EXPLANATORY MEMORANDUM TO

THE MULTINATIONAL TOP-UP TAX (PILLAR TWO TERRITORIES, QUALIFYING DOMESTIC TOP-UP TAXES AND ACCREDITED QUALIFYING DOMESTIC TOP-UP TAXES) REGULATIONS 2025

2025 No. 406

1. Introduction

1.1 This explanatory memorandum has been prepared by His Majesty's Revenue and Customs (HMRC) on behalf of His Majesty's Treasury (HMT) and is laid before the House of Commons by Command of His Majesty.

1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Declaration

2.1 James Murray MP, Exchequer Secretary to the Treasury confirms that this Explanatory Memorandum meets the required standard.

2.2 Richard Thomas, Deputy Director for Base Protection Policy, at HMRC confirms that this Explanatory Memorandum meets the required standard.

3. Contact

3.1 Jonathan Spittles at HMRC email: pillar2.consultation@hmrc.gov.uk can be contacted with any queries regarding the instrument.

Part One: Explanation, and context, of the Instrument

4. Overview of the Instrument

What does the legislation do?

4.1 The Instrument supports the UK's implementation of the Organisation for Economic Co-operation and Development ("OECD")/G20 Inclusive Framework Pillar Two model rules. Specifically, the Instrument sets out a list of each:

- territory that has implemented a qualifying income inclusion rule such that it is specified as a Pillar Two territory and the date from which the specification applies,
- tax that is a qualifying domestic top-up tax and the date from which the specification applies (and the respective territories of those taxes), and
- tax specified as being accredited for qualifying domestic top-up tax safe harbour purposes and the date from which the accreditation applies (and the respective territories of those taxes).

4.2 The Instrument also provides HMRC the power to specify 'by notice': a territory as a Pillar Two territory, a tax as a qualifying domestic top-up tax, and a tax that is an accredited qualifying domestic top-up tax.

Where does the legislation extend to, and apply?

4.3 The extent of this instrument (that is, the jurisdiction(s) which the instrument forms part of the law of) is the United Kingdom.

4.4 The territorial application of this instrument (that is, where the instrument produces a practical effect) is the United Kingdom.

5. Policy Context

What is being done and why?

5.1 The Instrument forms part of the legislative framework applying the OECD/G20 Inclusive Framework Pillar Two rules within the UK.

5.2 Pillar Two is a global tax reform coordinated by the OECD/G20 Inclusive Framework which aims to ensure that large multinational enterprises pay an effective tax rate of at least 15% in every jurisdiction in which they operate.

5.3 To do this, it sets out a common framework for calculating the effective tax rate in each relevant jurisdiction.

5.4 Where the effective tax rate is less than the minimum rate of 15%, the difference between the effective tax rate and the minimum rate of 15% is applied to a measure of profits for the jurisdiction to arrive at an amount of top-up tax. Any top-up tax for a jurisdiction is then allocated to members of the multinational group.

5.5 To ensure the intended distribution of taxing rights and prevent double taxation, the rules respect taxes paid under other jurisdictions' income inclusion rules and domestic minimum top-up taxes.

5.6 This is achieved by recognising those taxes and territories which have met international agreed standards. The OECD/G20 Inclusive Framework published internationally agreed lists of qualifying taxes and territories on 15 January 2025, providing a basis for the UK Government to make decisions about recognising rules in other jurisdictions, which are given effect through this Instrument.

5.7 The rules implemented in those territories and by those taxes have been reviewed by HMRC. This review determined that the territories have qualifying income inclusion rules and that the taxes implemented by the relevant domestic laws are equivalent to domestic top-up tax and meet the conditions for accreditation for the safe harbour.

5.8 As such the pre-conditions to specify these territories and taxes in regulations are met, and this should be done in order to correctly implement the Pillar Two rules in the UK.

5.9 This Instrument includes in UK legislation: a list of territories that have implemented a qualifying income inclusion rule, a list of taxes which are qualifying domestic top-up taxes (and the respective territories of those taxes), and a list of taxes that are specified as being accredited for qualifying domestic top-up tax safe harbour purposes (and the respective territories of those taxes).

What was the previous policy, how is this different?

