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International taxation – global and domestic minimum tax

Dear Sir or Madam

Alvarez & Marsal (**A&M**) welcomes the opportunity to provide comments to the Treasury consultation in respect of the exposure draft primary legislation and subordinate legislation and consultation paper to implement the global and domestic minimum tax (also known as Pillar Two).

About us

A&M is a leading global, independent privately-held professional services firm. Over the past forty years we have grown to more than 9,000 employees, delivering value to our clients through more than 80 offices and across 40 countries. As of today , A&M Australia employs 200+ professional staff in our four offices across Australia.

A&M Tax's multi-disciplinary tax teams provide integrated tax services, from tax advice, to tax compliance and reporting and governance. Our tax professionals provide services to private mid-market, larger corporate and ASX as well as global clients without audit-based conflicts of interest, as we do not provide audit services.

Our submission

The Pillar Two reforms are one of the most significant reforms to the international tax system in its history. A&M supports the introduction of these reforms in a manner which is consistent with the OECD/G20 Inclusive Framework (**IF**) on Base Erosion and Profit Shifting's Model Rules and related guidance.

As the income inclusion rule (**IIR**) and domestic minimum tax (**DMT**) is proposed to start retrospectively for certain taxpayers (from 1 January 2024), it will be critical to ensure that businesses are provided with sufficient guidance and support quickly in order for them to comply with Pillar Two.

In this submission, we have addressed the specific questions posed by Treasury in the exposure draft legislation and consultation paper as well as provided some comments on aspects of the legislation we believe could be improved to minimise complexity and compliance costs for taxpayers.

Please do not hesitate to contact Sean Keegan on +61 427 681 132 or Neil Pereira on +61 414 354 586 should you have any questions in relation to this submission.

Yours sincerely

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1. Questions posed in the Consequential Bill

a) Delayed exchange of the GloBE Information Return between jurisdictions

(Refer paragraph 3.33 of the Consequential Bill Explanatory Memorandum)

Treasury comment: There could be a circumstance where the GloBE Information Return is not received from the foreign government agency within the time period specified in the Qualifying Competent Authority, notwithstanding the GloBE Information Return being filed by the UPE or a Designated Filing Entity. In this circumstance, the Commissioner may by notice in writing require a Constituent Entity to lodge the GloBE Information Return in the approved form within 21 days after the Commissioner provides such notice. Penalties for failing to lodge the return under Subdivision 286-C of Schedule 1 to the TAA 1953 can apply if not lodged by the Constituent Entity within the required time.

In order to reduce compliance and administration costs, where exchange of information (EOI) allows it, the Commissioner should avail himself of this mechanism to exchange the GloBE Information Return.

If the Commissioner requires the GloBE Information Return to be filed by the Constituent Entity, we submit that:

- A GloBE Information Return prepared by a UPE or Designated Filing Entity in a foreign jurisdiction may be in a different form to the approved form. The Constituent Entity should be able to file the GloBE Information Return to the Commissioner, in the form filed by the UPE or Designated Filing Entity in their foreign jurisdiction. This would be the same outcome as if the foreign jurisdiction's revenue authority had exchanged the GloBE information Return with the Commissioner.
- If the Commissioner requires the GloBE Information Return to be filed in the approved form, the timeframe for lodging the GloBE Information Return should be extended to no less than 60 days after the Commissioner provides notice, given the proposed significant penalties involved if a return is lodged late. We consider 21 days to be unreasonable as Constituent Entities would need to work with the UPE jurisdiction to not only obtain the GloBE Information Return, but also to ensure that they can obtain the necessary information to complete the approved form accurately, should there be any variance in the disclosures.

b) Lodgment of DMT Returns

(Refer paragraph 3.41 of the Consequential Bill Explanatory Memorandum)

Treasury comment: Currently all Constituent Entities of an Applicable MNE Group that are located in Australia for the purposes of the Assessment Bill are required to lodge a DMT Return. We are seeking views on whether there are circumstances in which lodgment of the DMT Return by a Constituent Entity might not be warranted. In particular, please also note the administrative collection mechanism for tax consolidated groups.

Having regard to the IF's guidance on the GloBE Information Return, the DMT return is likely to be a significant administrative burden, adding compliance costs to taxpayers where DMT is unlikely to be collected given Australia's existing high corporate tax rate. There should be safe harbours which allow Constituent Entities located in Australia to be exempt from filing the DMT return where it is clear that no DMT will be payable, for example, where:

- they are tax transparent entities (e.g. trusts and partnerships);
- they satisfy the permanent simplified calculations safe harbour (i.e. the de minimis test, the ETR test, or the routine profits test); or
- they derive solely passive income e.g. interest, leasing income etc. (which means that they are likely to pay tax at greater than the minimum rate given Australia's high corporate tax rate).

