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In Confidence

Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

GLOBAL ANTI-BASE EROSION TAX RULES FOR NEW ZEALAND

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to introduce Global Anti-base Erosion Rules (GloBE rules) in New Zealand.

2. Cabinet approval is sought as this is a policy change that will in some circumstances impose tax on large multinational enterprises (MNEs) operating in New Zealand, where their income, in either New Zealand or other countries where they operate, bears an effective tax rate of less than 15%.

3. This paper sets out the estimated one-off and ongoing administration costs for Vote Revenue, covering the GloBE rules and country by country reporting (CbC 2.0). CbC 2.0 supports the implementation and ongoing implementation of the GloBE rules. Cabinet approval is sought to note these estimated costs and to delegate to the Minister of Finance and the Minister of Revenue the decision on funding sources for this initiative.

Relation to Government Priorities

4. This proposal relates to the international tax workstream on the Government's tax policy work programme. The Government is committed to ensuring that MNEs pay their fair share of tax. This includes participating in multilateral solutions to the challenge posed by economic globalisation to the international tax framework.

Executive Summary

5. The GloBE rules are the main part of the G20/OECD-led Pillar Two proposal. The purpose of the GloBE rules is to ensure that large MNEs are subject to tax of at least 15% on their mobile income, in every country where that income is earned. This will reduce the incentive for them to take advantage of low tax rates and other tax concessions.

6. The success of this proposal depends on it being adopted by a critical mass of countries. At the moment, it appears that adoption by the EU, Japan, Switzerland and Canada is very likely, with adoption also likely in Australia and the UK. This is more than enough to be a critical mass. By adopting GloBE rules, New Zealand will contribute to that critical mass, as well as raise a modest amount of revenue and simplify compliance for New Zealand-based MNEs.

7. Subject to Cabinet approval, the changes recommended in this paper will be included in the next available omnibus tax bill, and apply from a date to be specified by Order in Council, giving Cabinet the flexibility to align the application date of our GloBE rules with other countries.

8. This initiative will require up to $17.300 million operating and capital funding which will be a mix of Crown Budget 2023 funding and Vote Revenue self-funding to be agreed as part of the Budget 2023 process

9. The estimated costs of $17.300 million includes $8.600 million capital and $8.700 million operating, over the forecast period (2022/23 to 2026/27) for the up-front build and on-going administration costs, covering the GloBE rules (Pillar Two) and the associated country by country reporting (CbC 2.0).

10. We currently estimate up to $25.000 million of additional tax revenue per annum beginning from 2026/27. This equates to $25.000 million in the forecast period (2022/23 to 2026/27). We recommend that the additional tax revenue be managed as a positive impact on the 2023 Budget operating allowance.

11. The net positive financial impact of this initiative over the forecast period (2022/23 to 2026/27) is $7.700 million (2022/23 to 2026/27) and $21.900 million per annum thereafter.

Background

12. Pillar Two is a G20/OECD initiative seeking to address tax base erosion risks caused by profit shifting by large MNEs. These risks arise because these MNEs can choose to shift income, particularly from capital or intangible property, to countries which charge no or little tax on that income. Sometimes this is because of general low tax rates. Other times it is because of targeted tax incentives.

13. The main plank of Pillar Two is the GloBE rules. These rules will ensure that large MNEs are subject to tax of at least 15% on their mobile income, in every country where that income is earned, reducing profit shifting incentives. They apply to MNEs with annual revenues of €750 million or more. The OECD estimates that they will increase global corporate income tax by approximately 9%, or US$220 billion pa.

14. The GloBE Model Rules (the Model Rules) were finalised by the OECD in December 2021, with detailed commentary released in March 2022 and further guidance in February 2023.

15. The rules require an MNE to calculate its effective tax rate (ETR) by comparing its tax in a country with its accounting profit (with certain adjustments) for that country. If the ETR is less than 15%, it must calculate the GloBE top-up tax it has to pay. GloBE top-up tax is the tax required to bring the ETR on mobile income in a country up to 15%. An MNE calculates this by taking its adjusted accounting profit for the country, subtracting the substance-based income exclusion (broadly, a 5% return on the tangible assets and payroll expenses in the jurisdiction[1]), and multiplying the result by the difference between 15% and its ETR.

[1] For an initial 10-year period the rate is higher than 5% and will reduce over time to 5%.

