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Treasury Consultation Paper – Global Agreement on Corporate Taxation

Dear Assistant Secretary

Ernst & Young (**EY**) welcomes the opportunity to respond to Treasury's Global Agreement on Corporate Taxation consultation (**Consultation Paper**).

We are supportive of the adoption of the GloBE/Pillar Two Model Rules into the Australian tax system. The adoption by other countries of the Global Pillar Two regime, in particular, the IIR and UTPR, will mean that were Australia not to adopt the rules, there is a risk of tax leakage to other jurisdictions which have implemented the rules. Logically therefore Australia should adopt the rules to ensure tax revenue does not unnecessarily leak offshore.

Furthermore, we understand the need to adopt the rules given the Australian Government's clear political commitment to the OECD BEPS process. Reputationally, Australia needs to be seen to be doing its part to address international tax planning issues.

As an overall comment, given that Australian companies are not expected to pay significant amounts of Pillar Two taxes since our existing tax framework is already robust by global standards, the primary guiding principle that should be adopted when incorporating the Pillar Two rules into our domestic law is reducing the very high degree of compliance and complexity that is reflected in the OECD Model Rules and Commentary.

Complexity is a major contributor to the compliance burden for businesses and the administrative burden for tax authorities. It creates substantial uncertainty. It also significantly exacerbates the risk of inconsistency across jurisdictions, which in turn increases the likelihood of disputes and double taxation. While there is significant complexity throughout the Model Rules and Commentary, a particularly prominent source of complexity is the use of financial accounting concepts as the starting point for measuring GloBE Income or Loss and Adjusted Covered Taxes combined with the requirement of myriad adjustments to the underlying financial accounting amounts.

These rules then lead to an enormous associated compliance burden including the requirement to prepare financial accounting data at the Constituent Entity level that, in many cases, is not being produced currently in the form that is specified. In addition, the many adjustments to be made would require new computations and maintenance of new data points which are not relevant for any other purpose. Simplifications, detailed guidance and relevant examples on an agreed basis would be extremely valuable in these areas. We amplify this in our detailed submission.

We attach an Appendix with our detailed submission comments in respect to the Consultation Paper.

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Should you have any questions in relation to the above or wish to discuss these matters in further detail, please do not hesitate to contact Tony Merlo (03 8575 6412, tony.merlo@au.ey.com) or Alf Capito (02 8295 6473, alf.capito@au.ey.com).

Yours sincerely

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Appendix – Comments on the Consultation Questions

Design of the two-pillar global agreement

Why a global deal on corporate taxation?

1. What are your views on the challenges facing the international tax system and what role do you see for the two-pillar multilateral solution to the tax challenges arising from digitalisation?

We support the OECD's Inclusive Framework approach in proceeding with a two-pillar multilateral solution to the tax challenges that arise from digitisation and other aspects of the existing international tax framework.

We believe that Pillar One naturally requires further work given the complexities that are inherent in it. However, the work on Pillar Two has been well developed and is in a state where Australia and other countries can proceed to implementation provided each country undertakes adequate and considered consultation in the final legislative design of the law.

2. Do you agree the two-pillar multilateral solution will help make the international tax system fairer?

The concept of fairness in the context of international tax is, by definition, a subjective one depending on whom the tax burden rests, and which countries are entitled to the relevant revenues. Accordingly, we see no useful statement to be made in the context of fairness, but we believe that a two-pillar multilateral solution will deal with many of the conflicting issues that have arisen in an ever-increasing complex and digitised world.

3. What costs and benefits do you see in Australia adopting the two-pillar multilateral solution?

Companies will have to set up systems to administer the two-pillar multilateral solution at significant cost to raise relatively immaterial tax revenues in Australia. However, we expect that implementation of such a solution will give rise to a more stable international tax environment and accordingly, a healthier international trading platform for companies and governments to equally enjoy the economic benefits thereof.

4. What second round global tax system effects might arise, in regard to actions other countries may take that may impact Australian interests?

As has been well documented and evidenced by recent actions, we expect that many countries will enact domestic minimum taxes which will naturally reduce the amount of tax to be collected by other countries arising from a multilateral solution. This may also give rise to a material drop in CFC revenue collected by governments of parent company jurisdictions.

It is also likely that there will be less incentive for a firm to offshore certain activities which would otherwise enjoy low rates of tax in foreign countries under existing rules.

However, countries may continue to redesign existing tax incentives in a manner that is not impacted by the Pillar Two rules.

5. What are the major areas of Pillars One and Two that are likely to generate uncertainty for your business? How could that uncertainty be best addressed?

The primary area that is likely to generate uncertainty is the interpretation by tax administrations of the interaction between Pillar Two rules, domestic tax rules and accounting treatments. There are a number of areas that still remain somewhat unclear and will no doubt be the subject of further elucidation by the OECD in either the GloBE Implementation Framework or elsewhere. As an example, there are a number of "book adjustments" that need to be made to arrive at the GloBE Income for the purposes of the appropriate ETR calculation. We are happy to provide more detailed input on some of our concerns in this regard to Treasury as a separate exercise.

What are the outcomes for the economy?

6. How do you think Pillars One and Two may impact investment decisions in Australia relative to the rest of the world?

At this stage with the uncertainty surrounding the Pillar One rules it is difficult to assess what the implications of these rules will be on investment decisions in Australia. Furthermore, since very few companies are impacted by Pillar One the likely impact on Australian investment is probably minimal.

However, there is likely to be greater impact from the introduction of the Pillar Two rules. At this early stage, it is difficult to estimate the impact that will arise from Pillar Two rules. Firstly, the majority of our Australian based clients that are impacted by these rules do not appear to have, at least at this stage of their computation efforts, concluded that they will be paying any material top-up tax. Second, many of our inbound clients are assessing the impact of top-up tax at the Head Office level and the ramifications of such a tax on inbound investment continue to be far from clear.

Given the novel nature of the Pillar Two rules, there is a risk that the benefit of specific government targeted incentives such as the R&D concession, as currently designed, may be clawed back.

Naturally any erosion of incentives may lead to mobile investments being wound down or transported to countries elsewhere, especially where the Australian tax concession was a key factor in attracting the activity to be performed in Australia in the first place.

