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# Draft Australian Pillar Two legislation released

*Australia's Global Anti-Base Erosion Model Rules (GloBE) rules are to be implemented as a new stand-alone tax law that imposes and assesses GloBE and domestic minimum top-up tax.*

**Alia Lum, Peter Oliver, Denis Larkin & Amanda Maguire**

The Australian Government, on 21 March 2024, released a draft legislative package implementing the Pillar Two Global Anti-Base Erosion (**GloBE**) rules in Australia. The Australian GloBE rules include the following:

- an Income Inclusion Rule (**IIR**) which will apply for income years starting on or after 1 January 2024;
- a domestic minimum top-up tax (**DMT**) which will apply for income years starting on or after 1 January 2024; and
- an Undertaxed Profits Rule (**UTPR**) which will apply for income years starting on or after 1 January 2025.

## Background

Australia is a member of the OECD/G20 Inclusive Framework on BEPS and endorsed the OECD's Two-Pillar Solution agreed to on 8 October 2021. The Pillar Two GloBE rules involve the introduction of a global minimum tax requirement set at a 15 percent effective tax rate (**ETR**).

The GloBE rules generally apply to Constituent Entities (**CEs**) that are members of a Multinational Enterprise (**MNE**) Group that has annual consolidated revenue of €750 million or more in at least two of the preceding four years. To be in scope, a group must have at least one entity or permanent establishment that is not located in the jurisdiction in which the Ultimate Parent Entity (**UPE**) of the group is located.

In the 2023-24 Federal Budget, the Australian Government announced its intention to implement Pillar Two and a domestic minimum tax, and the draft legislative package is consistent with the announcement.

A brief outline of the OECD Model GloBE Rules (**Model Rules**) is set out at **Appendix 1.**

## KPMG Observations

### General

The Australian GloBE rules broadly follow the Model Rules, with no apparent major changes to the core principles of the Model Rules.

However, the Australian GloBE rules are not a strict replication of the Model Rules, and generally include additional detail and some reordering. In some cases, but not always, the additional detail is drawn from the Model Commentary and/or Administrative Guidance. In this way, the Australian approach is broadly similar to that adopted by Canada. Definitions have been incorporated into the sections to which they relate, rather than contained in a separate chapter.

The legislation states that the interpretation of the rules is to be in a manner consistent with the Model Rules, Model Commentary (as amended from time to time), Agreed Administrative Guidance (both published and any other such guidance), Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules and any other document prescribed by regulations (noting no documents have been prescribed as yet).

The Australian GloBE rules are implemented as a new stand-alone tax law that imposes and assesses GloBE and DMT.

While the Australian GloBE rules include charging and framework provisions for the UTPR, no detailed rules have yet been released.

The draft legislation package comprises primary and subordinate legislation. The primary legislation includes:

- **assessment legislation** which establishes the liability and framework of the Australian GloBE rules (i.e. broadly, Chapter 1, part of Chapter 2 and Chapter 10 of the Model Rules);
- **imposition legislation** which imposes the tax payable under the Australian GloBE rules; and
- **legislation making limited consequential and miscellaneous amendments** to the Australian tax laws (discussed below).

The subordinate legislation is in the form of a legislative instrument and comprises the key operative aspects of the Australian GloBE rules (i.e. part of Chapter 2, and Chapters 3 – 9 of the Model Rules). The use of secondary legislation is intended to allow future OECD Pillar Two administrative guidance to be more easily adapted and incorporated in a timely and efficient manner (i.e. given it will not be required to pass Australian Parliament in order to be implemented), while retaining an appropriate level of parliamentary oversight.

Together, the primary and subordinate legislation total over 200 pages of draft rules, with almost 200 pages of accompanying explanatory materials.

The monetary thresholds in the Australian GloBE Rules are denominated in EUR, with the intention to avoid annual rebasing calculations and to minimise the difference between the Australian threshold and thresholds set by other jurisdictions.

