24 January 2025

Australian Pillar Two legislation now effective

With the registration of the Pillar Two subordinate legislation on 23 December 2024, the full package of legislation implementing the Pillar Two Global Anti-Base Erosion (**GloBE**) rules in Australia now has legal effect. This may trigger new current tax disclosures for financial statements.

Overview

To recap, the Australian GloBE rules include the following:

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

Further background to the Australian Pillar Two rules as well as a brief outline of the OECD Model GloBE Rules (**Model Rules**) is set out at **Appendix 1**.

The recent legislative developments are as follows:

- the 'primary' legislation which implements the Pillar Two Global Anti-Base Erosion (**GloBE**) rules in Australia received Royal Assent (i.e. enactment) on 10 December 2024. The primary legislation includes:
  - an **Assessment Act** which implements the framework for imposition of top-up tax under the Australian GloBE rules;
  - an **Imposition Act** which imposes the top-up tax payable under the Australian GloBE rules; and
  - a **Consequential amendments Act** which makes consequential and miscellaneous amendments to the Australian tax laws;
- the 'subordinate' or 'secondary' legislation was registered on 23 December 2024 and commenced on 24 December 2024). The subordinate legislation includes the

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detailed operational Australian Pillar Two rules. The subordinate legislation is in force but subject to a disallowance period outlined further in Appendix 1.

Together, the primary and subordinate legislation total over 280 pages of provisions, with over 450 pages of accompanying explanatory materials.

We outline key features of the Australian Pillar Two legislation below.

1 Assessment legislation

The assessment legislation establishes the liability and framework of the Australian GloBE rules (i.e. broadly, Chapter 1, part of Chapter 2 and Chapter 10).

The Australian GloBE rules are implemented as a new stand-alone tax law that imposes and assesses top-up tax under the IIR, DMT and UTPR.

The legislation states that the interpretation of the rules is to be in a manner consistent with the Model Rules, Model Commentary, Agreed Administrative Guidance (**AG**), 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 legislation has application outside Australia and extends to acts, omissions, matters and things outside Australia. This is relevant to the joint and several (**J&S**) liability of Constituent Entities (**CEs**) of a Multinational Enterprise (**MNE**) Group (see below at 3.1).

2 Secondary legislation

2.1 Income Inclusion Rule

The IIR imposes top-up tax on a Parent Entity of an MNE Group located in Australia, generally, the Ultimate Parent Entity (**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 effective tax rate (**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.

An important interaction issue is the operation of the Australian GloBE rules in the context of the Australian tax consolidation rules. Guidance has now been provided to clarify certain matters. In relation to the application of Article 6.2.2 which treats the acquisition or disposal of Controlling Interests as an acquisition or disposal of the assets and liabilities of the target (the Australian equivalent provision is section 6-50), the explanatory statement to the secondary legislation (**ES**) now confirms that this provision applies where there is a transfer of Ownership Interests which results in an 'exit' from an existing tax consolidated group (**TCG**) and an 'entry' into another TCG. However, where there is an 'exit' but there is no 'entry' into another TCG, the rules under section 6-50 are not applicable.

In relation to Article 6.3.4 (Australian equivalent is section 6-70), the fair value adjustment election can be made by a CE that is required or permitted to adjust the basis of its assets and liabilities to fair value for tax purposes. The ES confirms that this would include circumstances where:

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- a CE joins or leaves a TCG; or
- a CE is subject to exit tax because of a cross-border re-organisation or change in tax residence.

The guidance also confirms that the election to apply consolidated accounting treatment in Article 3.2.8 (the Australian equivalent provision is section 3-200) is available for multiple entry consolidated (**MEC**) tax groups.

2.2 Domestic Minimum top-up Tax

Under the AG, 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, 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 at 3.3 below in relation to the interactions with the Australian 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 the Australian DMT 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 the Local Financial Accounting Standard Rule, a jurisdiction can opt to use accounts prepared under local accounting standards and in local currency in certain circumstances for QDMTT purposes (and allowing such an option will still satisfy the QDMTT Safe Harbour).

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While the draft Australian DMT rules included the Local Financial Accounting Standard Rule, this has been removed from the final rules. Accordingly, DMT GloBE ETR calculations will generally follow the UPE consolidated financial statement GAAP and reporting currency.