For this reason, care needs to be exercised in ensuring that at both Federal and State Government levels, incentives that were designed for the purpose of encouraging investment in Australia are not unintentionally undermined by the introduction of Pillar Two.

7. Do you envision Pillars One and Two incentivising any behavioural changes and/or business restructures over the medium to long term?

It is far too early to determine whether business restructures will occur as a result of the introduction of the two-pillar multilateral solution. However, as mentioned in the response to Question 6, where Pillar Two has the effect of eroding the marginal benefit of conducting activities in Australia, it is likely that these activities will either not occur in Australia, or if they are currently in Australia, they may be wound down and be conducted elsewhere or not at all.

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What are the estimated revenue impacts?

8. Do you agree with the assumption that no Australian headquartered multinational will be in the scope of Amount A, given the current proposed thresholds and exclusions?

Naturally, we cannot make an assessment as to whether no Australian headquartered MNEs will be in the scope of Amount A. However, to our knowledge and based on our client base, it seems that with the various carve outs that have been afforded for Amount A there will be few, if any, companies that will be within scope of Amount A.

How will the global deal be implemented?

9. What challenges do you foresee with the OECD timelines, which have Pillar Two coming into effect in 2023 and Pillar One coming into effect in 2024?

The OECD's timeline for a 2023 calendar year start date presents a number of practical challenges for Australia's implementation of Pillar Two. The Australian Government has commenced the public consultation process for Pillar Two in October 2022. With the Federal Budget delivered on 25 October 2022, the Federal Parliament has a limited number of sitting days before the end of 2022.[1] At the earliest, domestic legislation is likely to be released in early 2023 which will involve a similar public consultation process (of at least 1 month). Tabling of the draft legislation in Parliament will be subject to the Parliamentary sitting schedule, meaning that domestic legislation may not be introduced until some time late in the first half of 2023.

Given the significance of the proposed legislative changes, a mid-year transition would pose issues for many taxpayers who have not prepared their accounting and tax systems for the increased compliance and reporting obligations because:

- Filing and payment obligations have yet to be defined for Pillar Two.
- The financial accounting treatment of Pillar Two taxes and resultant disclosures have yet to be established by the relevant accounting and other bodies.
- Taxpayers do not have visibility of the proposed legislation *prior* to release which means that taxpayers have not been afforded *sufficient time* to design an appropriate system with suitable tax governance and controls to ensure the correct data is being collected and reported.

Our concern is that early adoption of Pillar Two by Australia *before* evidence of US and/or EU implementation will have a negative impact on investment in Australia. This concern would be addressed by aligning Australia's implementation timeline with that of an appropriate critical mass of adopting countries. In this regard, a possible start date of 1 January 2024 (meaning the new rules

[1] Parliament of Australia, Events Calendar, accessed on 10 October 2022 https://www.aph.gov.au/News_and_Events/Events_Calendar/Events_Search_Result#range=yearly&display=calendar&from=2022-01-01&to=2022-12-31&senate=1&house=1&estimates=1&sb=1&sa=1&ss=1&committees=0&sh=0&hh=0&jh=0&sc=0&ir=0&visit=0&tr=0&se=0&ex=0&od=0&general=0&pubhol=0

should apply for income years commencing on or after 1 January 2024) for the proposed rules may be more suitable than the OECD's current timeline.

10. What design features would you like to see within the existing Pillar One and Two frameworks? For example, are there any approaches to implementation which may mitigate implementation challenges?

In respect of the Pillar Two framework, we welcome a constantly updated "whitelist" of jurisdictions which are considered to have implemented an IIR, UTPR and/or Qualified Domestic Minimum Tax (**QDMT**) that meets the international standard and are "qualifying". This would reduce uncertainty and complexity in the administration of, and compliance with the GloBE Model Rules in Australia.

As the OECD Inclusive Framework moves towards finalising the GloBE implementation framework, Australia's Pillar Two framework should provide a mandatory and binding dispute resolution mechanism for multilateral disputes arising from interpretative issues and double taxation cases. The agreement among Inclusive Framework members on the GloBE rules creates a new multilateral system of minimum taxation, which operates in parallel to the domestic tax systems of these jurisdictions (including Australia). It is important that it is clear from the outset that these rules are introduced as a set of globally agreed common rules, with agreed global interpretations and a global, mandatory and binding operating mechanism.

11. What interaction issues could arise between Pillar One and Pillar Two, and other Australian or foreign tax laws? How should these interactions influence the way Australia implements the two-pillar multilateral agreement?

In relation to potential interaction issues between Pillars One and Two, given the limitations on scope on Amount A of Pillar One, the number of Australian outbound MNE Groups that may have potential interactions between Amount A and the GloBE rules is likely to be small. However, many inbound MNE Groups are likely to be in scope of Amount A of Pillar One. In addition, a much broader range of taxpayers (including Australian outbound MNE Groups) may be impacted by Amount B of Pillar One. With this context, the Australian implementation of Pillar Two will need to address a number of issues, including:

- The impact of the final agreed Amount B adjustments should be considered to ensure that there is no mismatch between accounting Globe Income and Loss and taxes paid under any Amount B adjustments.
- The ordering of application of Pillar One and Pillar Two for taxpayers that are subject to both initiatives will need to be considered. It is expected that Amount B (and A) adjustments should be treated as Covered Taxes. Therefore, it will be important to ensure all relevant Pillar One information is available in time for any Pillar Two (or DMT) filings that are due.
- Clarification on which tax rate will apply (for the purposes of determining Covered Taxes in the Pillar Two ETR calculation) if there is a Pillar One Amount A allocation. For example, if an entity has operations in Singapore and has no entity/presence in Australia but derives source revenue in Australia, there is currently no guidance on whether we would use Singapore's ETR or Australia's ETR as the market jurisdiction when calculating ETR under Pillar Two. If Singapore's ETR is used instead of Australia's ETR, this could result in a lower ETR for the purposes of Pillar Two and potentially result in top-up tax.

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- Clarification on whether Australian superannuation funds will qualify as Excluded Entities under Pillar One and Two.

