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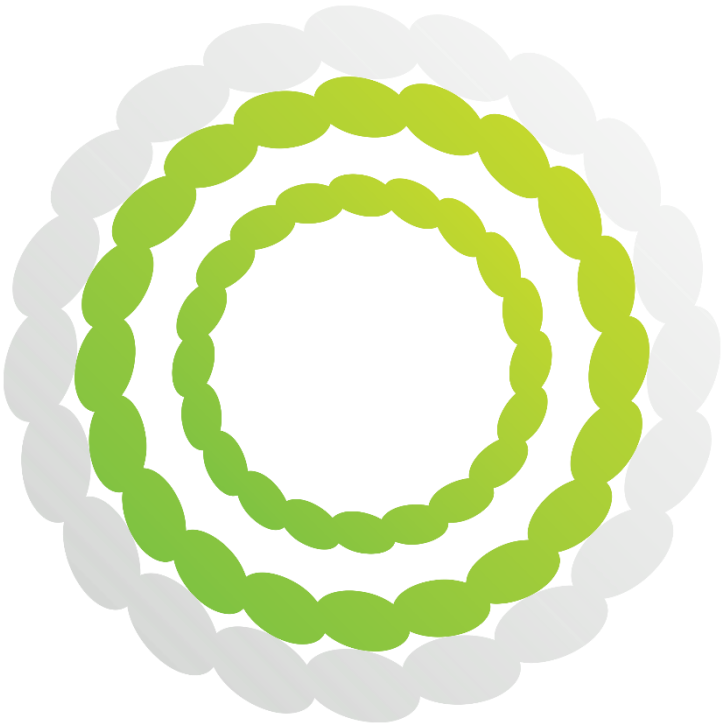

Tax Insights

Australia introduces Pillar Two Exposure Draft legislation

On 21 March 2024, Treasury released the highly anticipated Exposure Draft legislation for the **implementation of OECD Pillar Two in Australia**. The package of Exposure Draft legislation includes both primary and subordinate legislation, along with accompanying explanatory materials and a discussion paper for stakeholder consultation and feedback.

The proposed income inclusion rule (**IIR**) and domestic minimum tax (**DMT**) will commence for **income years starting on or after 1 January 2024**, while the undertaxed profits rule (**UTPR**) will commence for **income years starting on or after 1 January 2025**.

As anticipated, the Exposure Draft legislation is broadly aligned with the OECD Pillar Two Rules which have been endorsed by Australia and 135 countries along with OECD commentary and agreed administrative guidance. The legislative framework constructed by the Exposure Drafts establishes a separate Assessment Act (the 'GloBE Assessment Act') to ascertain the amount of the new Top-up Tax Amounts under the IIR, the Domestic Top-up Tax Amounts under the DMT and Tax under the **UTPR**, as well as the core group and entity concepts and provide for 'The Rules', which will be implemented via Ministerial legislative instrument.

A consequential amendments Act will also be introduced as part of the primary legislation, dealing with a limited number of amendments to the *Administrative Decisions (Judicial Review) Act* 1977, *Income Tax Assessment Act* 1997, *International Agreements Act* 1953 (Agreements Act) and the *Taxation Administration Act* 1953 (TAA), inserting new Part 3-18 to cover the new set of returns and payment of tax.

The consultation period for the discussion paper and primary legislation is open until **16 April 2024**, and the consultation period for The Rules is open until **16 May 2024**.

Key points

When?

- Top-up Tax under the IIR and DMT will apply from income years beginning on or after 1 January 2024. The UTPR begins for income years on or after 1 January 2025.
- Australian entities could be subject to new financial reporting obligations once the Exposure Drafts pass through both Houses of Parliament and may already be subject to such requirements depending on their global footprint. Amendments to IAS 12 already require limited reporting changes and Australian entities and their auditors should monitor the Exposure Draft timing in preparation.

Who?

- The rules apply to all 'Applicable MNE Groups' that meet the € 750 million global turnover threshold and have a global footprint.
- Entities that are 'GloBE located' in Australia include Australian resident companies, Australian partnerships and trusts and entities with Australian permanent establishments.