Further, given members of a tax consolidated group are not liable to pay tax, they should also be exempted from filing a DMT return (rather than needing to rely on appointing the head company as the Designated Local Entity). Refer to our submission in (3)(e) below for our further comments on the mechanics of appointing a Designated Local Entity and Designated Filing Entity.

The above assumes that any such filing exemptions should not prevent the DMT from meeting the requirements of an OECD approved Qualified Domestic Minimum Top-up Tax (**QDMTT**).

Further guidance should also be provided on the information required to be provided in a DMT return given the retrospective start date so that taxpayers can update their systems and processes to start to collect this information as soon as possible.

c) Timing issues for franking credits

(Refer paragraph 3.68 of the Consequential Bill Explanatory Memorandum)

Treasury comment: We are seeking views on timing issues in respect of franking credits and debits. In particular, at what point in time, or for what period of time, does a Constituent Entity of an Applicable MNE Group need to be a franking entity for Domestic top-up tax to give rise to a franking credit in the relevant franking account? In this regard, please see the text that is struck-out in both:

- item 9 of the table in item 3, subsection 205-15(1)

- item 14 of the table in item 7, subsection 205-30(1)

We consider the time that a Constituent Entity is considered to be a franking entity should be 'for the whole or part of the income year' rather than on the day on which the payment is made. This is because payment of DMT is due at least 15 months after the end of the relevant income year in which the DMT arises. This is also consistent with the time when an entity needs to be a franking entity in respect of income tax (refer item 2 of the table in subsection 205-15(1) and item 2 of the table in subsection 205-30(1) of the *Income Tax Assessment Act 1997 (Cth)* (**ITAA 1997**)).

d) Interactions with other laws, including the Australian foreign hybrid mismatch rules, controlled foreign company regime and foreign income tax offsets

(Refer paragraph 3.75 of the Consequential Bill Explanatory Memorandum)

Treasury comment: In particular, it is intended to legislate to ensure that while a FITO will be available for top-up taxes imposed under a foreign jurisdiction's QDMTT (including where the income is subject to tax in Australia through our CFC rules) a FITO will not be available for top-up taxes imposed under a foreign jurisdiction's IIR or UTPR, to avoid known circularity issues that arise if a FITO for such taxes were to be permitted. This is consistent with paragraph 45 in Chapter 4 of the Commentary (page 96). As the Commentary is the OECD document released on 14 February 2022 to complement the OECD Model Rules, this approach is consistent with the approach outlined in the OECD rules. The amount of any offset would be subject to the conditions in Division 770 of the ITAA 1997. Also, it is intended to legislate so that the hybrid mismatch rules (Division 832 ITAA 1997) do not take into account top-up taxes imposed under a QDMTT, IIR or UTPR.

Further consideration should be given to the mechanics of the FITO rules in Division 770 of the ITAA 1997 to ensure that they will appropriately interact with the top-up tax rules. For example:

- FITOs can only be claimed to the extent that the foreign tax is included in your assessable income for the year (subsection 770-10(1)). It should be clarified how a foreign DMT will be traced to amounts included in an Australian Constituent Entity's assessable income given DMT is calculated based on jurisdictional GloBE income.
- Given top-up taxes will be paid 15 months after the income year, taxpayers would need to amend tax returns in order to include a FITO paid in relation to a foreign DMT (as tax returns for large corporate taxpayers are typically due within 7 months after the end of the income year). To avoid the administrative cost of amending tax returns, Treasury should give consideration to whether a reasonable estimate of a foreign DMT can be included as a FITO even if it is not paid yet.

Regarding the hybrid mismatch rules, there is a potential double taxation issue where the hybrid mismatch rules do not take into account foreign top-up taxes. This is because the hybrid mismatch rules may operate to deny a deduction which is not allocated to the relevant jurisdiction under Pillar Two. This means for Pillar Two purposes, the denied deduction has no impact on the ETR calculated in the low/no-tax jurisdiction, potentially causing top-up taxes to arise in relation to the same amount.

2. Questions posed in the Consultation Paper

We broadly agree with the proposed policy position and approaches in relation to interactions with the domestic law (subject to our comments regarding the mechanics of the FITO and hybrid mismatch rules in (1)(d) above). This is on the basis that they align with the IF's recommendation to determine domestic taxes before applying the Pillar Two rules.