More broadly, in the context of the GloBE Model Rules under Pillar Two, there are many potential interactions with Australia's domestic income tax laws which require careful consideration. Some examples include:

- The Controlled Foreign Company (**CFC**) regime contained in Part X of the *Income Tax Assessment Act 1936* (**ITAA 1936**), which is addressed in more detail at Question 32.
- The hybrid mismatch provisions contained in Division 832 of the *Income Tax Assessment Act 1997* (**ITAA 1997**), which is addressed in more detail at Question 31.
- The franking credit regime, which is addressed at Question 34.
- Foreign Income Tax Offsets (**FITOs**) available under Division 770 of the ITAA 1997, and in particular, whether top-up tax payable under the IIR or UTPR or alternatively, whether tax collected under a QDMT should be treated as a foreign income tax for the purposes of the FITO rules. As a general comment we would expect that this would be the case, irrespective of whether the top-up tax is treated as an extension of income tax under Australian tax law.

12. Are there any other comments or issues you wish to raise in relation to the Pillar One and Two rules that should be considered by Australia in the design and implementation stage?

No additional comments.

What are the compliance costs and impacts on large multinationals?

13. What changes (e.g. to processes or systems) do you anticipate that businesses may be required to make in order to comply with Pillar Two?

Pillar Two is a new compliance obligation which requires businesses to prepare a new set of consolidated calculations and lodge this with the revenue authorities at least annually.

To be prepared for the Pillar Two compliance, businesses will need to undertake the following:

- **Operating model –** The business will need to design and implement an operating model for delivering the ongoing Pillar Two compliance process. This could involve some or a combination of:
  - In-house preparation by the current tax and or other teams (e.g. finance).
  - Use of a shared service centre or an outsourced provider to provide a managed service.

  Other considerations here include whether the process should be centralised or decentralised, who owns the process, who from the business needs to be engaged (e.g. finance, IT, HR, corporate secretarial, M&A) and what hand-offs are required. Given the number of stakeholders involved, there may be a significant change management exercise required and there may need to be new KPIs implemented across functions to ensure this is executed well initially and continues to work well moving forward. This is therefore wider than just a tax project.

- **Define and map data set –** Businesses will need to define a Pillar Two data set containing the data points required for the Pillar Two calculations and revenue authority form disclosures. This data set will need to be mapped to data from existing or possibly changing systems as some businesses are already undertaking system transformation – we have seen many instances of this. Depending on the nature of the business, each data set could contain more than 100 data points. The number of mappings will depend on a number of different systems and can be a significant exercise for complex businesses who operate using different ERPs and different solutions for tax provision and tax return calculations across jurisdictions. Given the very technical nature of the data points, the business will generally need assistance from an advisor to help understand what the data points are asking for and to help refine and review this data set to ensure the right information is being collected.
- **Define and implement a data collection process –** Businesses need to determine how the data is going to be collected both for the initial modelling exercise and on an ongoing basis. Where there are gaps in the data, tax will need to engage with IT, finance and other functions to create the data. They will need to work with different functions to map out the data collection process to ensure it is efficient and has strong governance to allow reliance on the data. Where the data collection requires manual intervention, there should be a roadmap to automate the collection of this data. This exercise will be required regardless of the operating model selected as the business will need an efficient way to collect data. For the initial modelling exercise, many organisations will most likely collect data in spreadsheets or in a data collection solution provided by an advisor. For the ongoing data collection, modifications to a number of finance and tax systems may be required to transform and automate the data collection. If the organisation is using spreadsheets to prepare their tax accounting or other relevant calculations, there may be significant changes to this process required to create efficiency. The extent of the change required will depend on the complexity in their technology ecosystem and the number of systems containing the data. Many organisations use different systems in different jurisdictions. Common systems which may be impacted include – ERP, Consolidation system, data repository (e.g. data lake, data warehouse), in-house spreadsheets, 3rd party direct tax compliance solutions and others.
- **Implement a solution for initial modelling –** Depending on the timing of the Pillar Two modelling, the business may require an interim solution to conduct modelling while they are selecting their technology solution for ongoing compliance, or they may outsource this modelling work to a provider.
- **Implement a solution for ongoing compliance** – Where the business wants to prepare the Pillar Two calculations in-house, they will need to implement a solution for preparing the Pillar Two calculations and managing the compliance process. There are a number of options here including bespoke on-premises build, license a solution (SaaS or on premise) from a 3rd party vendor. Note many of these offerings are still in early stages of development.

14. Do you have any suggestions relating to implementation of Pillar Two that could help minimise your compliance costs?

As an overall comment, given that Australian companies are not expected to pay significant amounts of Pillar Two taxes since our existing tax framework is already robust by global standards, the primary guiding principle that should be adopted when incorporating the OECD GloBE Model Rules into our

domestic law is the primary goal of reducing the very high degree of compliance and complexity that is reflected in the OECD Model Rules and Commentary.

Complexity is a major contributor to the compliance burden for businesses and the administrative burden for tax authorities. It creates substantial uncertainty. It also significantly exacerbates the risk of inconsistency across jurisdictions, which in turn increases the likelihood of disputes and double taxation. While there is significant complexity throughout the Model Rules and Commentary, a particularly prominent source of complexity is the use of financial accounting concepts as the starting point for measuring GloBE Income or Loss and Adjusted Covered Taxes combined with the requirement of myriad adjustments to the underlying financial accounting amounts.

These rules then lead to an enormous compliance burden requiring preparation of financial accounting data at the Constituent Entity level that in many cases is not being produced currently in the form that is specified. In addition, the many adjustments to be made would require new computations and maintenance of new data points which are not relevant for any other purpose. Simplifications, detailed guidance and relevant examples on an agreed basis would be extremely valuable in these areas.

The GloBE Implementation Framework will be a critically important Framework with respect to:

- Interpreting the Model Rules and Commentary.
- Establishing uniform compliance requirements and administrative practices.
- Providing mechanisms for ensuring consistency across jurisdictions.
- Preventing and resolving disputes.

Given the central role that it will play, it must be made clear that the GloBE Implementation Framework, including the Agreed Administrative Guidance contained in it, is an integral part of the GloBE package like the Model Rules and Commentary that must be followed by Australia and other jurisdictions that choose to implement Pillar Two. There must be a clear and effective process to ensure that jurisdictions take any action necessary under their legal systems to incorporate all aspects of the GloBE Implementation Framework in their domestic laws or otherwise fully adopt it, with well-defined and appropriate repercussions for any jurisdiction that does not do so. Moreover, it must be clear that these requirements apply with respect to domestic rules adopted by jurisdictions, such as a QDMT.

