January 2025

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Tax Alert

Pillar Two Rules now in force in Australia

At a glance

- Australia has implemented the Pillar Two global and domestic minimum tax rules into domestic law.
- The Australian Pillar Two rules apply to MNE Groups with consolidated annual revenue of at least EUR 750 million in at least two of the four fiscal years immediately preceding the test year, in line with the OECD Model Rules.
- The Pillar Two rules have retrospective application to fiscal years starting on or after from 1 January 2024.
- In-scope groups need to prepare for the financial reporting and compliance obligations that will be required under the new domestic and global minimum tax.
- How EY can help.

The Australian Government registered the *Taxation Multinational Global and Domestic Minimum Tax Rules* (the Rules) on 23 December 2024. This follows the enactment of the primary legislation which received Royal Assent on 10 December 2024. This finalises the implementation of the OECD's Pillar Two global minimum tax solution in Australia. In-scope groups need to prepare for the financial reporting and compliance obligations that will be required because of this new law, including disclosures that may be required in the 31 December 2024 interim or annual financial statements.

The registration of the Rules follows public consultation of the Exposure Draft of the Rules (ED Rules) between March 2024 to May 2024. The Rules commence the day after they are registered, being 24 December 2024 and have retrospective application to fiscal years starting on or after 1 January 2024.

The Rules are largely in line with the OECD Model Rules. However, there have been some important changes made in the Rules as compared to the ED Rules, most notably the removal of the requirement to use local financial accounts for the purposes of calculating the Australian Domestic Minimum Tax (DMT) top-up tax liability. This Tax Alert sets out details of this change, along with other important changes in the final Rules.

Final Australian Pillar Two framework

Australia's Pillar Two rules apply to multinational enterprise groups (MNE Groups) with consolidated annual revenue of at least EUR 750 million in at least two of the four fiscal years immediately preceding the test year, which is in line with the OECD Model Rules.

The final Australian Pillar Two rules consist of the following primary and subordinate legislation:

- *Taxation (Multinational – Global and Domestic Minimum Tax) Act 2024* (Assessment Act)
- *Treasury Laws Amendment (Multinational – Global and Domestic Minimum Tax) (Consequential) Act 2024* (Consequential Act)
- *Taxation (Multinational – Global and Domestic Minimum Tax) Imposition Act 2024* (Imposition Act)
- *Taxation (Multinational Global and Domestic Minimum Tax) Rules 2024 (the Rules).*

The final legislation implements:

- A DMT with retrospective application to fiscal years starting on or after 1 January 2024
- A global minimum tax by imposing top-up tax through an Income Inclusion Rule (IIR) with retrospective application to fiscal years starting on or after 1 January 2024
- An Undertaxed Profits Rule (UTPR), applying to fiscal years starting on or after 1 January 2025
- Consequential amendments that facilitate the administration of the top-up tax, including the preparation of new returns and notifications for filing in Australia for in-scope MNE Groups.

The Rules comprise the key operative aspects in line with the OECD Model Rules, including Transitional CbCR Safe Harbour, the Transitional UTPR Safe Harbour and the qualified domestic minimum top-up tax (QDMTT) Safe Harbour. The Rules are made as a Legislative Instrument, which is a form of subordinate legislation, to allow the Government to make changes to the Rules quickly and efficiently, in response to new OECD Administrative Guidance to ensure the Rules are maintained and updated, and that Australia's Pillar Two Rules remain qualified.

Certain parts of the OECD Administrative Guidance have not yet been incorporated in the final Rules, such as the recognition of deemed deferred tax where there are divergences in the GloBE and accounting carrying values, the simplification approach for applying the DTL Recapture Rule on a FIFO/LIFO basis and the additional guidance on the allocation of profits and taxes in structures including flow-through entities. It is expected that this guidance should be incorporated into the Rules in due course and may have retrospective application to maintain qualified status at the OECD level.

Given the Rules are a Legislative Instrument, the Rules must be tabled in each House of Parliament, within 6 sitting days of registration. The Rules are then subject to a disallowance period of at least 15 sitting days in each House, where disallowance motions may be raised by Members or Senators.

Financial reporting implications

On the basis that the Australian Pillar Two law is considered 'substantively enacted' for AASB and IFRS purposes as at 31 December 2024, in-scope groups need to prepare for the financial reporting obligations that will be required under Pillar Two in any 31 December 2024 interim or annual reports. This should include undertaking a detailed assessment of the potential impact of Pillar Two to determine what disclosures will need to be made.

