-type: none"> • who is treated under a foreign tax law as paying a pro rata portion of the amounts paid by you? • whose foreign tax law treatment of your expenditure you are not aware of? <p>FH 9 – double deduction defensive rule</p>	<p>If you are a non-resident who is entitled to a tax deduction in New Zealand for some of your expenditure, that expenditure may be deductible in two (or more) countries. Similarly if you are a resident who is fiscally transparent under the tax law applying to any of your owners. If the other country does not have a hybrid rule that denies a deduction in the other country (that is, a rule equivalent to section FH 8) you need to consider section FH 9 before deducting any expenditure you have incurred</p>	<p>Hybrid entity /Branch/Dual resident disclosure and Double deduction disclosure</p>
10.	<p>Are you a dual resident company?</p> <p>FH 10</p>	<p>If yes, as well as not being able to group any loss with the income of another company (section IC 7(2)), you need to consider section FH 10 of the hybrid rules before deducting any expenditure you have incurred.</p> <p>Note that dual residence can arise very easily and can be unintended. For example, a company that is incorporated in New Zealand and managed and controlled in another country may be dual resident.</p>	<p>Hybrid entity /Branch/Dual resident disclosure</p>
11.	<p>Are you claiming a deduction for a payment to a member of your <i>control group</i> in a country without hybrid rules?</p> <p>FH 11</p>	<p>If yes, is that payment part of an arrangement or flow of funds that involves a hybrid mismatch within your <i>control group</i>. The payment will be part of such an arrangement or flow of funds for these purposes if it funds, directly or indirectly, a hybrid mismatch within your <i>control group</i>. There is no need for any connection between the payment and the hybrid mismatch. You need to take into account all information within your possession in making this determination. Where the deduction is material, you should make enquiry of your group tax function as to whether the payment is part of a hybrid mismatch arrangement. If there is not a clear “no”, given on the basis of reasonable enquiry, then no deduction should be claimed.</p>	<p>Imported mismatch disclosure</p>

	Guidance question	Comment	Disclosure question
12.	<p>Are you claiming a deduction for a payment under an arrangement, other than those identified above, where there are any indications that the arrangement has been undertaken on the basis that it will produce a deduction/no inclusion outcome that would give rise to counteraction under the hybrid rules if the arrangement were entered into with a related party or a control group member.</p> <p>FH 3 – FH 7 and FH 11</p>	<p>Taxpayers are expected to consider all information within their knowledge and control in order to determine whether a payment is made under a <i>structured arrangement</i> as defined in section FH 15. If you are making a payment under a <i>structured arrangement</i>, you need to consider the possible application to payments under that arrangement of all of sections FH 3 to FH 7 and FH 11 of the hybrid rules.</p>	<p>As applicable, depending on the nature of the mismatch.</p>