It is also essential that the GloBE Implementation Framework includes an ongoing process for identifying issues where guidance is needed, providing that guidance, and ensuring that jurisdictions follow such guidance. This process could build on the process that has been used with respect to country-by-country reporting (**CbCR**), under which guidance continues to be updated periodically. Such guidance would help support certainty and harmonised implementation. Where the guidance allows for a flexible approach to a particular matter, it should be complemented with a compilation of individual jurisdiction approaches. Given that the GloBE rules determine tax liabilities, the ongoing process for guidance must be timely and efficient. Moreover, any guidance that represents a change rather than a mere clarification should be applied prospectively, with the potential for the taxpayer to elect retroactive application in appropriate cases.

15. Would a Domestic Minimum Tax in Australia add to, or alternatively, mitigate the compliance costs of implementing the GloBE Model Rules?

If a QDMT is adopted into Australian tax legislation, it should only operate as a defensive rule. That is, the DMT should only operate to protect Australia's tax base against the operation of IIRs or UTPRs of foreign jurisdictions.

To streamline compliance with Pillar Two, we recommend that the approach to filing for a potential DMT in Australia is consistent with the approach to filing the GloBE Information Return in the UPE jurisdiction. Otherwise, there could be a situation where the UPE files the GloBE return in the UPE jurisdiction and a Constituent Entity based in Australia may be required to file separately in respect of a DMT applied locally, creating additional layers of compliance.

16. If any of your related companies is a resident in a jurisdiction that does adopt the Global anti-Base Erosion (GloBE) Model Rules, do you consider that your compliance burden will be largely the same whether or not Australia adopts these rules?

In general, we anticipate that MNE groups will have a significantly increased compliance burden as a result of the adoption of the GloBE Model Rules. We do not believe the overall compliance will be impacted by one country adopting GloBE and Australia not adopting, as MNE groups with an Australian presence will still be required to perform the relevant analysis and calculations regardless. The compliance burden is likely to be higher where jurisdictions, including Australia, adopt a QDMT as we anticipate this would require local filing in those jurisdictions.

Australian implementation of the GloBE Model Rules

Mode of implementations

17. Do you have any comments on how Australia should implement the GloBE Model Rules into domestic law?

The GloBE Model Rules should be implemented into domestic law in a manner which ensures consistency with the rules and work compatibly with the domestic law, whether that is by way of incorporation into existing legislation or by inclusion in a separate taxing Act.

As a member of the Inclusive Framework, Australia has committed to the GloBE Model Rules and therefore will implement the rules into the domestic framework. However, there will be several considerations when implementing into domestic law, only one of which is whether the laws are in a separate Act or not.

Given the GloBE Model Rules are considered to be tax rules, we consider it will be important to keep the legislation broadly aligned to existing tax legislation. Regardless of whether the rules are implemented in a separate Act or not, the relevant legislation should conform to existing tax legislation style and drafting. That is, the laws should be principle-based legislation which is clear and supported by explanatory memoranda. The GloBE Model Rules themselves can be incorporated by specific reference to the OECD rules so that there is no doubt that the law is designed to be an implementation of those rules in a manner which directly reflects those rules. But we suspect the

difference between the OECD drafting compared to the typical drafting embodied in our legislation may present problems, leading to uncertainty.

One factor which may be decisive in determining whether a separate Act is required, is whether any tax to be paid under the GloBE Model Rules is considered to be an 'income tax' as defined in the Tax Acts.

One of the key features of Australia's tax system is that we have a system based on self-assessment. It will be important to determine whether the basis of the GloBE Model Rules will be one of self-assessment as well. This will be determinative for when the Commissioner of Taxation comes to administer the legislative rules and the processes which he will establish in order to do so. To the extent that existing and established processes can be utilised, familiarity with these exist both with the administrator and with organisations who need to comply with the rules. Given the complexity of the rules, familiarity with the existing processes may alleviate some compliance concerns. The self-assessment position may also assist in determining how the GloBE return is treated by MNEs and the Commissioner alike.

Another key consideration will be whether the GloBE Model Rules are subject to the general machinery of the current features of domestic tax law. In addition to the self-assessment basis of the rules, this will include whether the same tax administration system will apply, such as the lodgement process, penalty regime, review rights and appeal processes, to name a few. Again, there is familiarity with these existing processes by both MNEs and the Commissioner. However, as the rules are global rules, there may need to be:

- Some modifications to the lodgement and payment processes which may not seamlessly operate for GloBE returns and the format of those returns (including the information requirements).
- Consideration given to the interaction of the penalty regime, particularly the SGE penalty regime, to the GloBE rules and whether any penalty regime is required at all, given the policy intent and purpose of the Model Rules.
- Consideration given to whether the general anti-avoidance rules in Part IVA of the *Income Tax Assessment Act 1936* (Cth) and other anti-avoidance measures are required given the potential unintended consequences of applying unilateral anti-avoidance rules to a global model of rules which operates on the basis of global consensus.

Given the complexity of the rules, and the Parliamentary process of law reform, consideration should also be given to providing the Commissioner of Taxation with a limited regulation making power which would allow him to make regulations where the GloBE Model Rules change by way of Inclusive Framework consensus. This would provide flexibility of approach for any changes, noting that Parliament could (and should) retain the rights over any significant changes.

Timing of implementation

18. Do you agree that the GloBE Model Rules should apply in Australia for fiscal years commencing on or after a specific date?

Please refer to our response to Question 9.

19. Do you have any comments on Australia's timing of adoption of the GloBE Model Rules, including any advantages or disadvantages of being an early/late adopter? What challenges do you foresee if the GloBE Model Rules were to commence in 2023 as proposed under the OECD timeline?

Further to our comments in Question 9, if Australia were an early adopter of the GloBE Model Rules, Australian headquartered MNE groups would be subject to an obligation to pay top-up tax in respect of an IIR and/or a DMT and be required to undertake additional compliance processes earlier than rest of world competitors, placing these MNE groups at a competitive disadvantage.

Our concern is that early implementation by Australia before evidence of implementation by a critical mass of countries will have a negative impact on investment into Australia. With the OECD Inclusive Framework still to finalise the GloBE Implementation Framework and many countries looking to implement the GloBE Model Rules in 2024, a 2023 start date would also mean that Australia does not have the benefit of insights into practical issues encountered by other tax administrations in administering the rules.