In accordance with *AASB 2023-2 Amendments to Australian Accounting Standards – International Tax Reform — Pillar Two Model Rules* (the Amendments) issued by the Australian Accounting Standards Board, these disclosures in annual reports include details relating to:

- The mandatory temporary exception to the accounting for deferred taxes arising from Pillar Two
- Disclosure of its current tax expense (income) related to Pillar Two income taxes in periods when the Pillar Two legislation is effective.

Key changes in the final Rules

Removal of local financial accounting standard and the local currency rules

Under the ED Rules, the local financial accounting standard and the local currency rules required the Australian DMT calculations to be performed based on financial accounts prepared in accordance with the accounting standards within the meaning of the Corporations Act 2001 and in AUD, provided certain conditions were met. These rules have both been removed in the final Rules.

The removal of these rules means that the default position under the GloBE Rules applies for Australian DMT purposes, meaning that the DMT calculations should be performed based on the MNE Group's Consolidated Financial Statements which are prepared based on the financial accounting standard of the Ultimate Parent Entity (UPE) and in the presentation currency of these Consolidated Financial Statements.

Reallocation of final withholding tax on distributions

The ED Rules did not provide for the reallocation of withholding tax on distributions for QDMTT purposes. This has been changed in the final Rules due to the inclusion of new Section 2-35(6)(d) which permits that an amount of Covered Taxes that is an amount in respect of 'Australian final withholding tax' can be allocated to Australia (the jurisdiction of the distributing Constituent Entity) for DMT purposes. However, this rule is limited to 'final' WHT only such that there would be no allocation of non-final WHT remitted in Australia for Australian DMT purposes. This would remain a Covered Tax of the jurisdiction of the receiving Constituent Entity.

For completeness, there is no reallocation of Covered Tax in relation to Permanent Establishments, Tax Transparent Entities, Controlled Foreign Companies (CFCs) or Hybrid Entities for Australian DMT purposes under the final Rules, in line with the OECD Administrative Guidance.

UTPR application and Transitional UTPR Safe Harbour

The UTPR is applicable under the Australian Pillar Two Rules for fiscal years starting on or after 1 January 2025.

The final Rules include provisions for computation and allocation of the UTPR, including a transitional exclusion for MNE Groups in initial phases of international activities.

In addition, the final Rules include an annual election to apply a Transitional UTPR Safe Harbour for the UPE jurisdiction that applies to fiscal year starting on or before 31 December 2025 and ending before 31 December 2026. Under the Transitional UTPR Safe Harbour, the UTPR top-up tax amount of each entity (including a joint venture (JV) and JV subsidiary as defined in the Rules) that is located in the jurisdiction of the UPE will be deemed to be zero if the UPE jurisdiction has a corporate income tax rate of at least 20 per cent.

An MNE Group that qualifies for both the Transitional CbCR Safe Harbour and the Transitional UTPR Safe Harbour has an option to choose which safe harbour to apply for the UPE jurisdiction.

Tax consolidated groups and multiple entry consolidated (MEC) groups

The final Rules includes special rules for allocating domestic top-up tax amounts and UTPR top-up tax amounts to Constituent Entities that are part of an Applicable MNE Group located in Australia and are subsidiaries of an Australian Tax Consolidated Group (TCG) or MEC Group.

If a Constituent Entity has an amount of domestic top-up tax or UTPR top-up tax amount and is a subsidiary member of a TCG or MEC, the Head Company (in accordance with the definition in *the Income Tax Assessment Act 1997* (ITAA 1997)) will be liable to pay the top-up tax amount. The Constituent Entity will not have any top-up tax liability, as the entire top-up tax amount will be allocated to the Head Company. In accordance with the Explanatory Statement, this is required to preserve the ordinary operation of a TCG or MEC Group being treated as a single entity for Australian taxation purposes, with the head company being responsible for the payment of tax liabilities.

The Explanatory Statement states that a MNE Group that has Constituent Entities in a TCG may elect for those Constituent Entities to be treated as a single Constituent Entity for the purposes of reporting domestic top-up tax amounts in the GloBE Information Return (GIR), provided certain conditions are met. This aggregated reporting election does not appear to extend to MEC Groups. However, this election is only referenced in the Explanatory Statement and does not currently appear to be included in the final Rules themselves.