What?

- The GloBE Assessment Act will apply after the application of Australia's income tax laws, as a separate tax.
- The Rules are broadly consistent with the OECD Pillar Two Rules, signalling that Australia's rules should be 'qualifying' for global peer review purposes. Safe Harbours are included and will be available for in-scope entities for periods beginning no later than 31 December 2026 (i.e. first three transitional years).
- For DMT purposes it appears that in-scope entities must use local Australian GAAP financial accounts if prepared and the fiscal year-end aligns with that of the parent. This could be particularly relevant to foreign headquartered MNE groups.
- Three new tax returns are introduced – the GloBE Information Return (**GIR**), the Australian GloBE Tax Return and the DMT Return. The GIR is a standardised return for information gathering consistent with the OECD Pillar Two Rules. The Australian GloBE Tax Return and DMT Return are supplementary returns required to assess and collect GloBE Top-up Tax and DMT Top-up Tax respectively and include a requirement for nil returns. The form of these returns is not yet known but will undoubtably create a significant compliance burden for in-scope Australian entities. The first returns and tax payments are due 18 months after year-end, which will be 30 June 2026 for the first in-scope entities and thereafter 15 months after year-end.

Other changes?

- A payment of Top-up Tax under the DMT will give rise to franking credits, however a GloBE Top-up Tax under the IIR or UTPR will not. Stakeholder comments are sought on the timing issues relating to franking credits. Given the filing and payment of Top-up Tax is due 15 months after an income year end it seems sensible not to time limit this rule.
- The Discussion paper notes that Treasury considers that it is appropriate for the Australian hybrid mismatch rules to continue to operate even if a foreign jurisdiction imposes global or minimum taxes. Stakeholder comment is sought on this position which appears to provide for an environment where double taxation can ensue, by virtue of a denied deduction in Australia and the application of a minimum tax on the same stream of income. These are live issues in practice and should be thoughtfully considered through the consultation process.
- FITOs are intended to be available for a foreign DMT but not for foreign top-up tax payable under a foreign IIR or UTPR. Australian taxpayers will need to review their existing processes for FITO to incorporate these new taxes into their systems.
- The application of anti-abuse rules including the proposed intangibles measure announced in the FY23-FY24 Federal budget has not been raised in the package.

In more detail

Legislative framework and timing

The Exposure Draft package contains three pieces of primary legislation together with subordinate legislation comprising The Rules which will be implemented via Ministerial legislative instrument.

The Rules are introduced in this manner to ensure that OECD guidance can be incorporated quickly and efficiently, recognising the evolving nature of the Pillar Two regime. Furthermore, the Rules must be interpreted consistently[1] with the OECD Pillar Two Rules, Commentary, Examples, Agreed Administrative Guidance, GloBE Implementation Framework and documents prescribed by the Rules. According to the draft explanatory memorandum (**EM**) this is required as the OECD Pillar Two Rules operate as a common approach, acknowledging Australia's commitment to ensuring that the Australian legislation is a qualifying Pillar Two regime by global standards.

The GloBE Assessment Bill defines Agreed Administrative Guidance as all published OECD guidance to date as well as "any other Agreed Administrative Guidance (within the meaning of the GloBE Rules)", indicating that the Australian legislation will be interpreted in an ambulatory fashion incorporating future technical issues which can be expected to be resolved at the OECD level. This is a welcome approach for in-scope entities applying the rules on a global basis and wanting to minimise potential international tax uncertainty. It also caters for future OECD guidance still in development, such as permanent safe harbours which appear in the Exposure Drafts and will therefore seemingly become automatically operational upon agreement at the OECD level and release of Agreed Administrative Guidance[2].

The GloBE Assessment Bill also confers a general Rule-making power on the Minister to make Rules necessary to give effect to the Act. There are guardrails contained in the GloBE Assessment Bill, such as conferring delegate powers to make notifiable instruments only on the Minister, Secretary of the Department or the Commissioner, which per the EM, are designed to ensure the Rules are used appropriately. Additionally, there is a sunset of 31 December 2026 on the Rule-making powers.