## Income Inclusion Rule

The IIR imposes top-up tax on a Parent Entity of an MNE Group located in Australia, generally, the UPE. The top-up tax applies in respect of a Low-Taxed Constituent Entity (**LTCE**) where the Parent Entity has an Ownership Interest in the LTCE and the LTCE is not located in Australia (i.e. the IIR does not apply in domestic situations where the LTCE is an Australian entity). A LTCE is a CE in a jurisdiction with net GloBE Income for the fiscal year and a GloBE ETR of less than 15 percent.

The Australian IIR includes the transitional country-by-country reporting (**CbCR**) safe harbour and permanent simplified safe harbour calculations.

There are some peripheral differences between the Model Rules and the Australian IIR. For example:

- Direct Ownership Interests and Indirect Ownership Interests are explicitly defined in the Australian rules, with a more prescriptive approach taken than in the Model Rules. Given the uncertainty within parts of the Model Rules on how to determine Ownership Interests percentages where there are varied rights to profits, capital and reserves, this is an area where different jurisdictions are starting to diverge in their approach and interpretation.
- There are new definitions for Excluded Service Entity, Excluded Exempt Income Entity (both of which are drawn from Article 1.5.2) and Excluded Non-Profit Subsidiary (which reflects the additional test from the February 2023 Administrative Guidance).

## Domestic Minimum Tax

Under the OECD Administrative Guidance, for a jurisdiction's domestic minimum tax to qualify as a Qualified Domestic Minimum Top-up Tax (**QDMTT),** it should be consistent with the design of the GloBE rules and provide for outcomes consistent with the rules, with the exception of certain mandatory and optional variations. There are additional requirements that must be satisfied for a jurisdiction to qualify for the QDMTT Safe Harbour, which would allow the top-up tax computation to be performed only at the local level under the QDMTT rules, and not applied a second time (under potentially different rules) under a parent entity IIR.

Consistent with the Model Rules, Australia's DMT will apply to MNE Groups that have annual consolidated revenue of €750 million or more in at least two of the preceding four years. To be in scope, a group must have at least one entity or permanent establishment that is not located in the jurisdiction in which the UPE of the group is located. In other words, Australia did not take the optional variation to apply its DMT to wholly-domestic groups or apply a lower revenue threshold.

Australia's DMT imposes top-up tax on a LTCE of an MNE Group that is located in Australia or is created in Australia and is a Stateless Constituent Entity. It can also apply to a Joint Venture (as defined under the GloBE rules), or a JV Subsidiary of a Joint Venture.

The DMT includes the mandatory variations required under the Model Rules, such as disapplying the provisions that reallocate GloBE Income and Covered Tax amounts between CEs where there is a permanent establishment, Controlled Foreign Company (**CFC**) or

Hybrid Entity. This revised ordering rule ensures that the DMT has priority taxing rights over another jurisdiction's domestic laws for these areas. See also our comments below in relation to the Australian Government's proposed approach to the CFC and foreign income tax offset (**FITO**) rules.

The Australian DMT also includes the mandatory variation to impose the rules to 100 percent of the top-up tax calculated for Australian CEs, rather than limiting the top-up tax by the percentage held by the UPE (including for Joint Ventures and their JV subsidiaries). The rules have not taken the optional variation to only apply its QDMTT to groups where all CEs located in the jurisdiction are 100 percent owned by the UPE or partially-owned Parent Entity for the entire fiscal year.

Under the Model Rules, there is a requirement to use parent entity consolidated financial statements and reporting currency. Under a QDMTT, jurisdictions can opt to use accounts prepared under local accounting standards and in local currency in certain circumstances (and allowing such an option will still satisfy the QDMTT Safe Harbour).

The Australian DMT rules include this allowable variation and require that local financial statements must be used to prepare the calculations where all of the CEs of the MNE Group that are located in Australia have financial accounts prepared in accordance with accounting standards, and those accounts are required under an Australian law to be kept or used, or externally audited. This requirement is switched off where the relevant financial accounts have a different accounting period to that of the UPE consolidated financial statements.

Permanent establishments that do not prepare separate financial accounts are taken to have the financial accounts of its Main Entity provided those accounts contain sufficient information to compute the top-up tax.