Readiness for implementation

20. We would like to understand your readiness for complying with GloBE Model Rules. Do you have any comments on the skills and capabilities of your responsible staff and advisers in undertaking the calculations and applying the GloBE Model Rules?

We have run a number of workshops around the practical aspects of complying with Pillar Two and the majority of businesses are not currently ready to comply with the rules. Despite the OECD releasing their final guidance in January 2022, many businesses have been waiting for the rules to be finalised. Most businesses are looking for more certainty around timing of the rules coming into effect and a better understanding of how the tax will be administered before kicking off a Pillar Two readiness project. Most businesses have at least one staff member with a high-level understanding of the rules, and some have commenced a degree of high-level modelling to understand the potential impact of Pillar Two.

Most businesses we have spoken to believe they have staff in the tax team with the skills and technical capabilities to understand the rules and undertake the calculation but in most cases, the staff have not had capacity to come up to speed with the GloBE Model Rules as yet given their existing compliance obligations. Some businesses believe they will need to increase their staff's capabilities around tax accounting. There will also need to be an education process for those outside the tax team (primarily finance) who will be responsible for collecting the Pillar Two data.

21. Do you have any comments on the timeframes that may be required to implement the required system and reporting changes for your business in undertaking the calculations and applying the GloBE Model Rules?

The timeframes will vary according to the complexity of the organisation and the availability of resources and any constraints such as blackout periods for system changes, however on average we would expect that this is a 12 to 18 month project given the volume of data and the potential number of systems involved.

22. Are there any remaining uncertainties or issues regarding Australia's adoption of the GloBE Model Rules, including but not limited to the computation of GloBE income, adjusted covered taxes, and the transitional rules, which requires further clarification?

Treatment of specific Australian taxes

The Australian legislation should provide clarity on which specific Australian taxes should be considered Covered Taxes for the purposes of the GloBE Model Rules, including in particular whether the following should be considered Covered Taxes:

- Diverted Profits Tax (**DPT**) charge arising pursuant to Part IVA of the ITAA 1936.
- Petroleum Resource Rent Tax (**PRRT**).
- Tax charges imposed on ship-owners and charterers under section 129 of the ITAA 1936.
- Tax charges imposed on agents of non-resident insurers.
- Withholding taxes imposed on payments made to non-resident insurers.
- Non-resident capital gain withholding.

Consolidation accounting

The OECD Commentary on Article 3.1.2 explicitly addresses the examples of the effects of purchase price accounting, or the elimination of profits or losses generated in intragroup transactions, stating that these particular pure consolidation adjustments should be excluded from Financial Accounting Net Income or Loss. However, on other items the OECD Commentary says (Article 3.1, paragraph 3):

> *"Items of income and expense, other than those attributable to purchase accounting, that are reflected in the consolidated accounts, rather than a Constituent Entity's separate accounts,* ***may be taken into account*** *in computing the Constituent Entity's Financial Accounting Net Income or Loss and GloBE Income or Loss only to the extent they can be reliably and consistently traced to the relevant Entity (e.g. stock-based compensation)."*

There are a number of circumstances where uncertainty may arise on the interaction between consolidation level accounting and local accounts in the context of the above commentary. We would welcome the opportunity to discuss these in more detail, however as a general comment it will be important that clarity is obtained on the circumstances where this clause could be applicable.

Foreign exchange

One of the more computationally intense and potentially material issues for companies to navigate will be the treatment of foreign exchange and Article 3.2.1. We consider that it will be important that the scope and application of "*Asymmetric foreign currency gains or losses*" be tested and explained clearly through examples in the Australian domestic implementation and integrated with Australia's functional currency rules (e.g. the calculation of the ETR in the currency of the local entity and then translated at the relevant rate of the ultimate parent).

Deferred tax liability treatment under Article 4.4.4 and recapture exception accruals

We are concerned with two aspects of the deferred tax liability mechanism under Article 4.4.4 and 4.4.5:

- Many Australian taxpayers in the services, engineering and construction industry may be adversely impacted by deferred tax liabilities arising on long term (greater than 5 year) contracts that are treated as work in progress and therefore do not qualify for the recapture exception accrual under Article 4.4.5. We would hope that the Australian law would accommodate flexibility to ensure that such deferred tax liabilities do qualify for the recapture exception accrual.
- There is also related uncertainty in relation to how to measure the "deferred tax liability" particularly where there are multiple contracts. There would appear to be a case here for an administrative approach to provide relief, perhaps looking at aggregating contracts, rather than requiring a dissection of deferred tax liabilities arising on individual contracts.

Imposing the Top-up Tax liability

23. If the UTPR is implemented by way of a denial of deductions or other alternative methods, including deemed income, do you have any views on how to allocate a UTPR Top-up Tax liability amongst Australian Constituent Entities?

In this context, there are two key guiding principles that can be observed in the OECD Pillar Two framework:

- Firstly, the UTPR regime incorporates a clear methodology for allocating top-up tax to jurisdictions where there is substance (by way of payroll and tangible asset proxies).
- Secondly, as a general rule, the GloBE rules only seek to allocate top-up tax to jurisdictions where a cash tax payable impact arises (more specifically, in a subsequent year no UTPR allocation is made to a jurisdiction where there was no cash tax impact in the prior year).

Broadly, we consider it logical to extend these same principles to the allocation to constituent entities within Australia. That is, to look at each separate Australian tax entity effectively as a separate "jurisdiction" when applying the above two principles to the allocation of a UTPR across the constituent entities in Australia.

There would however be some separate considerations required in applying such a framework, including:

- Consideration may need to be made to providing some exceptions and adjustments where Australian entities (such as employing entities or asset-owning entities) service other Australian entities that are separate taxpayers for Australian income tax purposes and therefore attract an inappropriately high UTPR liability.
- Constituent entities that are themselves members of a single consolidated or MEC group would be treated as a single taxpayer under such a methodology when determining how much of the Australian UTPR should be allocated to separate taxpayers in Australia.
- Where a consolidated or MEC group is allocated a UTPR liability, consideration should be given to implementing an approach similar to the tax sharing agreement methodology for the UTPR. This is discussed in further detail in our response to Question 25 below.
- In relation to UTPR allocated to entities with tax losses an approach under Article 2.6.3 could be applied, whereby in the subsequent year no allocation is made to that entity. For the prior

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year however where there is a UTPR allocated to that entity consideration could be given reducing the tax loss to reflect the UTPR.