Exposure Drafts

Primary legislation	Content / purpose
Imposition Bill[3]	Formal imposition of tax in accordance with the GloBE Assessment Act
GloBE Assessment Bill[4]	Operative provisions for • The Top-up Tax Amounts under the IIR (section 4(1)); • The Domestic Top-up Tax Amounts under the DMT (section 7(1)); and • Tax under the UTPR (section 10(1)). Core group and entity concepts (reflecting Chapter 1 of the OECD Pillar Two Rules) Incorporation of the Rules and Rule-making powers and functions Keeping of records (8 years) Interpretation including definitions relevant to the Entity concepts, Elections, Ownership Interests and Location of Entities and Permanent Establishments (including stateless constituent entities)

[1] Section 3, Assessment Bill
[2] See Chapter 8, Division 2 of the Rules and paragraph 8.47 of the Explanatory Statement to the Rules
[3] *Taxation (Multinational – Global and Domestic Minimum Tax) Imposition* Bill 2024
[4] *Taxation (Multinational – Global and Domestic Minimum Tax)* Bill 2024

Primary legislation	Content / purpose
Consequential Bill[5]	Amends the TAA such that the Commissioner has general administration of the GloBE Assessment Bill, meaning it is a 'taxation law' as defined in section 995 of the Income Tax Assessment Act 1997. As a result, the Commissioner's general powers including information gathering under Subdivision 353-A in Schedule 1 to the TAA and administrative penalties for false and misleading statements and failing to lodge apply. Note the base penalty amount is doubled for amounts arising in relation to a Top-up tax. Inserts new Subdivision 127 in Schedule 1 to the TAA to require returns and cater for the collection of tax. Amends the secrecy provisions in Division 355 to allow taxation officers to disclose protected information: • About one Constituent Entity to another Constituent Entity of the same Applicable MNE Group; and • About a JV or JV subsidiary to a Constituent Entity, trustee or a partner that holds a direct ownership in that JV or JV subsidiary; for the purposes of administering the Assessment Bill. Makes amendments to Division 205 of the ITAA 97 to enable payment of DMT to give rise to franking credits. Makes amendments to the Agreements Act to ensure the Imposition Bill, the GloBE Assessment Bill and the Rules override Australia's tax treaties in the event of inconsistency.
Subordinate legislation	
Rules[6]	Detailed Rules outlining the computations required to determine tax liability amounts, special rules, administration, transition and definitions. The structure of the Rules closely resembles that of the OECD GloBE Rules and is discussed in more detail below

The legislation will apply to income years beginning on or after 1 January 2024[7] for the IIR or DMT and 1 January 2025[8] for Top-up Tax imposed under the UTPR.

Given the short consultation period for the primary legislation it is possible that the Government may look to pass this legislation in the May/June 2024 Parliamentary sittings. This timing could impact Australian in-scope entities with a fiscal year-end of 30 June as these entities could have a positive obligation to make disclosures in year-end financial statements as to the impact of the global minimum tax, if the legislation attains substantive enactment (passes both Houses of Parliament) by 30 June, underscoring the need for Australian entities to be prepared to comply with the new rules.

[5] *Treasury Laws Amendment (Multinational – Global and Domestic Minimum Tax) (Consequential)* Bill 2024
[6] *Taxation (Multinational – Global and Domestic Minimum Tax) Rules* 2024
[7] Section 4(3) and 7(3), Assessment Bill
[8] Section 10(3) Assessment Bill

What are the OECD Pillar Two Rules?

The drafting in the Exposure Draft package closely resembles the OECD Pillar Two Rules that were published in December 2021, along with subsequent agreed OECD commentary and guidance. This consistency will be important to ensure that foreign headquartered in-scope entities can enjoy the benefit of the Qualified Domestic Minimum Top-up Tax (QDMTT) Safe Harbour and to ensure the rule-order operates appropriately for both foreign and Australian headquartered groups.

The Rules apply to large multinational groups with annual consolidated group revenue of **at least € 750 million (approx. AUD 1.2 billion) over at least 2 of the preceding 4 years** and contain the following key components:

- Part 2-1: An income inclusion rule (**IIR**) applies on a top-down basis and will apply to Australian headquartered groups and Australian intermediate parents (entities with foreign subsidiaries) where the foreign parent does not have a qualified IIR (such as the US), or a partially-owned parent entity. The tax due is the 'top-up' amount needed to bring the overall tax on the profits in each country where the group operates up to the minimum effective tax rate of 15%.
- Part 2-4: A domestic minimum top-up tax (**DMT**) aligned with GloBE computation. DMT tax payable in respect of any low-taxed profits of a group's entities in a country are paid to the local tax authority under a QDMTT. Part 2-4 applies the DMT to in-scope entities located in Australia, including joint ventures, partnerships and trusts and Australian permanent establishments and will apply to both foreign headquartered and Australian headquartered entities.
- Not yet drafted: While the GloBE Assessment Bill contains the framework for the UTPR the Rules do yet contain the rule set. Under the OECD Pillar Two Rules the UTPR will apply as a secondary (backstop) rule in cases where the effective tax rate in a country is below the minimum rate of 15%, but the income inclusion rule has not been fully applied. The UTPR tax is allocated, based on a formula, to countries where the group operates which have adopted the undertaxed profits rule. The UTPR is delayed until 2025 and in practice should only apply in Australia in the context of foreign headquartered groups.

As recommended the GloBE threshold is denominated in Euros, meaning currency fluctuations will not distort the bases between Australia and other countries. The Rules have incorporated the Agreed Administrative Guidance relating to non-Euro denominated amounts.

The Rules include provision for Safe Harbours, including the Transitional CbCR Safe Harbour which will be a compliance saving option for many in-scope entities. The Safe Harbour Rules follow the OECD rule set and deem the Top-up tax to be nil in a country which satisfies one of three tests during the transition period which runs up until income years starting on or before 31 December 2026:

- The De minimis test – broadly the jurisdiction total revenue is less than EUR 10 million and profit before tax is less than EUR 1 million;
- The Simplified ETR test – broadly income tax expense divided by profit before tax is equal or greater to the transition rate (15%: 2024, 16%: 2025, 17%: 2026); or
- The Routine profits test – broadly the jurisdictional profit before tax is equal to or less than its 'substance based income exclusion amount'.

There are certain adjustments and special rules regarding the sources of data to comply with in order to apply these tests, which must be satisfied each year to continue reliance (once out, always out). Pleasingly, the Rules follow the OECD Pillar Two Rules very closely, including provision for the recent Agreed Administrative Guidance released in December 2023 that provides clarity on the meaning of 'Qualified Financial Statements' for the purposes of applying the Transitional CbCR Safe Harbours.

Limited interpretation of the Rules in an Australian specific context has been adopted by the Rules and the Explanatory Statement (**ES**) to the Rules. For example, the ES acknowledges that the Australian imputation system will give rise to a 'Qualified Imputation Tax'[9], but does not expand on the meaning of Covered Taxes, Qualified Refundable Tax Credits or tax consolidation groups within the Rules in an Australian context. This would be useful guidance which may be required from the Australian regulators as in-scope entities seek to understand the application of The Rules in practice.

Particularly relevant to foreign headquartered groups is the source of data used for the purposes of the DMT – if all in-scope Australian entities in the MNE Group prepare financial accounts and the entities share the same year-end as the ultimate parent, the DMT is computed using amounts per the accounts prepared in accordance with the local accounting standards (i.e. A-IFRS).

Compliance – returns and tax payments

Australian in-scope entities will be required to comply with the Rules and file the requisite returns regardless of whether they have a GloBE-related tax liability. This is by far the most significant impact to Australian in-scope entities and will require investment of time and resources to implement the necessary changes to tax systems and controls to comply.

Three new returns – the GloBE Information Return, the Australian GloBE Tax Return and the DMT Return – are prima facie required by all Australian located entities that are part of an in-scope MNE group, including nil returns. The first return for an in-scope entity will be lodged 18 months after its year-end and thereafter 15 months post year-end, aligning with the payment of tax. Deferrals of lodgement dates are not allowed and the review period for returns is 4 years post lodgement. Global peer review and other tax certainty procedures are in development by the OECD and it remains to be seen how this co-ordinates with the proposed review period.