16. The obligation to pay GloBE top-up tax is allocated between countries according to one of three rules.

 16.1 First, if the country where the income is earned has enacted a domestic minimum tax (DMT) the top up tax will be paid to that country.

 16.2 Second, the tax may be paid under the Income Inclusion Rule (IIR) which applies on a top-down basis, giving the ultimate parent entity (UPE) country or an intermediate parent entity country the right to collect GloBE top-up tax for the country where the income is earned, if it has not been taxed under a DMT

 16.3 Third, if no DMT or IIR applies to the under-taxed profits of a member of an MNE, the Undertaxed Profits Rule (UTPR) will allocate GloBE top-up tax in proportion to the group's payroll costs and tangible asset values in each country with GloBE rules. This ensures that if the country where an MNE has its headquarters decides not to implement GloBE rules, the MNE will still have to pay top up tax if it operates in countries that have GloBE rules.

17. Approximately 20-25 New Zealand headquartered MNEs are in scope.

GloBE Rules for New Zealand

Should New Zealand adopt GloBE rules

18. New Zealand has a relatively high corporate tax rate and (with the exception of capital gains) a broad tax base. We have robust rules for ensuring income from New Zealand activities of foreign firms is taxed in New Zealand. We also have rules ensuring that New Zealand firms cannot easily avoid New Zealand tax on foreign income, except where that income arises from the conduct of an active business in the country where the income is taxable.

19. Despite our relatively strong rules for preventing profit shifting out of New Zealand, there remains some residual ability for foreign owned MNEs to shift taxable profits out of New Zealand to lower tax countries. Our strong rules also create a risk that companies will not want to be headquartered in New Zealand.

20. If the GloBE rules are adopted by a critical mass of countries, these risks will be significantly reduced. By adopting the GloBE rules, New Zealand will be contributing to the critical mass, supporting the success of the proposal internationally. Adopting the GloBE rules would also raise a modest amount of revenue, which would otherwise be collected by other countries under the UTPR.

21. s 9(2)(f)(iv) [redacted]

s 9(2)(f)(iv) [redacted]

22. We propose that New Zealand adopt GloBE rules, on the basis that they will come into effect only if a critical mass of other countries is also committed to bring GloBE rules into effect.

23. We propose that the GloBE rules application date is specified by an Order in Council. This will give Cabinet the flexibility to align the application date of our GloBE rules with their application date in other countries.

Incorporation into New Zealand law by reference to the Model Rules

24. If a country adopts GloBE rules, it must adopt the OECD's Model Rules, commentary and the administrative guidance (except for a domestic minimum tax, which is optional). Adoption is proposed to be by incorporation into domestic legislation (not by treaty). Where a country's incorporating legislation departs from the Model Rules, there is a risk its GloBE rules will not be "qualifying" and other participating countries will continue to apply GloBE top-up tax to the country's in-scope MNEs under the UTPR. To address the risk of our GloBE rules not being qualifying, we propose that the rules are incorporated into New Zealand law by reference to the Model Rules, Commentary and administrative guidance. There will be limited areas where the rules need to be adapted or clarified, but the general approach will be to follow the agreed OECD Model Rules where possible. Where changes are required, these will respect the intended outcomes agreed in the OECD.

25. The effectiveness of the GloBE rules depends on consistency in their implementation in different countries. For example, there would be a high risk of over or under-taxation if implementing countries adopted different rules to measure the level of taxation and top-ups required in each country. Incorporating the rules into New Zealand law by reference to the Model Rules will reduce these risks.

26. It will be desirable, as a default position, for future changes to the OECD Model Rules to be automatically incorporated into New Zealand law, for periods beginning after those changes are made. That will reduce the burden of the GloBE rules on the New Zealand tax legislative process and maximise the likelihood of cross-country consistency and of our rules being qualifying. It will involve no substantive loss of sovereignty, since if it wants to, Parliament can enact law declaring that a change made at OECD level should not have effect in New Zealand. It will be important to ensure that as changes become effective, they are made publicly available to New Zealand taxpayers.

27. That said, we do propose that the 15% rate of tax under the GloBE rules is included in the proposed Bill. This will ensure that the fundamental issue of the tax rate, which sets the floor on the race to the bottom on taxes, can only be changed by Act of Parliament.

No imputation credits for GloBE top-up tax under the IIR or UTPR

28. The Model Rules state that if the payment of tax under a country's IIR or UTPR gives rise to a benefit, the IIR or UTPR will not be qualifying, and other participating countries

will continue to apply GloBE top-up tax to the country's in-scope MNEs under their UTPR.