A significant interaction with domestic law that is not addressed in the Consultation Paper is with the tax consolidation rules in Part 3-90 of the ITAA 1997. In particular, as the head company is liable to pay top-up tax on behalf of all of its subsidiaries', there needs to be detailed rules in place to deal with part year subsidiaries such as:

- Ensuring that a head company is not liable for the subsidiaries' top-up tax relating to the pre-acquisition/post-disposal period; and
- Clarifying how GloBE elections will work for joining/leaving subsidiaries and whether they can be re-made upon joining a new tax consolidated group for ease of compliance.

3. Other comments

a) Start date

Whilst the introduction of measures on a retrospective basis is not ideal from a tax certainty perspective, we appreciate the need to align Australia's start date on the measures with other countries, including Korea, the UK and member states in the EU. However we do note that key trading partners such as New Zealand and Singapore will have deferred start dates for the IIR of 1 January 2025 and we submit that a deferral should also be considered in Australia.

A number of our subsequent comments are primarily targeted at limiting any unfairness and additional cost to taxpayers caused by a retrospective introduction of the IIR and DMT.

b) Details on UTPR

There is still no detail on the design of the UTPR. Given the potential complexity of the measure, it is imperative that details are released before its proposed enactment in Australia on 1 January 2025 so that taxpayers have sufficient time to collect the necessary information.

c) Penalties

We strongly oppose the increase of administrative penalties for false and misleading statements to double, and failure to lodge penalties to 500 times, to align with penalties that apply to significant global entities.

Given the proposed retrospective date of enactment of the IIR and DMT, and the complexity of the rules, the introduction of severely increased penalties would be manifestly unfair. We consider that reliance on the IF's transitional penalty relief rules where a tax authority can choose not to apply penalties where an MNE group has taken 'reasonable measures' during the transition period does not provide sufficient certainty for taxpayers.[1]

We recommend that an increase in penalties should only be considered after a post-implementation review of the Pillar Two rules is undertaken (refer to our submission point (3)(e) below).

d) Australian-specific guidance on Rules

We support the alignment of definitions and concepts in the exposure draft legislation with the IF's Model Rules. However guidance should be provided to taxpayers (in the Explanatory Memorandum and/or ATO product) to confirm how the Pillar Two rules are to be applied in an Australian context. For example it would be useful to confirm:

- The types of Australian taxes that are and are not Covered Taxes;

[1] Refer to Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two) published by the OECD on 20 December 2022

- Confirmation that MITs, AMITs and their sub-trusts are Excluded Entities; and
- Confirmation of the types of timing differences that are included in the concept of a Recapture Exception Accrual.

Further guidance should also be provided on:

- The start date of the Pillar Two measures in overseas jurisdictions;
- The types of foreign taxes that are and are not Covered Taxes (including whether they are Qualified Refundable Tax Credits or Marketable Transferable Tax Credits);
- Whether other countries have a QDMTT; and
- How Australia's rules interact with overseas jurisdictions, particularly where start dates do not align.

We also observe that the exposure draft legislation is difficult to navigate as definitions are spread across the Rules and the Assessment Bill. Guidance should be published referencing the legislation to the relevant parts of the IF's Model Rules for ease of reference to the relevant Commentary and other related guidance.

e) Designated Filing Entity and Designated Local Entity

The appointment of a Designated Filing Entity and Designated Local Entity is critical to ensuring that Constituent Entities in an MNE Group can meet their filing obligations under the Pillar Two rules efficiently.

However there is currently insufficient guidance as to:

- When and how a valid appointment is made;
- Whether such an appointment can be revoked;
- What happens in a M&A context when a Designated Filing Entity and Designated Local Entity joins another tax consolidated group
- Whether such an appointment is invalid if one Constituent Entity in the MNE Group does not validly make the appointment; and
- How penalties apply if a Designated Filing Entity or Designated Local Entity does not file on time or makes incorrect disclosures.

This should be clarified in the legislation given the proposed significant penalties for failure to lodge.

f) Post-implementation review

Given the significant changes being proposed under the Pillar Two reforms, a post-implementation review is critical to ensure that the rules are functioning appropriately. We recommend that the review is performed by no later than 31 December 2027, after taxpayers have lodged their first Pillar Two tax returns and before the roll-out to all entities upon expiry of the transitional safe harbour period (for years that end after 30 June 2028).