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

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).

The Australian DMT includes a special rule for TCGs, including MEC groups. Under this rule, the head company of the TCG is deemed to be liable for the top-up tax of the group, and the subsidiaries are deemed to have a nil top-up tax amount. This means that the head company will be the only CE responsible for the payment of DMT top-up tax liabilities.

2.3 Undertaxed Profits Rule

The Australian UTPR is structured as an additional top-up tax rather than a denial of tax deductions.

The UTPR applies to CEs of an MNE Group that are located in Australia where an amount of the Total UTPR Top-up Tax is allocated to Australia and considered to be distributed to the CE. The allocation to Australia has regard to the relative number of employees and value of tangible assets located in Australia as compared to other UTPR jurisdictions. This is consistent with the Model Rules.

The distribution to a CE located in Australia is also based on the relative number of employees and value of tangible assets of that CE as compared to the other Australian CEs.

Consistent with the Australian DMT, the UTPR also includes the special rule for TCGs, meaning that the head company of a TCG will be the only CE responsible for the payment of UTPR top-up tax liabilities.

Consistent with the AG, there is a transitional UTPR safe harbour election which applies to fiscal years beginning on or before 31 December 2025 and ending before 31 December 2026 (i.e. FY25 for a 31 December year end and FY26 for a 30 June year-end). This rule operates to deem the UTPR Top-up Tax to be nil for UPE jurisdictions with a corporate income tax that applies at a rate of at least 20 percent.

The UTPR includes the exclusion for MNE Groups in the initial phase of international activity.

3 Consequential amendments legislation

3.1 Joint and Several Liability

The legislation provides for J&S liability of top-up tax related liabilities between all Group Entities of an MNE Group (limited exceptions set out below). This includes both Australian and foreign CEs in an MNE Group, noting the extra-territorial application of the assessment legislation mentioned above.

J&S liability does not apply to the following:

- Excluded Entities (consistent with the Model Rules definition);

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- Group Entities that are prohibited according to the effect of an Australian law from incurring a liability, such as a company in liquidation; and
- Securitisation Entities (noting the Consequential amendments Act was amended in response to feedback received as part of the Senate inquiry in relation to the Act).

No rules have been provided which allow for a Group Entity to leave a MNE Group clear of the group liability (i.e. 'clear exit').

There are also targeted rules which apply obligations and primary liabilities in relation to trusts, partnerships, joint ventures, joint venture subsidiaries and any other entities that prepare financial statements. This includes unincorporated JVs that are liable to pay an amount under the minimum tax rules.

3.2 Compliance and administration

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

3.2.1 Pillar Two returns

Broadly, an Australian CE is required to give a GloBE Information Return (**GIR**), Australian IIR/UTPR Tax Return and DMT Tax 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 Australian IIR/UTPR tax return and DMT tax return are Australian specific returns intended to provide the ATO with additional supplementary information needed to assess and collect the Australian IIR/UTPR and DMT top-up taxes. The ATO is currently consulting on these filings.

Although individual CEs have an obligation to file the Australian returns, the rules include the ability for a Designated Local Entity to file the returns on behalf of the other CEs (e.g. allowing an Australian head company to file on behalf of the Australian group).

The Australian IIR/UTPR tax return and DMT tax return are required to be filed even where there is no top-up tax liability.

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 by the GIR due date.

In addition, where the ATO does not receive the GIR from the foreign government agency, the Commissioner may, by written notice, require that an Australian CE of an MNE Group provide the GIR within 21 days.

3.2.2 Top-up tax payment

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

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3.2.3 Penalties

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

While the OECD's common understanding on transitional penalty relief is acknowledged in the explanatory memorandum (**EM**), the legislation does not explicitly provide for transitional penalty relief (i.e. the ordinary rules in relation to the Commissioner's power to remit penalties apply). The ATO intends to provide guidance on the application of penalties.

3.2.4 Other administrative matters

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 4 years.

In relation to private rulings, the Commissioner may decline to make such a ruling where it would not be reasonable to comply with the application. The EM includes a number of examples including where issuing a ruling would require assumptions to be made on how other jurisdictions apply their respective domestic rules implementing the GloBE Rules and DMT.