29. Generally New Zealand income tax paid by a New Zealand company gives rise to an imputation credit, which can be passed on to the company's shareholders when the company pays a dividend. However, if New Zealand's IIR or UTPR give rise to an imputation credit, although sufficient tax will be paid at a corporate level under the IIR or UTPR, the entire GloBE top-up tax amount will be available as a dollar-for-dollar tax reduction to the shareholder's tax liability and the imposition of the IIR or UTPR would be unwound on distribution. This benefit would result in our IIR and UTPR being non-qualifying, so we propose that GloBE top-up tax payable under the IIR and UTPR does not give rise to imputation credits.

30. A payment of tax under a country's DMT which gives rise to an imputation credit, will not result in the DMT being non-qualifying. This is specifically provided for in the GloBE rules and reflects that, whilst the DMT must be based on the GloBE rules, it is a local tax on local profits.

Charging tax allocated to New Zealand under the UTPR

31. The Model Rules include two approaches for charging tax allocated to a country by the UTPR. Individual countries are left to choose one of these approaches. The first approach denies an income tax deduction on otherwise deductible expenses of the MNE group. The second approach treats the GloBE top-up tax as a separate tax liability independent of income tax. The outcome of either approach must be to produce an additional cash tax impost in the country equal to the top-up tax allocated to it. The amount of this impost in a particular year is subject to the limit that it should not exceed the tax benefit of tax deductions otherwise available to entities in that country in that year.

32. We propose that this GloBE top-up tax be charged as a separate tax liability in New Zealand. This will ensure that the liability will not impact provisional tax. It will also eliminate some of the complexity of using the income tax system to impose a GloBE liability. We propose that the tax would be a joint and several liability of all New Zealand entities in an MNE group.

Domestic minimum tax

33. The GloBE rules give countries the option to introduce a DMT, which would use the same tax base as the GloBE rules but give the local country priority in the collection of the GloBE top-up tax. For New Zealand, this tax would be closely based on the GloBE rules but would apply to undertaxed profits in New Zealand.

34. A DMT could be imposed solely on New Zealand headquartered in-scope MNEs or expanded to apply also to foreign headquartered in-scope MNEs operating in New Zealand. The likelihood of any MNEs being subject to GloBE top-up tax on their New Zealand income is low because of our high corporate income tax rate and general lack of tax preferences. However, we propose that a DMT be adopted for New Zealand headquartered MNEs as this will ensure that whatever happens, they do not need to pay tax under any other country's UTPR. This will minimise their compliance costs.

Denying a deduction or foreign tax credit for GloBE taxes in another country

35. The design of the GloBE rules makes it clear that GloBE top-up tax under the IIR or UTPR should not be either creditable or deductible for non-GloBE income tax purposes. The top-up tax is determined after taking into account income tax imposed on the income attributable to a country, whether that tax is imposed by the country itself or another country.

36. Given that the GloBE top-up tax is calculated after taking into account tax imposed under a worldwide or CFC tax regime, it would clearly not be appropriate for the GloBE top-up tax to be creditable or deductible when calculating those taxes. Therefore, we propose that taxpayers be denied a foreign tax credit or deduction for GloBE top-up tax paid in another country. This does not apply to tax imposed under a DMT.

Additional policy decisions

37. This paper also seeks Cabinet's agreement to delegate authority to the Minister of Finance and Minister of Revenue to make additional joint decisions on any policy and drafting issues arising as appropriate.

Operational and financial impacts

International tax work programme

38. There are currently seven proposed international tax initiatives on the government's tax and social policy work programme which are expected to be implemented over the next four financial years and are at various stages of development. This international tax workstream aligns with OECD initiatives and is focused on people and businesses, including multinational companies, paying their fair share of tax. The initiatives are:

- Taxation of the platform economy (included in the Taxation (Annual Rates for 2022-23, Platform Economy and Remedial Matters) Bill (No 2)
- OECD Pillar One
- OECD Pillar Two (Global anti-Base Erosion Rules – GloBE)
- Country by Country reporting (CbC 2.0) – this supports the implementation and ongoing implementation of the GloBE rules
- Crypto Asset Reporting Framework (CARF)
- Common Reporting Standard schema (CRS 2.0)
- s 9(2)(f)(iv)

39. Because the initiatives are at different stages of development there is no overall picture of the financial impact. Officials' current assessment is that once implemented, this work programme will be overall revenue positive – the tax revenue gains will exceed the implementation and on-going administration costs of the initiatives. Inland Revenue will update Ministers on the cumulative financial impact of this programme of international tax initiatives as the individual items are reported on for policy decisions and implementation.