As a potential alternative approach, UTPR top-up tax liabilities could be allocated to separate tax entities in proportion to their taxable income. This would have the result that Australian Constituent Entities with no taxable income would not be allocated any UTPR top-up tax liability. However, this approach could be open to criticism based on questions of fairness, particular where an entity with no taxable income has substance in Australia (and thereby effectively contributed to the allocation of the top-up tax liability to Australia).

24. Do you have any views or comments on how the adjustments should apply in years where Constituent Entities are in losses or have insufficient deductions?

Please refer to our response to Question 23 above.

25. Do you have any concerns if the Top-up Tax liability was to be joint and several amongst Australian Constituent Entities, whether under the IIR or the UTPR (if implemented by way of a separate tax charge)?

We would suggest that there should be no joint & several liability in relation to separate taxpayers in Australia (as distinct to different constituent entities within a consolidated or MEC group where there would be joint and several liability). In particular, this would be problematic to implement given different taxpayers in Australia may have minority interest holders (where a concept of joint & several liability would be difficult to justify). This would also be further compounded by the possibility those separate taxpayers may have completely independent business units.

Proceeding on the basis that there should be appropriate limits on the joint and several liability of MNE Group members in this regard, it is important to note that Australia already has a well-established framework to deal with these types of issues in an income tax context, being the Tax Sharing Agreement (**TSA**) concept under Division 721 of the ITAA 1997. In principle, we do not see any reason why a similar approach could not be taken in this context.

In particular, a TSA provides a 'reasonable allocation' of the total group income tax liability to each group member. Where such a 'reasonable allocation' is made, and each group member pays their respective allocation of group tax liabilities, they should not be held liable for further group tax liabilities. The adoption of a similar approach to allocating top-up or UTPR tax liabilities to MNE Group members in Australia within an existing consolidated or MEC group would seem logical and important to reduce uncertainties in an M&A context through a clean exit mechanism.

Administrative provisions

26. Are there any particular issues which should be considered in developing the necessary administrative or 'machinery' provisions in Australia's domestic implementation of the GloBE Model Rules?

Please refer to our response to Question 17.

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GloBE Information Return

27. Do you see any issues with a GloBE Information Return that requires disclosure of detailed information supporting the calculation of these steps?

As noted previously, we believe the adoption of GloBE will result in increased compliance burden for MNE groups. As such, we would welcome adoption of a simplified GloBE Information Return that is tied to existing available information (such as audited financial statements, local tax returns and CbCR reports), rather than detailed disclosure of calculations and associated workpapers that are not readily available.

We anticipate that MNE groups will need a significant amount of data for which certain systems need to be in place in order to meet GloBE Information Return requirements. At the same time, tax service providers will also need to implement systems to facilitate preparation and (electronic) filing of GloBE returns. We already anticipate that MNE groups will need to invest significant capital and resources in order to prepare and implement systems necessary to perform the GloBE calculations.

Accordingly, we would welcome early guidance on the ATO's systems for the filing of GloBE returns, in particular the level of detailed information to be included in the return, so that MNE groups can adequately prepare for filing requirements.

We recommend that any local filings should be aligned to the global IIR filing, and specifically we encourage Treasury to consult with other members of the Inclusive Framework to ensure consistent filing obligations for QDMT.

Finally, we would encourage Treasury to provide additional guidance on whether certain safe harbour measures may be implemented either initially or permanently, that would allow MNE groups to adopt simplified filing using pre-existing information (such as CbCR data).

28. Do you have any additional feedback on how the GloBE Information Return could be designed (including on content, filing, and exchange of information requirements)?

As noted in our response to Question 27, we believe a simplified GloBE Information Return, is the best approach, utilising as many existing information and data points as possible to avoid incremental compliance burdens for MNE groups.

Further, as previously noted, the content of the QDMT return should be aligned to the group GloBE Information Return and where each jurisdiction of a group files a QDMT return, so no additional GloBE return should be required.

We would encourage engagement from the ATO and foreign tax authorities that would enable MNE groups to demonstrate compliance via robust processes and controls, instead of the submission of detailed forms and data.

We recommend the GloBE Information Return is filed centrally only (i.e. via UPE jurisdiction) and sharing of the return is undertaken through existing information exchange regimes, with local filing required only as a last resort.

Safe harbours

29. Do you have any comments on possible scope, design, and conditions of access to a safe harbour?

We believe that developing effective safe harbours could be valuable in reducing the compliance and administration burdens of the GloBE Model Rules, significantly reducing (or eliminating) the need for detailed computations required under Pillar Two. In many cases, the top-up tax due by MNE Groups will be minimal, compared to the projected compliance burden without appropriate and effective safe harbours.

It is our view that Treasury should consider implementing (or implement in-line with the OECD/Inclusive Framework), the following safe harbours:

- **Safe harbour for groups that have filed GloBE Returns for multiple years with no top-up tax** - Provide relief from the GloBE Model Rules for a specific number of years (e.g. 3 years) in cases in which the MNE Group has filed GloBE Information Returns for several consecutive years (e.g. 3 years), based on which minimal top-up tax has arisen. Such a measure would reduce the compliance burden for MNE Groups with a history of ETRs at or above the agreed minimum rate, allowing tax administrations to focus on reviewing MNE Groups with lower ETRs. This could be contingent on no significant legislative changes occurring, and no material changes to the MNE Group's operations, reducing compliance burden for MNE Groups with a history of ETRs at or above the agreed minimum rate.
- **Should the OECD/Inclusive Framework publish a 'whitelist' of jurisdictions that are considered not to be below an ETR of 15%, Australia should consider a safe harbour for these jurisdictions** – This could be combined with a list of incentives/special regimes that could lead to an ETR below 15%. If an MNE Group does not make use of the listed incentives/special regimes, it would meet the safe harbour criteria for a jurisdiction that is on the ETR whitelist, significantly reducing its compliance burden. This is not dissimilar to our existing CFC rules Whitelist approach.
- **A safe harbour measure should be developed under which MNE Groups that operate in a QDMT jurisdiction do not need to lodge a Pillar Two calculation for that jurisdiction**

30. Do you have any views on a Country-by-Country Reporting-based safe harbour, how it should be designed, and what adjustments would need to be made to the reported amounts?