There is no requirement under the legislation to register with the ATO for IIR/UTPR and DMT purposes.

3.3 Cross-border tax interactions

The legislation includes several amendments to the Australian income tax laws. The amendments reflect the Federal Government's general policy approach 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.

3.3.1 Controlled foreign company (CFC) rules

The CFC rules are updated to deny a notional allowable deduction for foreign IIR/UTPR top-up tax. The EM states that the amendments ensure a notional allowable deduction will only be allowed for foreign DMT tax.

3.3.2 Foreign income tax offset (FITO) rules

Consistent with above, Australia's foreign tax credit / FITO rules are updated to exclude foreign IIR/UTPR top-up tax from being eligible for a FITO claim (the same applies for FITO claims in respect of foreign top-up tax paid by a CFC in relation to attributable income). The EM states that the amendments ensure a FITO can only be claimed in respect of a foreign DMT tax.

In addition, a novel feature of the legislation is a new integrity rule which broadly denies a FITO in circumstances where the MNE Group is entitled to a benefit in a foreign jurisdiction which effectively compensates or reverses the economic effect of the foreign DMT tax. The rule operates to reduce the amount of foreign DMT claimable as a FITO in respect of any of the following benefits:

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- the amount of a refundable tax credit that is refunded to an entity because the credit exceeds income tax liability;
- consideration received for the transfer of a transferable tax credit to which the entity was entitled in respect of foreign income tax of that jurisdiction;
- cash or cash equivalent amounts recognised as government grants under International Accounting Standard 20 (or a comparable accounting standard applicable under a foreign law); and
- a benefit of a kind specified by the Minister in respect of a specified jurisdiction (noting no such Ministerial determinations have been made as yet).

The EM sets out some examples on how the FITO cap would operate. Under one such example the foreign entity has a $10 corporate tax liability, $5 foreign DMT liability and a $6 government grant – in such a case the FITO would be capped to the $10 corporate tax liability (as the $5 DMT liability is reduced by the $6 cash grant, but not below zero).

3.3.3 Hybrid mismatch rules

The 'subject to foreign income tax' definition is amended to disregard foreign GloBE tax and other foreign minimum tax. The effect of this is that the operation of the hybrid mismatch rules remain unaffected by the payment of foreign top-up tax.

3.3.4 Foreign hybrid rules

These rules are amended to provide that a reference to 'foreign income tax' does not include foreign GloBE tax and other foreign minimum tax. This ensures that tax continues to be appropriately imposed on the relevant partners of the foreign hybrid.

4 KPMG Observations

The Australian GloBE rules should now be considered substantively enacted from the effective date of the secondary legislation, being 24 December 2024. Accordingly, separate Pillar Two current tax disclosures may be required for 31 December 2024 accounts in Australia. In-scope MNE Groups should confirm this position with their auditor and ensure appropriate recognition for their 31 December 2024 financial statements.

The Australian GloBE rules are broadly consistent with the Model Rules. There are some peripheral differences, in particular, the Australian rules include provisions which reflect principles from the AG. The ES helpfully includes conversion tables which provide assistance in identifying the comparable Australian legislative reference to the Model Rules, Commentary and AG (and vice versa).

The OECD has recently confirmed the qualified status of Australia's legislation on a transitional basis. Accordingly, the Australian DMT will be a QDMTT. The OECD will complete a full legislative review of implementing jurisdictions in or after 2026.

To date, some jurisdictions have included J&S liability in their Pillar Two rules, whilst others have not. The J&S of Australian and foreign CEs of an MNE Group is significant and is likely to give rise to tax due diligence and M&A complexities. The approach to J&S liability in Australia is quite different to the approach taken by many other jurisdictions. To date, it would seem that the Netherlands is the only other country to impose J&S liability on foreign CEs and jurisdictions such as Canada and New Zealand allow for the discharge of the J&S liability in certain circumstances.

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While the EM notes that the J&S liability rules ensure that the Commissioner can collect on tax-related debts in an efficient and timely manner, the necessity for the breadth of the liability in the context of a measure that is not estimated to raise large amounts of revenue and is estimated to raise top-up tax through a small amount of MNE Groups (100 inbounds, 40 outbounds) is not readily apparent.