40. The overall net financial gain (additional tax revenue less implementation and on-going administration costs) from the GloBE rules and Country by Country reporting 2.0 over

the forecast period is $7.700 million (2022/23 to 2026/27) and $21.900 million per annum thereafter.

OECD Pillar Two and Country by Country reporting

Financial implications - Additional tax revenue

41. The proposed GloBE rules are expected to increase tax revenue. The following table sets out the estimated tax revenue increase. The estimates are subject to considerable uncertainty and are based on a number of assumptions including the final policies and rules. The timing of these revenue benefits will be dependent on policy implementation dates, and the timing of adoption by other countries. We currently estimate up to $25.000 million of additional tax revenue over the forecast period, with ongoing additional tax revenue of $25.000 million per annum.

	$million				
Crown revenue and receipts: Tax revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
OECD GloBE rules	-	-	-	-	25.000
Country by Country reporting 2.0	-	-	-	-	-
Total revenue	**-**	**-**	**-**	**-**	**25.000**
Total operating	**-**	**-**	**-**	**-**	**(25.000)**

42. This estimate was arrived at by Inland Revenue with the help of the OECD's global economic impact assessments (which continue to be updated). There are a high number of assumptions in this model, as it is dependent on the final rules (in particular safe harbours), how and which countries implement GloBE rules and the behavioural response of MNEs based on work done by the OECD.

43. It is expected that some additional revenue would be raised through applying the UTPR to foreign-owned MNEs with substance in New Zealand and the DMT to New Zealand headquartered MNEs. It is also possible that additional revenue will be raised from foreign headquartered MNEs who have a reduced incentive to shift profits out of New Zealand. However it is not possible to estimate the amount of this revenue.

44. An increase in New Zealand income tax is also forecast due to reduced profit shifting by New Zealand headquartered MNEs, as a result of a critical mass of other countries adopting the GloBE rules. This has been estimated at approximately $16 million per year after the GloBE rules have been adopted by the critical mass of countries. This benefit will arise whether or not New Zealand adopts GloBE rules itself.

45. It is proposed that this additional tax revenue be managed as a positive impact against the Budget 2023 operating allowance.

Financial implications – up-front build costs and on-going administration

46. Inland Revenue has estimated that the up-front build costs and on-going administration of these two initiatives to be $17.300 million, $8.700 million capital and $8.600 million operating over the forecast period with on-going administration cost of $3.100 million a year. These estimates are subject to any significant changes in the final policies and rules that may materially change these estimates. The following table sets out the capital and operating costs for the up-front build and on-going administration.

	$million				
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears
Capital expenditure					
OECD GloBE rules	-	-	5.300	-	-
Country by Country reporting 2.0	-	-	3.400	-	-
Total capital	**-**	**-**	**8.700**	**-**	**-**
Operating expenditure					
OECD Pillar Two	-	0.200	1.500	2.300	2.300
Country by Country reporting 2.0	-	0.100	0.600	0.800	0.800
Total operating	**-**	**0.300**	**2.100**	**3.100**	**3.100**
Total expenditure	**-**	**0.300**	**10.800**	**3.100**	**3.100**

47. The up-front build and on-going administration costs involve system changes to support the standardised reporting by large multi-national groups and information exchanges between tax jurisdictions of key financial information (GloBE information return). In addition, system changes will be required to impose a standard top-up tax (a new tax) to ensure such group pay a minimum level of tax in each jurisdiction where they operate. Inland Revenue estimates that it will require an additional six staff to administer the proposed GloBE rules.

48. The Pillar Two initiative will leverage off the existing reporting requirements under the CbC rules. As part of the implementation of Pillar Two, Inland Revenue will incorporate the current CbC reporting into START and streamline the process. Leveraging off the current reporting requirements will minimise the additional compliance costs for impacted entities. Furthermore, it will provide a sustainable solution to ensure that Inland Revenue can meet its international obligations.

Legislative Implications

49. Implementing these proposals requires changes to the Income Tax Act 2007 and Tax Administration Act 1994. It will also require an Order in Council to be agreed to by

Cabinet in order to bring the rules into effect. This Order in Council will be prepared after a critical mass of countries have committed to implement the GloBE rules.