Whilst a CbCR based safe harbour could help reduce compliance costs for in-scope MNE Groups (particularly if coordinated with CbCR obligations), it is our view that should Treasury implement any CbCR-based safe harbour, it should be on an opt-in basis only.

Any proposed CbCR-based safe harbour should not be mandatory on the basis that the current CbCR safe harbour rate calculation does not account for deferred taxes. The inclusion of deferred tax movements as a covered tax in computing CbCR ETR may be welcomed by some, though conversely will result in additional compliance burdens and complexity for others (particularly smaller in-scope MNE Groups).

Should Treasury proceed with a CbCR-based safe harbour, our suggested approach would be to provide a carve out for territories which have an ETR as calculated using the group's CbCR report in

excess of a safe harbour rate (which should be set slightly above the 15% minimum rate so that GloBE adjustments would be unlikely to bring the ETR below this amount). We note that this amount should not be excessively high such that it would limit the number of groups and territories likely to qualify.

Any CbCR-based safe harbour regime should leverage existing CbCR taxable income and expense data where possible, with minimal subsequent adjustments. A mechanism which looks at the average CbCR ETR over a pre-determined period of years prior to, and including, the year in question in order to determine whether the safe harbour continues to be met could be beneficial. Provided that the average ETR of the jurisdiction over that period does not fall below the safe harbour threshold, the safe harbour could continue to apply despite the fact that individual year's ETR in isolation is below the relevant threshold.

Interaction with integrity provisions

31. Do you have any specific concerns on potential interactions with integrity provisions of the Australian tax law, such as the controlled foreign company (CFC) rules and the hybrid mismatch rules, and any uncertainties which may arise from their interaction with the GloBE Model Rules?

Australia's hybrid mismatch rules in Division 832 of the ITAA 1997 rely in certain circumstances on characterising a payment as being 'subject to foreign income tax'. In designing the Australian implementation of the GloBE Model Rules, consideration should be given to whether this definition should recognise top-up tax payable (either in Australia or overseas) under the rules. However, we appreciate that there are difficulties with his approach given the top-up tax or UTPR will not necessarily be able to be clearly correlated with a specific hybrid transaction (or more specifically, a "payment" under the hybrid rules.

Notwithstanding this, there will be circumstances where recognition should be given to top-up tax paid, where a D/NI mismatch would otherwise apply. In this regard refer to our comments to the integrity rules under 832-J discussed in our answer to Question 11 where this is clearly the case. There may also be other specific hybrid mismatch scenarios (for example, under the hybrid payer mismatch provisions) where a payment is made to a no tax or nil tax rate jurisdiction resulting in a D/NI mismatch characterisation, when such a D/NI characterisation would be inappropriate if top-up tax is paid in relation to payments received by that no tax or nil tax rate jurisdiction.

32. Are there any issues which you think may arise in allocating taxes imposed under Australia's CFC Tax Regime?

The GloBE Model Rules include a mechanism to allocate tax paid on income attributed under CFC regimes down to the CFCs themselves (albeit subject to capped tax rates in respect of certain passive income). In this regard, we consider some of the issues with this CFC tax allocation could include the following:

- The definition of a CFC under Australian domestic tax law can be broader than the relevant control test under the OECD rules. There is a question of the circumstances in which tax paid in a jurisdiction (such as Australia or otherwise) should be allocated down to the CFC (e.g. in the context of joint ventures, as defined in the GloBE Model Rules). In such circumstances, we consider that taxes should still be allocated to CFCs as defined under the local law,

irrespective of whether the CFC is actually controlled or a Constituent Entity under the OECD rules.

- It will be important that clarity be obtained on what foreign rules (e.g. US GILTI) qualify as a Controlled Foreign Company Tax Regime for the purposes of GloBE rules. This will be important for both inbound and outbound groups. Australian inbound groups will require certainty as to the classification of these regimes in order to undertake both DMT calculations as well as Australian ETR calculations under the GloBE Model Rules. Outbound groups will require certainty in order to appropriately allocate taxes between jurisdictions under Australia.
- The treatment under the CFC rules (section 393) and the Foreign Income Tax Offset rules (section 770-135) of top-up tax paid in foreign jurisdictions either under Pillar Two or DMTs. In particular, consideration should be given to whether such amounts should be allowed as a deduction or FITO, and how to address situations under the GloBE Model Rules where top-up tax is paid in a different entity to the CFC in which the GloBE income rests.
- Differences in the treatment of foreign Permanent Establishments (**PEs**) of CFCs, given the GloBE Model Rules treat PEs as separate constituent entities whereas in most cases the CFC rules aggregate the income and expenses of CFCs and their foreign PEs.

More broadly, Australia's current CFC rules were enacted in 1991 as an early specific anti-avoidance regime. The rules have been amended in some ways since that year, however broadly their function and application has not been revised materially since that date. More recent attempts to revise the legislation to better align with modern CFC rules and international standards have stalled. Consideration should strongly be given to reviewing and updating the CFC rules at the same time as the implementation of the GloBE Model Rules.

Corporate restructuring under GloBE

33. Do you have any comments on how the GloBE Model Rules in relation to corporate restructurings and holding structures may interact with Australia's tax laws on mergers and acquisitions, including tax consolidation? Do you also have any comments on how the GloBE Model Rules could be implemented so that interactions with our domestic rules, including tax consolidation, do not lead to outcomes inconsistent with the GloBE Model Rules?

Provision of clear guidance will be important for matters related to the tax consolidation regime, including the following:

- Which tax consolidation events under Part 3-90 of the ITAA 1997 should be covered by Article 6.2.2, such as consolidated group formation, joining and leaving events etc. This is not clear under the current drafting of 6.2.2.
- The circumstances in which a fair value election under Article 6.3.4 might apply in the context of other tax consolidation events.
- The treatment of tax consolidation events that take place prior to the GloBE Model Rules coming into effect (including whether tax consolidation step-ups arising under the Allocable Cost Amount process prior to 30 November 2021 should be respected for the purposes of the GloBE Model Rules).
- The operation of the transitional provisions in Articles 9.1.2 and 9.1.3 in the context of particular tax consolidation step-ups.

