



POLICY AND REGULATORY STEWARDSHIP

Tax policy report: OECD Pillar Two: GloBE rules – Additional decisions

Date:	4 April 2023	Priority:	Medium
Security level:	In Confidence	Report number:	IR2023/105

Action sought

	Action sought	Deadline
Minister of Finance	Agree to recommendations Note the contents of this report	11 April 2023
Minister of Revenue	Agree to recommendations Note the contents of this report	11 April 2023

Contact for telephone discussion (if required)

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4 April 2023

Minister of Finance
Minister of Revenue

OECD Pillar Two: GloBE rules – Additional decisions

Purpose

1. This report seeks joint agreement to additional decisions necessary for the introduction into Parliament of legislation giving full effect to the GloBE rules in New Zealand.

Background

2. On 3 April, Cabinet agreed to:
 - 2.1 adopt the OECD's Pillar Two Global Anti-Base Erosion (GloBE) rules in New Zealand once a critical mass of other countries do so;
 - 2.2 incorporate the GloBE rules into New Zealand tax law by reference to the OECD Model Rules, commentary, and administrative guidance; and
 - 2.3 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 [CAB-23-MIN-0111 refers].
3. The GloBE rules ensure that multinational enterprises (MNEs) with annual revenues above €750 million are subject to tax of at least 15% on their mobile income, on a country-by-country basis. Where income in a country is subject to an effective tax rate (ETR) of less than 15% it will be subject to a 'top-up tax'. A top-up tax can be collected, in the following order, by either:
 - 3.1 the country in which the MNE derived the relevant income, under a Domestic Minimum Tax (DMT);
 - 3.2 the country in which the MNE is headquartered, or an intermediate parent is located, under an Income Inclusion rule (IIR); or
 - 3.3 all countries that have adopted the rules in which the MNE has operations, under an Under-taxed Profits Rule (UTPR).
4. The OECD Model Rules were approved by the more than 130 countries in the OECD-led Inclusive Framework in December 2021, with detailed commentary released in March 2022 and further administrative guidance released in February 2023. If a country adopts the GloBE rules, it must adopt the OECD Model Rules, commentary, and administrative guidance to ensure they are applied consistently across countries. The GloBE rules are expected to be adopted by participating countries in 2023, effective from no earlier than 2024 (for DMTs and IIRs) and 2025 (for UTPRs).
5. Cabinet has agreed to incorporate the GloBE rules into legislation by reference to the OECD Model Rules, commentary, and administrative guidance, rather than by converting them into New Zealand legislation. This significantly reduces the administrative cost for government and increases the likelihood that our GloBE rules will be considered "qualifying", meaning locally headquartered MNEs will be subject to New Zealand's IIR and not be required to pay top-up tax in other jurisdictions.

Additional decisions

6. Officials have identified the following areas for ministerial decisions in addition to those already made by Cabinet.

GloBE Registration

7. Officials consider that a registration requirement for in-scope MNEs with operations in New Zealand, similar to the system used for GST, would significantly lower the administrative burden of the GloBE rules for IR. This would give us a defined and regularly updated population to monitor.
8. However, the exact scope of the rules will not be clear until safe harbour negotiations are finalised. To allow for flexibility as the regime develops, GloBE registration details would take an electronic form to be prescribed by the Commissioner.
9. We recommend MNEs be required to register with IR within six months of the end of the first income year in which they are in scope of New Zealand's GloBE rules and to deregister with IR within six months of the end of the first year in which they are out of scope of New Zealand's GloBE rules.

Top-up tax return

10. The GloBE rules stipulate that in-scope MNEs must file GloBE information returns (GIRs) in jurisdictions in which they operate, which will contain the information required to calculate any top-up tax the MNE must pay. However, it is up to each jurisdiction to determine the rules for filing a tax return for the top-up tax.
11. Officials consider that all in-scope MNEs with operations in New Zealand should be required to file an annual top-up tax return in New Zealand. If they have no top-up tax liability, the return would simply be nil. This would ensure that they all make a conscious and affirmative statement regarding their New Zealand top-up tax position.
12. To allow for flexibility as the regime develops, the top-up tax return would take an electronic form to be prescribed by the Commissioner. We envisage a short return.