50. If approved, we propose including the legislative changes resulting from these recommendations in the next omnibus taxation bill, scheduled for introduction in early 2023.

Impact Analysis

Regulatory Impact Assessment

51. The Quality Assurance reviewer at Inland Revenue has reviewed the OECD's Pillar Two GloBE Tax Rules Impact Summary and considers that the information and analysis summarised in it meets the quality criteria of the Regulatory Impact Analysis framework.

This issue has been subjected to wide consultation, including through a public issues paper. As identified in the Key Limitations or Constraints on Analysis section, a difficulty with assessing the revenue implications of the various options has been establishing the administrative costs of adopting the GloBE rules without knowing aspects of the detailed design, and the extent to which behavioural changes occur if a critical mass of other countries adopt the GloBE rules.

Climate Implications of Policy Assessment

52. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population Implications

53. There are no population implications arising from the proposals in this paper.

Human Rights

54. There are no human rights implications arising from the proposals in this paper.

Consultation

55. Consultation has been undertaken with affected taxpayers, representative bodies and their advisors. They are broadly supportive of proposals. However, some stakeholders do not support the proposal to incorporate the GloBE rules into New Zealand by reference to the Model Rules, and most do not support the proposal to not provide imputation credits for top-up tax paid under the IIR and UTPR.

56. The Treasury and Inland Revenue have been consulted in the preparation of this paper and support the changes.

Communications

57. Subject to approval from the offices of the Ministers of Finance and Revenue, Inland Revenue will make an announcement on this policy once Cabinet decisions have been made. The Minister of Revenue will also make an announcement about the

introduction of the bill which will contain this proposal. A commentary on the bill will be released at this time.

Proactive Release

58. We propose to proactively release this Cabinet paper, associated minutes, and key advice papers in whole within 30 working days of the public announcement of Cabinet's decisions.

Recommendations

The Minister of Revenue recommends that the Committee:

1. **agree** to adopt GloBE rules for New Zealand;

2. **agree** that the GloBE rules be incorporated into New Zealand law by reference to the OECD Model Rules, Commentary and administrative guidance;

3. **agree** that amendments to the OECD Model Rules, Commentary and administrative guidance be incorporated automatically into New Zealand law;

4. **agree** that no imputation credits be provided for GloBE top-up tax;

5. **agree** that GloBE top-up tax allocated to New Zealand by the Under-Taxed Profits Rule be charged as a separate tax liability;

6. **agree** to adopt a Domestic Minimum Tax for New Zealand headquartered MNEs;

7. **agree** that taxpayers be denied a foreign tax credit or deduction for GloBE top-up tax paid in another country;

8. **agree** that recommendation 1 to 7 should apply from a date to be specified by Order in Council;

9. **agree** to delegate authority to the Minister of Finance and Minister of Revenue to make additional joint decisions on any policy and drafting issues arising as appropriate;

Financial and operational implications

10. **note** the following forecast changes to tax revenue resulting from the decisions at recommendations 1 – 9 to implement the GloBE rules, with a corresponding impact on the operating balance and net debt:

	$m – increase / (decrease)				
Vote Revenue Minister of Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & Outyears
Crown Revenue and Receipts: Tax revenue	-	-	-	-	25.000
Total operating	**-**	**-**	**-**	**-**	**(25.000)**

11. **note** that after a critical mass of countries adopt the GLoBE rules, forecast revenue will increase by around $16 million a year, regardless of whether New Zealand adopts the GLoBE rules.

12. **agree** that the additional tax revenue in recommendation (10) should be managed as a positive impact against the 2023 Budget operating allowance.

13. **note** that the estimated costs of the up-front build and on-going administration of the GloBE proposal and the associated CbC reporting changes is $17.300 million, being $8.700 million capital and $8.600 million operating, over the forecast period (2022/23 to 2026/27) with an on-going administration cost of $3.100 million a year from 2025/26 onwards.

14. **delegate** authority to the Minister of Revenue and the Budget Ministers to approve up to $17.300 million funding for this initiative and to agree the mix of funding from Budget 2023 allowances and Vote Revenue as part of the Budget 2023 process.

Legislative implications

15. **agree** that the changes recommended above be included in the next available omnibus tax bill;

16. **note** that this Cabinet paper, the associated Cabinet minute, and Regulatory Impact Assessment will be released on Inland Revenue's website.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Hon Grant Robertson
Minister of Finance