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CONFIDENTIAL

The Manager
Base Erosion and Profit Shifting Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

Implementing the OECD Hybrid Mismatch Rules Consultation Paper

Dear Sir/Madam,

AustralianSuper is Australia's largest single superannuation fund and is run only to benefit members. We don't pay commissions to anyone to recommend us, nor do we pay dividends to shareholders. The fund has over 2.2 million members and manages over $130 billion of members' assets. Our sole focus is to provide the best possible retirement outcomes for members. Our concern is that, in its current drafting, the proposed Division 832 of the *Income Tax Assessment Act 1997* (**ITAA97**) will have a disproportionate and unintended impact on Australian superannuation funds and for AustralianSuper's over 2.2 million members.

Broadly, when investing offshore, Australian superannuation funds can often invest through transparent collective or special purpose vehicles. In this regard, Australian superannuation funds are:

- subject to tax in Australia in respect of their worldwide income (subject to the proportion of fund income attributable to assets supporting members in accumulation phase); and
- entitled to claim foreign income tax offsets (FITO) in accordance with Division 770 of the ITAA97 in respect of underlying foreign taxes they are taken to have paid
- unable to access the participation exemption for distributions paid on foreign equity distributions under subdivision 768-A of the ITAA97.

It is these key features of the taxation rules, as they apply to Australian superannuation funds that result in the importance of the application of the "foreign hybrid" rules in Division 830 of the ITAA97 in respect of investments in foreign entities that would otherwise be characterised as foreign "companies" for income tax purposes.

Based on the current drafting of the proposed Division 832, the deducting hybrid provisions are likely to be triggered in a wide range of outbound investments where foreign entities are treated as "flow through" for Australian and foreign income tax purposes. In a typical Division 830 foreign hybrid, when determining its Australian and foreign income tax liability, the relevant entity would claim a deduction for the same expenditure or capital allowances in both Australia and the foreign jurisdiction. Furthermore, while the same income is brought to account in both jurisdictions, given the Australian superannuation fund 15% tax rate, it is likely that superannuation funds may have excess FITOs that, absent the proposed rules and subject to the FITO cap restrictions, may be used to offset tax on other income. The proposed legislation seeks to neutralise this excess FITO as a perceived mischief. However, as discussed above, this "mischief" is merely an intended consequence of the current income tax law where Australian superannuation funds are subject to foreign tax at rates higher than their Australian statutory rate.

This would mark a significant departure from the current FITO regime and could result in a quasi-bucketing system reminiscent of former foreign tax credit regimes – a policy decision that would adversely impact Australian superannuation funds.

Additionally, based on the current drafting, it is not clear whether the neutralising provisions will operate to neutralise FITOs that are available to be utilised, or merely all excess FITOs that are generated from a specific investment. As the income that Australian superannuation funds derive that is attributable to their pension phase members is exempt from Australian income tax, the associated FITOs derived on that income is also not available. As such, any neutralising provisions should only seek to neuetralise FITOs that are remaining to be utilsied following the determination of the share that is attributable to pension members and the operation of the FITO cap. Should this not occur, the provisions would detrimentally operate to deny a perceived benefit that was never available.

Finally, from a practical perspective, we are concerned that the proposed legislation places a significant compliance burden on superannuation entities that invest billions of dollars in offshore vehicles. We see the following practical difficulties in complying with the proposed legislation:

- This would effectively require a tracking of income, expenses and FITOs on an investment by investment basis as opposed to on a pooled basis
- The proposed legislation could operate in instances where, due to commercial reasons to take a small stake, the superannuation fund has no right to obtain the relevant information to confirm whether the rules would apply
- It is unclear how the rules would apply where there is a funneling vehicle that invests in a range of investments that absent the other income and expenses may be subject to the hybrid legislation, but when pooled with other income and expenses may not result in excess FITOs.

We understand that the above outcomes were not intended and we ask that you amend the current drafting to ameliorate the disproportionate application to Australian superannuation funds.

We welcome the opportunity to discuss these comments with you in more detail at your request.

Yours faithfully,

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