GloBE penalties

13. The commentary on the GloBE rules states that jurisdictions should make penalties or sanctions for non-compliance with the GIR commensurate with penalties or sanctions in respect of other information return filing obligations in the jurisdiction.
14. Once the GloBE rules are incorporated, and if you agree to introduce a top-up tax return, penalties for not filing or late filing of a tax return (up to \$500) and shortfall penalties (from 20% to 150% of a shortfall in a tax position) already in the Tax Administration Act can be amended to apply to top-up tax. However, we consider two new penalties are desirable.
15. Officials believe a penalty should apply where an in-scope MNE with operations in New Zealand does not register on a timely basis. The administrative burden for IR of keeping track of which MNEs are in scope would be prohibitive. If IR does not know who is in scope of the rules it cannot apply the GloBE rules effectively.
16. We believe a penalty should also apply where an in-scope MNE with operations in New Zealand does not file a complete GIR on a timely basis. That is because IR cannot determine whether an MNE has a top-up tax liability without the information in the GIR. Moreover, with respect to a New Zealand-headquartered MNE, New

Zealand is obliged to exchange certain information with other jurisdictions in which the MNE operates, fifteen months after the end of the MNEs' fiscal year. If a GIR is incomplete or filed late, we will be unable to fulfil our information exchange obligations.

17. We have found two examples of penalties in the TAA that could be considered commensurate for non-compliance with these obligations, on the basis that they also apply to large MNEs. Both are civil penalties of up to \$100,000. The relatively high penalty reflects the size of the taxpayers affected. We therefore recommend introducing equivalent civil penalties of up to \$100,000 where an in-scope MNE with operations in New Zealand:
 - 17.1 does not complete GloBE registration on a timely basis; or
 - 17.2 does not file a complete GIR on a timely basis.
18. We note that, in Australia, a "significant global entity" who does not file a tax return by the due date can be liable for a late filing penalty of between \$111,000 and \$555,000, depending on how overdue the return is.

Country-by-Country Report penalty

19. The Country-by-Country Reporting rules were implemented in 2016 as part of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan to help jurisdictions risk assess large MNEs primarily as to their compliance with transfer pricing rules. They require MNEs with a combined revenue of €750 million or more (the same population that is subject to the GloBE rules) to provide an annual report that breaks down key elements relevant to their transfer pricing policies by jurisdiction. The Country-by-Country Report (CbCR) is the forerunner to the GIR. In addition to continuing to be used for transfer pricing risk assessment, it will be used for transitional safe harbour calculations under the GloBE rules and is therefore also necessary for the effective administration of the rules.
20. Currently, there is no penalty under New Zealand law for not filing a CbCR. Officials expect future OECD peer reviews of our GloBE and CbCR rules to note this and recommend a penalty be introduced to incentivise compliance, particularly given the flow-on impact to other jurisdictions with whom we are obliged to exchange information collected in the CbCR. Given this, and the size of the in-scope taxpayers, officials recommend applying an up to \$100,000 civil penalty to in-scope MNEs with operations in New Zealand who do not file a complete CbCR return on a timely basis. This aligns with the penalty recommended for the GIR.

Domestic Income Inclusion Rule vs Domestic Minimum Tax (DMT)

21. On 3 April Cabinet agreed to our recommendation to introduce a DMT alongside the GloBE rules (which mandatorily include an IIR and a UTPR) [CAB-23-MIN-0111 refers]. In the Cabinet paper, we explained that the DMT would ensure that if a New Zealand-headquartered MNE had an effective tax rate of below 15% on its New Zealand income in a given year (e.g., because it makes an untaxed capital gain), New Zealand would collect the top up tax rather than another country.
22. Following recent work by the OECD, it is now clear that the tax we described as a DMT is better described as a domestic IIR. This is because:
 - 22.1 it is only intended to apply to New Zealand headquartered MNEs; and
 - 22.2 if a New Zealand ultimate parent entity has a direct subsidiary that is low-taxed where there is also a minority interest, the tax is only intended to apply for the portion of the low-tax profits attributable to the New Zealand MNE's ownership.

