

## OPERATIONAL STATEMENT

# Administration of the imported mismatch rule – section FH 11

Issued: 30 June 2021

OS 21/02

Operational statements set out the Commissioner of Inland Revenue's view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement is intended to clarify the Commissioner's expectations as to how taxpayers will meet their self-assessment obligations when applying the imported hybrid mismatch rule in s FH 11 of the Income Tax Act 2007 to payments to members of their control group, and how the rule will be administered by Inland Revenue in relation to such payments.

All legislative references in this Statement are to the Income Tax Act 2007, unless otherwise specified.

## Introduction

1. The imported mismatch rule in s FH 11 is one of the hybrid mismatch rules introduced as subpart FH with effect for income years beginning on and after 1 July 2018. Section FH 11 is discussed in detail in *Tax Information Bulletin* Vol. 31, No. 3 (April 2019) from page 74.
2. The purpose of the imported mismatch rule is to deny a deduction for a payment by a New Zealand taxpayer to the extent that that payment funds, directly or indirectly, a hybrid mismatch occurring entirely outside New Zealand, if certain requirements are met. This Statement sets out the Commissioner's approach to administering the imported mismatch rule.
3. This Statement is not intended to provide a safe harbour. Compliance with the Statement does not guarantee that there will be no deductions disallowed under s FH 11. However, compliance with the Statement will reduce the likelihood of lack of reasonable care penalties being imposed where an imported mismatch is later found to exist.

## Summary of approach

4. Where a taxpayer makes a deductible payment to a person who is resident in a country that does not have hybrid mismatch rules corresponding to those in subpart FH, they are expected to take certain steps in order to ensure compliance with the imported mismatch rule contained in the section.
5. This Statement deals with payments that are made to a person who is in the same group as the taxpayer. Where the steps required by the Commissioner, as explained in [13] are taken a taxpayer will have complied with their self-assessment obligations under s FH 11.
6. Where the appropriate steps are not taken the Commissioner may require evidence of the taxpayer's compliance with s FH 11. Where evidence is not provided in a timely manner, this may result in a denial of the relevant deductions in New Zealand, and in the taxpayer being unable to present such evidence subsequently in a dispute.

## Application of the statement

7. This Operational Statement applies to all arrangements referred to in s FH 11 and applies from the 2021 income year.

## Discussion

### *Criteria*

8. The criteria for the application of s FH 11 are as follows:
  1. A New Zealand resident taxpayer or a New Zealand deducting branch (funder) makes a payment in an income year,
  2. To a person in a country outside New Zealand that is not subject to hybrid rules equivalent to those in New Zealand in relation to that payment,
  3. The funder is allowed a deduction in New Zealand for the payment,
  4. The payment provides funds, directly or indirectly, for a payment (funded payment) by a person outside New Zealand (payer) to another person (payee), and
  5. The funded payment gives rise to a hybrid mismatch that is not counteracted by hybrid mismatch rules.
9. The imported mismatch rule applies to payments to third parties (but only if there is a structured arrangement) and payments to control group members (whether or not the arrangement is a structured arrangement). The rule applies to structured arrangements in income years commencing on or after 1 July 2018 and non-structured arrangements in income years commencing on or after 1 January 2020.
10. Compliance with the imported mismatch rule requires New Zealand resident taxpayers and New Zealand deducting branches to have knowledge of the tax treatment of payments that are made entirely outside of New Zealand. This requires them to obtain information from persons outside New Zealand.
11. The following is an outline of the approach that the Commissioner expects taxpayers to take to ensure they are complying with the imported mismatch rule in relation to payments to control group members. If this approach is not taken, taxpayers risk having deductions denied.