Allowance is made for a 'designated' entity to file on behalf of all Australian located entities, and in the case of a GIR filed with a foreign agency, international agreements (likely in the form of a multilateral agreement) may discharge this obligation.

The form of the final GIR was published by the OECD in July 2023, and may be subject to further guidance at the OECD level. The GIR includes abbreviated disclosures where a jurisdiction satisfies a safe harbour and allows for aggregated reporting for tax consolidated groups. Ideally the form of the Australian GloBE Return and DMT Return will replicate these disclosures. The GloBE Assessment Bill also makes reference to approved forms required for various 5-year and annual elections available under the Rules, to be developed in due course.

Tax consolidated groups

Subdivision 127 of the Consequential Bill introduces the concept of a 'GloBE consolidated group' and mandates that Top-up tax is payable (under the IIR for foreign jurisdictions or the DMT for Australian entities) by head companies of a tax consolidated group. However non-consolidated Australian entities will also have primary liability where Top-up applies. The Exposure Drafts do not provide specific rules for MEC groups.

In light of the approach in Subdivision 127, Australian in-scope tax consolidated groups should review their tax sharing and funding arrangements to ensure they appropriately cater for the imposition of Top-up tax under the DMT (and potentially look at these arrangements more broadly in a global context) on the head entity on behalf of group members. No specific amendments appear to be proposed in the Consequential Bill to deal with joint and several liability or clear exit concepts.

[9] See paragraph 3.26 of the ES to the Rules

Further considerations for Australian consolidated groups include:

- Whether rules related to tax consolidated groups extend to MEC groups in an Australian context; and
- Application of the historical carrying value rules where an acquirer 'steps up' its tax values upon tax consolidation. Australian groups should be particularly vigilant with M&A activity in light of the Rules.

Other interaction issues

There are number of interaction issues noted in the discussion paper but limited proposed amendments in the Consequential Bill. How these issues will be resolved and within what timeframe will be an important consultation point. The key interaction issues tabled for consultation are:

- Hybrid mismatch rules (Division 832 ITAA 97) – the Treasury view anticipated in the discussion paper is that the hybrid mismatch rules, including the targeted integrity financing rule, should continue to operate even where a foreign jurisdiction imposes a global or domestic minimum tax. Stakeholder feedback is sought on whether any amendments are required to the 'subject to foreign income tax' definition (not anticipated by Treasury). This will be particularly relevant for foreign headquartered groups that could face double taxation if both sets of rules continue to apply. Practical examples will be particularly useful to raise during consultation.
- The foreign hybrid entity rules (Division 830 ITAA 97) are anticipated to continue to operate. This will have an impact on the definition of tax transparent and hybrid entities within the Rules.
- A foreign income tax offset (FITO – Division 770 ITAA 97) is anticipated to be allowed for a foreign DMT. Treasury considers that this will be a natural conclusion with no specific amendment required. Australian entities should review their FITO profiles in this regard to provide useful feedback to Treasury on this point.
- Similarly, Treasury does not anticipate a need for any amendment to the Australian CFC rules in light of the GloBE rules.

Of note the discussion paper does not mention consideration of a general or targeted anti-avoidance rule in light of the OECD Pillar Two Rules, a key point of practical consideration for in-scope entities seeking to understand how Pillar Two affects ordinary business transactions. It is also expected that the consultation will deal with the proposed intangibles measure announced by the Government in the FY23-FY24 Federal budget, although this has not been specifically addressed in the discussion paper.

Next steps

The OECD Pillar Two Rules are a major new taxing right applicable to entities operating in Australia and should be carefully considered by both Australian and foreign headquartered MNE groups with a presence in Australia.

As the Rules will apply to income years commencing on or after 1 January 2024, Australian taxpayers should ensure they understand their future compliance requirements including their financial reporting obligations and assess the impact of the rules in Australia.

Deloitte has a multi-disciplinary approach to bring together experts in international tax, tax technology and global compliance to help plan for this new environment. Please reach out to your Deloitte team to find out how we can assist.

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