If not all CEs in Australia prepare local financial statements meeting the conditions outlined above, then the usual GloBE rules requirement to use the UPE consolidated financial statements and reporting currency will apply.

Where DMT computations are prepared using local accounting standards, Australian currency should be used, unless one or more of the Australian CEs do not use Australian currency as their functional currency. Where another functional currency is used, there is a five-year election that can be made to choose to use either Australian currency or the reporting currency of the UPE consolidated financial statements.

Consistent with the model rules, the Australian DMT includes the transitional CBCR safe harbours, as well as the permanent safe harbours released by the OECD to date (being the UTPR safe harbour and the de minimis safe harbour).

There will be a future peer review process by Inclusive Framework members to confirm that Australia's DMT is a Qualifying DMT and meets the QDMTT Safe Harbour requirements. However, the DMT appears designed in a manner aimed at meeting both sets of tests.

## Administration

The administrative and compliance aspects of the Australian GloBE rules are broadly consistent with the Model Rules and Implementation Framework.

### Filing requirements

Broadly, an Australian CE is required to give a GloBE Information Return (**GIR**), Australian GloBE Tax Return and DMT Return to the Australian Taxation Office (**ATO**). These returns are all required to be filed by the last day of the 15th month after the end of the fiscal year (18 months after year end for the transitional first year in the regime). For a 30 June year end MNE Group, the first filings will be due by 31 December 2026.

The GIR is the standardised form published by the OECD and developed in accordance with the GloBE Implementation Framework, which will typically be lodged on behalf of the MNE Group by the UPE or another Designated Filing Entity. It includes the information required to assess an entity's tax liability consistent with the GloBE rules.

The Australian GloBE tax return and DMT return are Australian specific returns intended to provide the ATO with additional supplementary information needed to assess and collect the Australian GloBE and DMT top-up taxes. The Australian GloBE tax return seems aimed at entities that could be liable for top-up tax under the Australian IIR (and likely UTPR), and so will mainly impact Australian headquartered groups. No detail has been provided in relation to the form of these filings, but it is hoped that the disclosures requested will not exceed the already very extensive disclosures in the GIR.

Although individual CEs may have an obligation to file an Australian GloBE tax return and DMT return, the rules allow for a Designated Local Entity to file the Australian GloBE Tax Return and DMT Return on behalf of the other CEs (such as allowing an Australian head company to file on behalf of the Australian group).

Where Australia has an agreement with a foreign government agency which provides for the automatic exchange of GIRs, Australian CEs do not have to file a GIR with the ATO, provided a number of conditions are met including notification to the ATO in an approved form.

The Australian GloBE return and DMT return are required to be filed even where there is no top-up tax liability. The Commissioner of Taxation has the discretion to defer the filing due date for these returns (but not the GIR).

### Payment requirements

The Australian GloBE and DMT top-up tax is due and payable on the last day of the 15th month after the end of the fiscal year. In the transitional year, this is extended to the last day of the 18th month. Interest charges (general interest charge and shortfall interest charge) can apply.

The rules provide an administrative approach for Australian tax consolidated groups, such that the head company is liable for the total GloBE and DMT top-up tax that is allocated to the subsidiary members of the tax consolidated group under the GloBE rules. When the head company pays the group liability, the subsidiary members are taken to have paid the

top-up tax at the same time.

### Penalties

The existing penalty regime within Australia's tax laws applies to GloBE and DMT top-up tax. The 'failure to lodge' penalty is aligned with the existing increased penalties for 'significant global entities' (**SGEs**). This means that the increased SGE penalties (announced to increase to a maximum of AUD 825,000) will also apply to CEs of MNE Groups for a failure to lodge the GIR, Australian GloBE return or DMT return.

### Objections

The rules provide the ability to object to a GloBE or DMT top-up tax assessment (time limit is 60 days after the notice of assessment). The period for ATO review of GloBE top-up tax and DMT top-up tax assessments is four years.

### Registration

There is no requirement under the draft legislation to register with the ATO for GloBE and/or DMT purposes.

## Other rules

The draft legislative package makes a number of limited consequential and miscellaneous amendments to Australia's tax laws, with the key changes outlined below:

- DMT top-up tax gives rise to franking (imputation) credits, while GloBE (IIR and UTPR) top-up tax does not;
- under Australian tax law, tax advisor fees are broadly deductible. The rules extend this provision, to provide a tax deduction for outgoings related to managing GloBE and DMT tax affairs and complying with an Australian obligation relating to GloBE and DMT tax affairs; and
- the rules explicitly deny a tax deduction for GloBE and DMTT.

## Interactions with Australian tax laws

Treasury has also published a consultation paper in relation to the interactions with Australia's tax laws. The paper provides proposed policy positions in relation to several Australian income tax measures.

Treasury's general policy approach is that Australian income tax laws will continue to apply prior to any application of the GloBE rules, with the result that a taxpayer would ordinarily calculate their regular income tax liability under the Australian tax law and subsequently calculate any GloBE or DMT top-up tax liability if their ETR falls below minimum tax rate.

As a general observation, the consultation paper does not envisage significant modifications to the existing Australian international tax law in response to the implementation of the GloBE rules, with only minor modifications being made to accommodate interactions or to clarify that the relevant Australian tax rules are unaffected by the GloBE rules and DMT.

In relation to the hybrid mismatch rules, it is broadly proposed that these integrity measures continue to be unaffected by global or domestic minimum taxes. That is, the operation of

either Australia's or a foreign country's GloBE rules (including any QDMTT) are not expected to have an impact on identifying whether a payment is subject to Australian tax (and thus whether an arrangement gives rise to a hybrid mismatch), with amendments to the current hybrid mismatch rules being proposed to ensure that taxes imposed by a foreign or domestic top-up tax, IIR and UTPR are disregarded for the purposes of the hybrid mismatch rules. Likewise, a foreign jurisdiction's implementation of the GloBE rules and any QDMTT will not be taken into account in determining whether an amount of interest or a derivative payment has been subject to tax at a rate of 10 percent or more for the purposes of the targeted integrity rule.

The hybrid entity rules in Division 830 of the Income Tax Assessment Act 1997, which broadly operate to align the Australian tax treatment with the treatment of foreign flow-through entities, are also expected to be largely unaffected by the Australian implementation of the GloBE rules and DMT. Therefore, where a foreign jurisdiction which currently imposes tax on the partners of a foreign limited partnership (such that the foreign limited partnership can be treated as a transparent foreign hybrid limited partnership (**FHLP**) for Australian tax purposes) chooses to implement its QDMTT in such a way as to impose tax on the partnership, the treatment of the entity as a FHLP would not be adversely impacted. Treasury intends to make amendments to sections 830-10 and 830-15 to ensure the current foreign hybrid treatments are unaffected by a QDMTT being imposed on these entities.

In relation to the FITO (foreign tax credit) rules, the proposed approach is that only QDMTT top-up tax will give rise to a FITO (not IIR or UTPR top-up tax). For the CFC rules, the proposed approach is that IIR and UTPR top-up tax do not reduce the Australian CFC tax liability, but a QDMTT top-up tax could do so.

The EM to the secondary legislation also notes that Australia's corporate income tax, similar to New Zealand's, meets the definition of a Qualified Imputation Tax and is therefore a Covered Tax.

## Next steps

Consultation on the draft legislative package is as follows:

- a short consultation period for the primary legislation and consultation paper which closes **16 April 2024**; and a
- longer consultation period for the subordinate legislation which closes **16 May 2024.**

Given the short consultation time in relation to the primary legislation, we expect the intention will be to introduce the legislation to the Australian Parliament in late May / June 2024. It is not yet clear whether the subordinate legislation will be registered at the same time or be delayed given the longer consultation period, however we expect the aim will be to align timing with the primary legislation.

Please let us know if you would like to discuss the impact of these measures on your operations, including what this may mean for upcoming annual reports and what will be required to prepare for implementation over the next 3-18 months. KPMG Australia will make submissions in relation to the draft legislative package, so please also provide any feedback comments to us.