### ***Determining whether adjustments required***

12. In accordance with s FH 11, if a New Zealand taxpayer funds a hybrid mismatch that occurs outside New Zealand an adjustment denying a deduction for some or all of the payments made by the New Zealand taxpayer is required to reflect the amount of the hybrid mismatch that has been funded by the payment from New Zealand. This will require the New Zealand taxpayer to have access to information relating to the offshore tax treatment of payments made outside New Zealand. Particularly in the case of a group whose headquarters are outside New Zealand, New Zealand's tax reporting will be relying on people outside of New Zealand being able to provide information on whether or not hybrid mismatches exist. These hybrid mismatches can occur, directly or indirectly, as part of structured transactions or unstructured transactions within control groups.
13. To comply with their self-assessment obligations under s FH 11 in respect of payments to control group members, the Commissioner expects that New Zealand taxpayers will:
  1. Identify payments made to non-resident control group members that are tax deductible before applying the imported mismatch rule,
  2. Determine whether any such payments are to a person that is in a jurisdiction that has not implemented hybrid mismatch rules equivalent to New Zealand's, and
  3. If the answer to 2 is yes, before claiming a deduction ensure that the group head office tax function has undertaken appropriate work to:
    - identify any hybrid mismatches within the group; and
    - determine the extent to which these are funded by otherwise deductible payments from New Zealand payers.
14. If the taxpayer is part of a group headquartered in:
  - New Zealand, the work referred to in step 3 will generally be taken by group employees in New Zealand, or at their direction
  - another country, the work referred to in step 3 may well be undertaken by group employees outside New Zealand. In that case, the Commissioner expects that the taxpayer will obtain from the group's head office tax function a written statement regarding that work.
15. For tax years beginning before 1 January 2020, in which only the structured imported mismatch applies, enquiries by the group head office tax function may be limited to

those necessary to determine whether there is or are, in relation to all transactions that are part of a structured arrangement involving the otherwise deductible payment by the New Zealand taxpayer, pricing or other facts or circumstances which mean that a member of the control group could reasonably be aware of the existence of the hybrid mismatch. For later tax years, this limitation does not apply.

16. In the case of a group that is not headquartered in New Zealand, if the steps taken by the group's head office tax function and communicated to the New Zealand taxpayer can reasonably be expected to accurately determine the extent, if any, of the application of the imported hybrid mismatch rule, and the taxpayer has no reason to believe that the determination is not correct, then the taxpayer has complied with its self-assessment obligations with respect to the rule.
17. There is no prescribed form for such a statement, but an example is provided below of the type of statement the Commissioner would expect to be provided, addressed from the Group Head of Tax to the relevant New Zealand personnel:

"I have ensured that suitably qualified personnel within the group have reviewed the tax treatment of all deductible cross-border payments by members of the group to determine whether they give rise to a hybrid mismatch. As a result of this review I can advise that

*[if no hybrid mismatches funded by New Zealand]* [New Zealand subsidiary/deducting branch] payments have not funded directly or indirectly any such mismatches;

*[Or, if there are hybrid mismatches funded by New Zealand]* [New Zealand subsidiary/deducting branch] payments totalling \$[. ] have funded directly or indirectly such mismatches;

In undertaking this review and making this determination, the principles set out in the OECD Final Report on hybrid mismatches and/or section FH 11 of the New Zealand Income Tax Act 2007 have been considered and complied with."

### ***No Evidence Obtained***

18. Where a New Zealand taxpayer has:
  - Claimed a deduction for payments to non-resident control group members in countries without hybrid rules corresponding to subpart FH, and

- In the case of a taxpayer that is a member of a foreign headquartered group, received no statement from its group head office tax function as set out above,
- In the case of a taxpayer that is a member of a New Zealand headquartered group, does not have evidence that the possible application of section FH 11 has been appropriately considered and analysed.

then the Commissioner may request from the New Zealand taxpayer, under s 17B of the Tax Administration Act (TAA), such a statement, or other evidence that the imported hybrid mismatch rule has been considered.

19. If a satisfactory response is not provided within 3 months the Commissioner may apply s 17F of the TAA to deny relevant deductions claimed in New Zealand, and, if proper notice is given, apply the evidence exclusion rule in s 17F(3) of the TAA.

This Statement was signed on 30 June 2021.

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## Legislative references

### **Income Tax Act 2007**

Section FH 11

Section FH 15

### **Tax Administration Act 1994**

Section 17B

Section 17F