5.10 The Pillar Two rules do not replace any previous policy.

5.11 While the lists of qualifying taxes and territories were being internationally agreed, resolutions for the 2024 Autumn Budget provided businesses with a temporary mechanism to recognise taxes and territories which were expected to meet, and then did meet, internationally agreed standards. This enabled those with accounting periods

ending 31 December 2024 to make accurate provisions for Pillar Two taxes in their 2024 accounts.

5.12 This Instrument provides certainty to business by introducing lists of territories and taxes into UK legislation, as that legislation always envisaged, and replaces the temporary mechanism for accounting periods that have not already ended.

6. Legislative and Legal Context

How has the law changed?

6.1 Multinational Top-up Tax and Domestic Top-up Tax are new taxes that were introduced in the Finance (No.2) Act 2023.

6.2 Section 241 Finance (No.2) Act 2023 provides for regulations to be made that specify which territories have implemented a qualifying income inclusion rule, referred to in the legislation as 'Pillar Two territories'.

6.3 Section 256 Finance (No.2) Act 2023 provides for regulations to be made that specify which taxes are qualifying domestic top-up taxes.

6.4 Schedule 16A Finance (No.2) Act 2023 provides for regulations to be made that specify which taxes are accredited qualifying domestic top-up taxes.

6.5 The powers are being used for the first time in making the Regulations.

Why was this approach taken to change the law?

6.6 This is the only possible approach to specify the territories, qualifying domestic top-up taxes and accredited taxes under the Finance (No. 2) Act 2023 and provide certainty to business.

7. Consultation

Summary of consultation outcome and methodology

7.1 As an integral part of the Pillar Two Rules, this Instrument forms part of the implementation of the outcome of the Government's earlier consultation on the introduction of Pillar Two in the UK. A report of the earlier consultation and summary of responses is available on the GOV.UK website.[1] In the consultation, respondents included a number of trade bodies, accounting firms, law firms, universities and various large businesses.

7.2 There has been no specific consultation on this instrument.

8. Applicable Guidance

8.1 This instrument does not implement or require specific guidance. Guidance relating to Pillar Two is currently available in draft form and in due course will be available in the form of an HMRC internal manual, 'The Multinational Top-up Tax and Domestic Top-up Tax Manual'.

[1] Consultation response on implementation of Pillar 2: https://assets.publishing.service.gov.uk/media/62d6f9fed3bf7f28643ca4e3/Pillar_2_Summary_of_Responses_for_20_July_2022.pdf

Part Two: Impact and the Better Regulation Framework

9. Impact Assessment

9.1 A Tax Information and Impact Note covering this instrument will be published on the GOV.UK website.[2]

Impact on businesses, charities and voluntary bodies

9.2 There is no, or no significant, impact on business, charities or voluntary bodies because this instrument ensures the intended working of the Pillar Two rules. Therefore, any impact has already been assessed under the implementation of the wider Pillar Two rules.

9.3 The legislation does not impact small or micro businesses.

9.4 There is no, or no significant, impact on the public sector because governmental entities are excluded entities for the purposes of the Pillar Two rules.

10. Monitoring and review

What is the approach to monitoring and reviewing this legislation?

10.1 The approach to monitoring this legislation is to review the qualifying territories in line with the OECD review process for Pillar Two qualifying status. When the OECD/G20 Inclusive Framework updates its lists, HMRC will review whether any changes are required in UK legislation.

10.2 The instrument does not include a statutory review clause.

Part Three: Statements and Matters of Particular Interest to Parliament

11. Matters of special interest to Parliament

11.1 The parts of this instrument that implement the provisions under Sections 241 and 256 Finance (No.2) Act 2023 will be enacted with retrospective effect under Sections 241(3) and 256(4) Finance (No.2) Act 2023 as they can only be beneficial to taxpayers.

11.2 The parts of this instrument that implement the provisions under Sections 241(1A), 256(1A), and Paragraph 2(1A) Schedule 16A Finance (No.2) Act 2023 provide HMRC the power to specify qualifying and accredited taxes and territories 'by notice'.

12. European Convention on Human Rights

12.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

13. The Relevant European Union Acts

13.1 This instrument is not made under the European Union (Withdrawal) Act 2018, the European Union (Future Relationship) Act 2020 or the Retained EU Law (Revocation and Reform) Act 2023 ("relevant European Union Acts").

[2] Tax Information and Impact Note: https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins