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Pillar Two – Global minimum effective tax rate: New Zealand draft legislation released

There has been a flurry of activity internationally bringing closer the reality of a 15% global minimum effective tax rate. New Zealand has joined this international movement by introducing draft legislation to Parliament which could see the global minimum tax rate rules (referred to as Pillar Two or the Global Anti Base Erosion (GloBE) rules) coming into effect from as early as 1 January 2024.

With Pillar Two legislation being introduced globally, the IASB also finalised updated accounting requirements in late May which means impacted groups are going to need to prepare for increased Pillar Two financial reporting obligations from 1 January 2023.

Whether you are a large New Zealand headquartered group or a New Zealand subsidiary of a large offshore group, the New Zealand rules are likely to directly impact you.

It is critical that impacted groups start planning now to ensure that they prepare for the significant data requirements (estimated 240+ data inputs will be required) and allow sufficient time to put processes in place to comply with this complex and unprecedented set of rules.

We provide below a high level overview of the GloBE rules, what's happening in New Zealand and the potential impact on multinational entities (MNEs) operating in New Zealand.

Overview of the global minimum effective tax rate rules

The GloBE rules have been developed as part of an OECD lead initiative in response to the tax challenges posed by the increasing globalisation and digitalisation of the world economy.

The GloBE rules are the main component of Pillar Two within the 'Two-Pillar' solution, endorsed by over 130 countries (including New Zealand) to reform the international income tax framework. In summary, Pillar One aims to ensure a fairer distribution of profits and taxing rights between jurisdictions, and Pillar Two aims to limit jurisdictions' 'race to the bottom' with respect to their corporate income tax rates.

In this regard, the GloBE rules have been designed such that MNEs with annual global revenues over €750 million (approximately NZ$1.3 billion) should pay a minimum 15% effective tax rate on mobile income in every jurisdiction in which they operate.

Specifically, the GloBE rules are a set of two interlocking measures that should result in a parent entity paying a 'top-up' amount of tax for a low tax subsidiary or vice versa. Our earlier Tax Tips includes further detail on the key components of the rules.

The rules are complex to apply and in a number of instances companies based in countries with high headline corporate income tax rates are still falling short of the 15% effective tax rate threshold when modelling the impact of these rules. The design of the rules means that a 15% global minimum effective tax rate can be achieved even if many of the countries where a global group operates in do not adopt the rules domestically.

What’s happening in New Zealand?

Draft legislation to give effect to the rules has now been introduced to Parliament as part of the Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill (the Bill).

The GloBE rules are proposed to be incorporated in New Zealand legislation, for the most part, by reference to the OECD Model Rules, associated Commentary and Agreed Administrative Guidance – rather than drafting New Zealand specific legislation. The driver for this approach to incorporating the rules is to mitigate the risk of interpretive errors or mismatches with other jurisdictions.

While the Bill is expected to be passed later this year, the application date of the GloBE rules is yet to be confirmed and will be set by Order in Council once the Government determines a ‘critical mass’ of countries have adopted the GloBE rules. This could be as early as 1 January 2024 (which would align New Zealand with Australia’s expected adoption date).

Officials’ published view is that, by holding off application until a ‘critical mass’ is deemed to have been achieved, New Zealand should not forgo GloBE tax revenue that would otherwise be collected under another countries’ GloBE rules, and that the already significant compliance costs for New Zealand headquartered MNEs should be minimised. This is on the basis that when a ‘critical mass’ of other countries have adopted the rules, New Zealand headquartered MNEs would be required to comply with, and pay GloBE tax, regardless of whether New Zealand adopts the rules. By New Zealand adopting the rules, those New Zealand headquartered MNE are able to file and return amounts to Inland Revenue rather than having detailed GloBE tax obligations with multiple different tax authorities.

The draft legislation also includes a domestic minimum tax (referred to as the Domestic Income Inclusion Rule) which would apply to New Zealand headquartered MNEs that are within the scope of the rules and that have ‘undertaxed’ income in New Zealand. Unlike other jurisdictions, New Zealand’s domestic minimum tax is **not** proposed to apply to foreign owned New Zealand subsidiaries.

Imputation credits would not be available for top-up taxes paid under the GloBE rules but would be available for taxes paid under the Domestic Income Inclusion Rule. The Bill does propose to permit foreign tax credits for top-up taxes paid under another jurisdiction’s qualified domestic minimum top-up tax.

While the Pillar Two rules are extremely complex and will have a pervasive impact on large MNEs, the rules are not expected to result in a material increase in the tax collected in New Zealand. Inland Revenue estimates that the GloBE tax that would be collected would only be around $25 million per annum.

WHAT’S HAPPENING IN OTHER JURISDICTIONS?

Globally, countries are taking steps to incorporate the Pillar Two rules into their domestic tax legislative frameworks. Many jurisdictions have similarly initiated domestic legislative procedures, released drafting legislation or have announced their intention to introduce measures consistent with the OECD’s Pillar Two proposals.

PwC has developed a country tracker which is continuously updated with the status of Pillar Two implementation in different countries and regions.

How are New Zealand taxpayers expected to be impacted?

Given the progress being made in other jurisdictions, our view is that it is almost certain that the required 'critical mass' will be achieved such that the Pillar Two rules will be "switched on" in New Zealand. However, an effective date of 1 January 2024 still seems ambitious.

New Zealand headquartered MNEs

Whilst the additional tax cost may not be significant for most New Zealand MNEs, the tax reporting obligations are going to trigger a significant compliance burden on taxpayers – understanding the data requirements of Pillar Two is pivotal in preparing for these upcoming changes and enabling compliance.

Even if the legislative implementation date is deferred, financial reporting obligations are likely to be relevant in the current financial year.

The significant levels of data required to be collated and analysed in order to comply with the rules is anticipated to be the main pain point. By way of example, the draft GloBE Information Return released by the OECD is over 70 pages long and contains an estimated 240+ data points – with a significant number currently sitting outside groups' ERP systems. Finance, legal, human resource and IT teams will be impacted by the impending changes.

New Zealand subsidiaries for foreign owned MNEs

In our experience to date, the headquarter jurisdictions of impacted MNEs are driving the Pillar Two efforts on behalf of the group – even where they are not implementing the rules domestically (e.g., the US). Generally, New Zealand subsidiaries have been (or are likely to be) required to assist in providing detail on local processes to enable relevant data to be gathered effectively.

In some cases, MNEs headquartered outside New Zealand could be subject to a 'Top Up Tax' liability in New Zealand – for example, where a New Zealand entity is an intermediate parent (and the Pillar Two rules have not yet been adopted in the jurisdiction of its parent entity), or where there is undertaxed mobile income in the parent jurisdiction.

It will also be important for New Zealand subsidiaries to stay across the Pillar Two registration and filing obligations to mitigate the risk of penalties being imposed (discussed further below).

Will the safe harbours provide relief?

In light of the significant compliance burden, the OECD has released details on transitional safe harbours that are intended to mitigate the complexity and compliance hurdle for impacted groups. Crucially, the safe harbour conditions involve less extensive calculations, draw on a smaller pool of data than the fully fledged GloBE calculations, and utilise data that is – in theory – already available.

The transitional safe harbours are predominantly based on Country-by-Country Report (CbCR) data. However, in order to access the transitional safe harbours, a "Qualified CbCR" is required. That is, a CbCR compiled and reconciled with data from the group consolidated financial statement or from the individual legal entity accounts (provided the accounts are prepared using an acceptable financial standard).

It will be critical to assess whether your CbCR is a Qualified CbCR. However, even when a safe harbour is available, the level of work required to comply with the rules should not be underestimated.

This PwC Global Tax Policy Alert provides further detail on the Safe Harbours. PwC can also assist with determining whether your CbCR meets the criteria to be considered 'qualified' and help to assess whether the safe harbour rules can be applied to your group.

Financial reporting requirements

Consideration of financial statement disclosures are becoming increasingly pressing as countries around the world progress toward 'substantial enactment' of the GloBE rules.