# Appendix 1

## Outline of the GloBE rules

The purpose of the GloBE rules is to introduce a global minimum tax requirement, set at a 15 percent ETR. The rules do this by imposing a 'top-up tax' on a jurisdictional basis, where an MNE Group's ETR in that jurisdiction is below 15 percent.

A summary of Model Rules is set out below.

### Chapter 1 – Scope

Chapter 1 defines the scope of the GloBE rules and in particular, defines an in-scope MNE Group (see section 1 above). Certain entities are excluded from the rules, including Pension Funds, Government Entities, Investment Funds that are UPEs, Real Estate Investment Vehicles that are UPEs and Non-profit Organisations.

### Chapter 2 – Charging Provisions

Under Chapter 2, the amount of Top-up Tax charged is determined by attributing the Top-up Tax of each LTCE to the Parent Entity under the IIR. Then, under the UTPR, the residual Top-up Tax (if any) is allocated to the CEs located in a UTPR jurisdiction.

A LCTE is broadly a CE of an MNE Group located in a jurisdiction which has a GloBE ETR of less than 15 percent.

### Chapter 3 – Computation of GloBE Income or Loss

Chapter 3 computes the income of a CE of an MNE Group for GloBE purposes.

This starts with a CE's accounting income or loss, with adjustments made to reflect the GloBE base. Some adjustments are mandatory while others are elective. There are also rules for allocating income between CEs.

### Chapter 4 – Computation of Adjusted Covered Taxes

Chapter 4 computes the Covered Taxes of a CE of an MNE Group for GloBE purposes.

This requires a determination of the types of taxes that qualify as 'Covered Taxes', and which year those taxes are allocated to. The starting point for calculating Covered Taxes is the accounting current tax expense and deferred tax. A number of adjustments are made to these amounts. There are also rules for allocating Covered Taxes between jurisdictions.

### Chapter 5 – Computation of ETR and Top-up Tax

Under Chapter 5, the Top-up Tax of each LTCE is determined. This involves determining the ETR on a jurisdictional basis, by aggregating each CE's Adjusted Covered Taxes and dividing by the aggregated GloBE Income or Loss.

A Top-up Tax Percentage for a jurisdiction is computed by subtracting the ETR from the 15 percent minimum rate. An Excess Profit amount is also computed by taking the Net GloBE Income for the jurisdiction and subtracting the Substance Based Income Exclusion (a formulaic carve-out based on a percentage of the MNE Group's payroll costs and tangible assets in the jurisdiction). The Top-up Tax Percentage is applied to the Excess Profit to

determine the Jurisdictional Top-up Tax, following any adjustment for Domestic Top-up Tax paid (i.e. under a DMT).

**Chapter 6 – Restructurings and Holding Structure**

There are special rules in Chapter 6 relating to acquisitions, disposals and joint ventures (including merger and demerger transactions).

**Chapter 7 – Tax Neutrality and Distribution Regimes**

Chapter 7 deals with the application of the GloBE rules to tax neutrality and other distribution regimes.

**Chapter 8 – Administration**

The administrative aspects of the GloBE rules are included in Chapter 8. This includes the filing of the GIR.

**Chapter 9 – Transition Rules**

Chapter 9 sets out certain transitional rules. For example, it includes rules that apply where an MNE Group enters with the scope of the GloBE Rules.

**Chapter 10 – Definitions**

Chapter 10 sets out the defined terms of the GloBE rules.

# Contact us


**Peter Oliver**
**Partner – International Tax**
KPMG Sydney
+ 61 (2) 9455 9520
E: peteroliver@kpmg.com.au

**Alia Lum**
**Partner, Australian Tax Centre**
KPMG Sydney
T: +61 2 9335 8332
E: alum@kpmg.com.au

**Denis Larkin**
**Partner, International Tax**
KPMG Sydney
T: +61 2 9335 7171
E: dlarkin@kpmg.com.au

**Amanda Maguire**
**Director, Australian Tax Centre**
KPMG Sydney
+ 61 2 9335 8348
amaguire@kpmg.com.au


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