Given the hybrid mismatch rules are unaffected by top-up taxes, there is likely to be effective double tax outcomes for some multinationals who are denied a deduction under the Australian hybrid mismatch rules and also pay GloBE top-up tax in respect of the same payment. This is particularly the case for the hybrid mismatch financing integrity measure, which denies deductions in respect of arrangements involving financing into Australia via an entity located in a no- or low-tax (10 percent or less) jurisdiction.

In relation to the foreign tax credit interactions, there may be issues with claiming a FITO where top-up tax is paid by a CFC under a foreign jurisdiction's DMT on a jurisdictionally blended basis (as there may not be alignment between the attributable income of the CFC and the foreign tax paid under the DMT liability allocation process).

As more refundable tax credit regimes emerge across the world to replace existing tax incentives that are neutralised by the global minimum tax rules, it will be important for outbound groups to assess the overall impact to the group of claiming new replacement incentives where they result in the loss of an entitlement to a FITO, as well as assessing on a more general basis how the payment of foreign DMT by their CFCs may impact their FITO position. The inclusion of consideration received for transferrable tax credits is likely to capture certain incentives provided under the US Inflation Reduction Act.

In relation to interactions between the Australian GloBE rules and the Australian tax consolidation rules, guidance has now been provided on a few key issues relating to Chapter 6, which is welcomed. However, from an M&A perspective it is important to note that the application Article 6.2.2 to the acquisition of a target will give rise to potentially significantly different GloBE consequences depending on the tax profile of the vendor.

From a tax compliance perspective, the Australian rules do not include a once-off requirement for in-scope MNE Group's to provide a registration notification (unlike other jurisdictions such as Belgium and the UK). As such, there is no immediate compliance deadline to adhere to.

Given the Australian Pillar Two rules are now implemented and the rules are already in effect, multinationals will need to ramp up preparedness for these measures over the coming months. This includes accounting disclosures, data gap resolution, stakeholder engagement and business planning.

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Appendix 1

5 Background to Australian rules

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 ETR.

The GloBE rules generally apply to CEs that are members of a 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 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.

After undertaking public consultation in March 2024 in relation to the draft primary and secondary legislation, the primary legislation was introduced on 4 July 2024. The bills were referred to the Federation Chamber on 22 August 2024 before moving to the Senate. The bills were also referred to the Senate Economics Legislation Committee which reported on 14 August 2024, recommending that the bills be passed.

The bills were passed by the Senate on 26 November 2024, including a Government amendment to preclude Securitisation Entities from being J&S liable for top-up tax liabilities of other Group Entities of the MNE Group. The House of Representatives approved the amendment on 27 November 2024 and hence the bills passed both Houses of Parliament on that date. The legislation received Royal Assent on 10 December 2024, meaning the primary legislation is enacted as at that date.

The secondary legislation was registered on 23 December 2024. It has legal effect from the date after registration, being 24 December 2024 and so is now in force. However, it must be tabled with Parliament within six parliamentary sitting days after registration (which would be between 4 - 13 February 2025) and then will be subject to a disallowance period of 15 parliamentary sitting days (likely to occur in mid to late May). Depending on when Australia's next federal election is called, this timeline may be pushed out further, as Parliament would not sit again until after the election. Although it is unusual for secondary legislation to be subject to disallowance, it is worth noting that the end of the disallowance period may occur after the next election.

The ATO is currently progressing the administrative aspects of implementation of the Pillar Two rules, including design of the tax filings and public guidance.

6 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.

6.1 Chapter 1 – Scope

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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.

6.2 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.

6.3 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.

6.4 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.

6.5 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).

6.6 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).

6.7 Chapter 7 – Tax Neutrality and Distribution Regimes

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

6.8 Chapter 8 – Administration

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

6.9 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.

6.10 Chapter 10 – Definitions

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

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Contact us

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

Peter Oliver
Partner, International Tax
KPMG Sydney
T: +61 2 9455 9520
E: peteroliver@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
T: + 61 2 9335 8348
E: amaguire@kpmg.com.au

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