These special rules outlined above for TCGs and MEC Groups does not impact the requirement for a domestic top-up tax amount and UTPR top-up tax amount to be calculated on an entity-by-entity basis for each separate Australian Constituent Entity, nor do they appear to impact the joint and several liability of subsidiary members or remove the requirement to file a separate DMT Return (or Australian IIR/UTPR Return) for each Constituent Entity.

There is no clarification included in the final Rules as to the interaction with Australia's tax consolidation rules specifically in relation to the tax cost resetting on the formation, joining or exit from an Australian Tax TCG under Division 705 and Division 711 of the ITAA 1997.

Securitisation vehicles

New definitions were included in the Rules to cover securitisation vehicles, aligning with the fourth tranche of OECD Administrative Guidance released in June 2024. The final Rules exclude a securitisation entity from being liable to any amounts of IIR, UTPR or domestic top-up tax, unless all the Australian Constituent Entities are securitisation entities. The definition of a securitisation entity in the final Rules aligns with the meaning in Section 820-39 of the ITAA 1997.

A new Section 128-35 was added to exclude a securitisation entity from the joint and several liability provisions in Sections 128-5 and 128-10 of the Taxation Administration Act 1953 (TAA 1953).

Rule to deny FITO for domestic minimum tax paid in foreign jurisdictions now enacted

As set out in our previous July 2024 Tax Alert, the Consequential Act introduced a new Section 770-145 in the ITAA 1997 to target future jurisdictional responses to global and DMT rules designed to compensate MNE Groups for the imposition of top-up tax, such as where a foreign jurisdiction implements a DMT but to maintain its competitiveness, effectively redirect the additional tax revenue back to the relevant MNE Groups through government grants, credits, or other incentives.

The new Section 770-145 provides that an entity will be denied a foreign income tax offset (FITO) for 'foreign DMT tax' paid where it (or another group or JV entity) is entitled to either:

- A refundable tax credit which is computed as an excess over the entity's income tax liability
- Consideration for the transfer of a transferable tax credit
- Cash or cash equivalent amounts recognised as government grants
- A benefit of a kind specified by the Minister (by way of legislative instrument) in respect of a specified jurisdiction.

Importantly, the definition of 'foreign DMT tax' includes tax that is payable under a foreign QDMTT. This means that a FITO may be denied for taxes paid under a foreign QDMTT that has been certified as qualified by the OECD Peer Review process where one or more of the above criteria is satisfied.

ATO consultation and administration

As set out in our previous December 2024 Tax Alert, the Australian Taxation Office (ATO) has formed a special purpose working group and is continuing to seek feedback on the administrative aspects of the implementation of the Pillar Two measures.

The ATO has been working on the design of the Australian DMT Return (DMTR) and the Australian IIR/UTPR Return (AIUTR), along with the foreign lodgement notification form which will be required to be completed to notify that the GIR has been lodged in a foreign jurisdiction. The ATO intends for the DMTR, the AIUTR and the foreign lodgement notification form to be combined into a single return. Each Australian Constituent Entity is required to lodge:

- An AIUTR where they have an Australian IIR/UTPR tax amount, including a nil amount
- A DMTR where they have an Australian DMT tax amount, including a nil amount.

Implications and next steps

The registration of the Rules represents a significant milestone and the final step in Australia's implementation of the OECD's Pillar Two global minimum tax solution. This brings Australia in line with the other 45 jurisdictions that have enacted Pillar Two in their domestic legislation.

Australian-based MNE Groups and foreign groups with a presence in Australia need to move quickly to finalise their Pillar Two impact assessments and commence work on implementation projects to meet the new financial reporting and compliance obligations.

How EY can help

Our EY Team of BEPS Pillar Two advisors can support you with:

- Understanding the financial reporting for full year or interim financial statements.
- Preparing for the new compliance obligations, including the preparation and filing of the GloBE Information Return, foreign lodgement notification, Australian IIR / UTPR Tax Return and DMT Returns.
- Current-state assessment of data availability, systems and processes and assistance with software implementation and process redesign.
- Providing technical advice on the Pillar Two rules and the interaction of Pillar Two with Australia's local tax rules.
- Training for your internal tax teams and other key stakeholders.
- Considering any other implications for your commercial arrangements.

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SCORE NO: 000240-25-AUNZ
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