In addition to the above tax consolidation interactions, as addressed at Question 25 above, it will be important to provide some mechanism by which entities may achieve a 'clear exit' from an MNE group without carrying with them liabilities to GloBE top-up tax. The absence of such a mechanism may adversely impact mergers and acquisitions.

Tax paid under the GloBE Model Rules and imputation

34. Do you have any views on whether any Top-up Tax paid by an Australian Constituent Entity under the GloBE Model Rules should give rise to franking credits?

In our view imputation credits should arise on the payment of GloBE taxes and any DMT for the following reasons:

- Australia's imputation regime is a deliberate policy design and is necessary to ensure that Australian taxpayers are subject to a single layer of tax on corporate income (at their respective marginal tax rates).
- If franking credits are allowed for GloBE tax, the effect of Australia's imputation regime when combined with the GloBE Model Rules is to impose a single layer of tax on GloBE income levied at the marginal rate of the ultimate shareholder beneficiary. Not allowing imputation credits for Australian tax paid would impose a double layer of tax amounting to the ultimate beneficiary's tax rate plus the 15% GloBE rate.
- Australia's imputation credit regime provides imputation credits on tax paid in Australia. Tax imposed in Australia under the IIR is clearly Australian tax, which benefits the Australian economy, and therefore presents a prima facie case for an imputation credit. Unlike taxes paid by foreign corporates offshore, it is unclear from a tax policy perspective why shareholders should be exposed to double taxation in this instance, given the tax is paid to the Australian government.
- Imputation credits are not in the nature of 'tax credits' as contemplated by the Commentary, as imputation credits arise only when corporate income tax is paid. There is no reciprocal 'benefit' to the MNE from the use of the imputation credits by the shareholders.
- Imputation applies on Australian tax paid, whether or not the income is foreign. It is a broad tax credit regime applicable to any Australian income tax paid, whether or not the tax is paid on foreign income (e.g. it applies to CFCs, branches).

We disagree with the suggestion at Page 24 of the Consultation Paper that a payment of tax which gives rise to imputation credits would cause Australia's IIR or UTPR to be a disqualified IIR/UTPR. The OECD is focused on benefits returning to the taxpayer, not on shareholder taxation.

- Neither the Inclusive Framework nor the OECD Commentary suggests that a payment of Australian IIR giving rise to imputation credits would immediately disqualify the IIR.
- The OECD Commentary[2] expressly distinguishes between whether the "benefits provided" are "related to the IIR or UTPR that it has implemented".[3] Examples of benefits given include tax incentives, grants, and subsidies.

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[2] OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)
[3] Ibid, Chapter 10, paragraphs 123 to 126

- The Commentary further notes that the assessment of that relationship (of the benefit to the IIR) must be determined based on the facts and circumstances of each case. Relevant considerations may include: "…whether the tax benefit or grant benefits only taxpayers subject to the GloBE rules, whether the benefit is marketed as part of the GloBE rules, and if the regime was introduced after the OECD/G20 Inclusive Framework started discussing the GloBE rules…".[4]
- We believe the OECD's aim with this aspect of the rules was to ensure that kickbacks were not introduced at the same time as the IIR to undermine or undo its effectiveness. Imputation should therefore be viewed in a different light, as clearly Australia's imputation regime both predates the GloBE Model Rules and applies more broadly than to just in-scope MNEs. In our view there are good arguments for why imputation can be seen as a benefit that is unrelated to the GloBE Model Rules (i.e the giving of credits does not immediately disqualify Australia's IIR).
- Otherwise, were arguments taken to their logical conclusion (with the view that Australian corporate tax effectively serves as a quasi-withholding tax on ultimate shareholder income), the existence of the Australian imputation credit regime arguably makes Australia a 'low-tax jurisdiction', as the issuance of imputation credits effectively means that corporate income is not taxed at the corporate level at all. This conclusion appears absurd.

Domestic Minimum Tax

35. Do you have any comments on whether or not Australia should adopt a Domestic Minimum Tax in conjunction with the implementation of the GloBE Model Rules?

Please refer to our response to Question 15.

36. Do you agree that a Domestic Minimum Tax in Australia should only apply to multinationals in the scope of Pillar Two (for example, not applying to businesses that only operate in Australia)?

The DMT should only apply to MNEs in the scope of Pillar Two and should *not* apply to businesses that only operate in Australia because these entities are within the domain of the Australian tax base and should be dealt with solely under Australian domestic tax legislation.

37. If Australia were to adopt a Domestic Minimum Tax, do you have any views on its design as a Qualified Domestic Minimum Tax (that is, on the Domestic Minimum Tax being consistent with the outcomes under the GloBE Model Rules)?

The DMT should be designed as a QDMT which is factored into the calculation of jurisdictional top-up tax.[5] If the DMT is not a QDMT, it would be treated as Covered Taxes under the GloBE Model Rules and instead, be included in the calculation of the jurisdictional effective tax rate and top-up tax percentage.[6]

38. If a Domestic Minimum Tax were to be implemented, do you have any views as to whether there should be a separate return (that is, in addition to the GloBE Information Return and any potential

[4] Ibid
[5] Ibid, Article 5.2.3
[6] Ibid, Article 4.2

local GloBE Tax Return), and do you have any additional feedback on this return? Would there be any particular issues if a Domestic Minimum Tax Return were to be due earlier than the GloBE Information Return?

Please refer to our response to Question 15.

39. If a Domestic Minimum Tax is implemented, how should the liability be allocated amongst Australian Constituent Entities? Should the liability be joint and several amongst Australian Constituent Entities?

We advise against a joint and several approach as comingling liabilities between entities gives rise to uncertainty and complications especially with changes in group and individual entity ownership.

To avoid the mixing of tax liabilities across corporate entities we suggest an opt in mechanism be available so that one entity in the group can elect to pay the DMT.

However, should joint and several liability be pursued for Australian constituent entities, it would be appropriate to consider an exclusion for partially owned entities from the scope. The allocation of liabilities belonging to other members of the group to partially owned entities and their subsidiaries is likely to be commercially problematic.

40. Do you have any views on whether tax paid in Australia under a Domestic Minimum Tax should give rise to franking credits?

Please refer to our response to Question 34.