23. This change in name does not affect the policy conclusion relating to the DMT and imputation credits, i.e., that unlike other tax paid under the GloBE rules, tax paid under a DMT/domestic IIR should give rise to imputation credits.
24. As the domestic IIR matches the policy outcome Cabinet has agreed to for the DMT in all but name, we ask Ministers to note the change in the name (but not the substance) of this element of the GloBE rules that the omnibus bill will introduce.

The GloBE rules in relation to tax treaties

25. The OECD has stated that the IIR and UTPR are both compatible with tax treaties, such as New Zealand's, based on the OECD Model. Nevertheless, the compatibility of the UTPR with the OECD model treaty has been the subject of some debate. This is on the basis that the UTPR is effectively an income tax imposed by a country (say New Zealand) on non-New Zealand income earned by a non-New Zealand company, where no New Zealand person has an interest in the non-New Zealand company. Accordingly, it is possible that some companies, and also some governments, may not agree with the OECD position, and might deny our ability to tax under the UTPR relying on a tax treaty between New Zealand and another country.
26. Officials do not believe that this would be likely to succeed if challenged in court. However, we do believe that it would be desirable to eliminate any possible uncertainty in this respect. Accordingly, we recommend confirming in legislation that the GloBE rules adopted by New Zealand apply notwithstanding the terms of a tax treaty, unless those terms expressly refer to the GloBE rules. This is consistent with the intention of the rules, and with the consensus position adopted by the OECD-led Inclusive Framework which has developed and approved the Model Rules. Although tax treaties usually take priority over the provisions of the Income Tax Act, there is precedent for such an over-ride in the Act.

Consultation

27. Officials have consulted with:
 - Australian tax officials on their administrative regime for tax reporting by large multinational groups;
 - the OECD on the distinction between a DMT and a domestic IIR.

Next steps

28. Draft legislation will be prepared in accordance with Ministers' decisions and included in the upcoming omnibus bill.

Recommended action

We recommend that you:

1. **agree** that MNEs with operations in New Zealand should be required to register with IR within six months of the end of the first income year in which they are in scope of the New Zealand GloBE rules and to deregister with IR within six months of the end of the first income year in which they are out of scope of the New Zealand GloBE rules.

Agreed/Not agreed

Agreed/Not agreed

2. **agree** to require all in-scope MNEs with operations in New Zealand to file an annual top-up tax return in New Zealand.

Agreed/Not agreed

Agreed/Not agreed

29. **agree** that an in-scope MNE with operations in New Zealand which does not register for GloBE when required to do so will be liable for a civil penalty of up to \$100,000.

Agreed/Not agreed

Agreed/Not agreed

30. **agree** that an in-scope MNE with operations in New Zealand who does not file a complete GloBE information return or files such a return late will be liable for a civil penalty of up to \$100,000.

Agreed/Not agreed

Agreed/Not agreed

31. **agree** that an in-scope MNE with operations in New Zealand who does not file a complete Country-by-Country report or who files such a report late will be liable for a civil penalty of up to \$100,000.

Agreed/Not agreed

Agreed/Not agreed

32. **note** that the domestic minimum tax Cabinet has agreed to implement is more accurately described as a domestic income inclusion rule and will be referred to as such going forward.

Noted

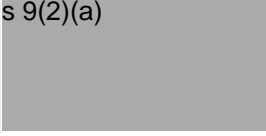
Noted

33. **agree** that the GloBE rules adopted by New Zealand should be given effect notwithstanding the terms of any tax treaty, unless those terms expressly refer to the GloBE rules.

Agreed/Not agreed

Agreed/Not agreed

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