Late last month, the International Accounting Standards Board (IASB) issued amendments to IAS 12 Income Taxes with respect to Pillar Two. In summary, the amendments;

1. provide a temporary exception from the requirement to recognise and disclose deferred taxes arising as a result of implementation of the Pillar Two rules; and

2. introduce targeted disclosure requirements relating to known or reasonably estimable Pillar Two exposures for affected companies (to help investors better understand a company's exposure to income taxes arising from the reform, particularly before legislation implementing the rules is in effect).

The New Zealand Accounting Standards Board (NZASB) needs to approve these amendments before they become applicable for NZ IFRS preparers. The timing of this has not been determined.

Therefore entities applying NZ IFRS will need to consider the financial reporting implications of the Pillar Two rules before the amendments are effective in New Zealand where the entity has a period end that falls between the date when Pillar Two legislation is enacted (or substantively enacted) in a jurisdiction the group is operating in and the date when the amendments to NZ IAS 12 becomes effective in New Zealand.

For more information, please refer to this PwC In Brief.

This is a relatively recent development, and the financial reporting implications are being worked through internationally. However, it is essential for businesses to consider those potential financial reporting implications early and engage with their auditors and advisors as soon as practical to ensure appropriate compliance with the relevant reporting requirements. Financial reporting disclosures are likely to be required well in advance of any Pillar Two filing obligations.

Apart from the amendments to IAS 12 above, other existing standards might already require certain disclosures relating to Pillar Two rules before enactment. For example, where an entity is expected to be significantly affected by the rules, management should consider disclosing information following the principles outlined in NZ IAS 1 para 17(c); or where the related laws are announced or enacted subsequent to reporting period end but before the related financial statements are authorised for issue, the entity would need to follow the NZ IAS 10 guidance for relevant disclosure.

COUNTRY BY COUNTRY REPORTING REQUIREMENTS

Given the GloBE rules and CbCR rules are closely linked, the draft legislation also includes proposed amendments to the CbCR regime. Specifically, CbCRs would need to be submitted in an electronic (XML Schema) format and a penalty of up to $100,000 would be introduced for incomplete and/or late filing.

Tax compliance requirements down the track

The draft legislation naturally includes additional compliance and filing requirements for those within the scope of the rules as well as penalties for non-compliance.

In summary:

Measure	Detail	Potential penalties
Registration with Inland Revenue	All in scope MNEs will be required to notify Inland Revenue that they are within the scope of the GloBE rules and register with Inland Revenue within six months of the end of the first income year they are within the scope of the rules. This would apply to both New Zealand headquartered MNEs and foreign MNEs with entities located in New Zealand (including branches).	Up to $100,000
GloBE Information Return (GIR)	New Zealand headquartered groups within the scope of the rules will be required to submit a GIR to Inland Revenue in the prescribed electronic format. The GIR would need to be filed in a standard template that is being developed by the OECD. A penalty could also be imposed on foreign headquartered MNEs with operations in New Zealand if the GIR is not filed on time in another jurisdiction, or if the GIR is filed in a country with which New Zealand does not have an exchange of information agreement.	Up to $100,000
Multinational Top Up Tax Return	All in scope MNEs would need to file an annual top up tax return in New Zealand stating the amount of top up tax payable (if any). This would be separate from and due one month after the GIR. The Multinational Top-up Tax Return would represent a self-assessment of any top-up tax in a form prescribed by the Commissioner of Inland Revenue.	$500

Next steps in Pillar Two readiness

With New Zealand's implementation of the Pillar Two rules fast approaching and potential penalties of up to $100,000 for failing to comply with the reporting requirements, groups should act now to understand the obligations for their group, as well as determining whether their current data models, systems, technology and processes can respond to the related tax compliance requirements.

For affected taxpayers, understanding the data requirements of Pillar Two is pivotal in preparing for these upcoming changes. With the potential related financial reporting implications and the volume of data required, even the most mature and well-administered taxpayers should be dedicating time to focus on this.

PwC's Data Input Catalogue is at the centre of PwC's end-to-end process for Pillar Two and defines the data requirements for Pillar Two, giving affected taxpayers a comprehensive understanding of the amount of work that lies ahead of them and can help anticipate the unique challenges they will face.

Our Global Pillar Two Readiness page provides further details on the rules. Please reach out to your PwC contact – we're here to help!

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