

Hong Kong Tax Alert

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Government launches public consultation on the implementation of the global minimum tax and a domestic minimum tax in Hong Kong

The government has recently issued a consultation paper¹ (the Paper) on the implementation of the global minimum tax and a domestic minimum top-up tax in Hong Kong (HKMTT) starting from 2025 onwards. The consultation will end on 20 March 2024.

Background

The global minimum tax under the international reform framework of a two-pillar solution to tackle base erosion and profit shifting (BEPS) risks arising from digitalization of the economy (commonly known as BEPS 2.0) targets multinational enterprise (MNE) groups with annual consolidated revenue of EUR 750 million or above. It ensures that these MNEs pay a minimum tax of 15% in respect of profits derived from every jurisdiction they operate in through two interlocking rules, the Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR), which together referred to as the global anti-base erosion (GloBE) rules. To preserve its own taxing right, a jurisdiction may also impose a domestic minimum top-up tax (DMTT). This seeks to put a floor on competition over corporate income tax among jurisdictions.

Scope of the consultation

The GloBE rules have already been finalized based on the international consensus and there is no room for deviation. As such, the Paper explains the policy considerations and the design features of the GloBE rules which are relevant to Hong Kong and invites views on matters that are left for consideration by the implementing jurisdictions (i.e., administrative framework of the GloBE rules as well as the design and administration of the HKMTT).

At this stage, the Subject to Tax Rule (STTR) under the GloBE rules is not covered by the Paper.

Note:

(1) The consultation paper can be accessed from the below link:

[https://www.fstb.gov.hk/tb/en/others/Consultation%20paper_Global%20minimum%20tax%20and%20HKMTT%20\(Eng\).pdf](https://www.fstb.gov.hk/tb/en/others/Consultation%20paper_Global%20minimum%20tax%20and%20HKMTT%20(Eng).pdf)

Legislative approach to be adopted

Hong Kong will adopt a hybrid legislative approach by directly incorporating the GloBE rules into the Inland Revenue Ordinance (IRO) with limited adaptations as far as practicable (i.e., a hybrid of what would otherwise be a full-scale direct reference or adaptation as adopted by certain overseas jurisdictions).

As such, the enacted GloBE rules in Hong Kong will have to be read and applied in the way that best secures consistency with the requirements and guidance in the Organization for Economic Co-operation and Development's (OECD) Commentary and Administrative Guidance in force immediately before the enactment. Specific provisions may also be added to deal with the interaction between the enacted GloBE rules and the existing provisions of the IRO.

The top-up tax under the GloBE or HKMTT regime is to be regarded as profits tax. Thus, the provisions relating to the GloBE rules and the HKMTT will be provided under the IRO rather than as an Ordinance separate from the IRO. It is considered that to regard the top-up tax as profits tax would help maintain tax certainty by riding on certain existing tax administration mechanisms such as tax collection, objections and appeals. It would also enable in-scope MNE groups to resolve any cross-border disputes in relation to their top-up tax liabilities in Hong Kong under the comprehensive avoidance of double tax agreements (CDTAs), under which profits tax is a covered tax.

Location of an entity

The government proposes that, for the purposes of the GloBE rules and HKMTT, with retrospective effect from 1 January 2024, an entity is a Hong Kong resident entity if (a) in the case where an entity is a company – the entity is incorporated in Hong Kong or, if incorporated outside Hong Kong, normally managed or controlled in Hong Kong; or (b) in any other case – the entity is constituted under the laws of Hong Kong, or if otherwise constituted, normally managed or controlled in Hong Kong.

Charging UTPR by way of an equivalent adjustment rather than denial of expenses

The GloBE rules provide that the UTPR may take the form of a denial of deduction for otherwise deductible expenses in an amount sufficient to result in the constituent entities located in the UTPR jurisdiction having an additional cash tax expense equal to the UTPR top-up tax amount allocated to that jurisdiction. Alternatively, the UTPR may take the form of an adjustment that is equivalent to a denial of a deduction.

The government proposes adopting the equivalent adjustment approach. The justification is that this approach will ensure that a constituent entity which is liable to pay the UTPR top-up tax for a fiscal year will have to incur a cash tax expense in the amount of the UTPR top-up tax, regardless of its own local tax position. As such, any carry-forward of UTPR top-up tax (where loss is sustained) will not be necessary. This approach also avoids complicated provisions to deal with the interaction of the denial with the existing profits tax rules.

UTPR not applying in the initial phase of international activity of MNE groups

The government proposes that Hong Kong will adopt the option of relieving MNE groups from the UTPR in their initial phase of international activity. The rationale for this proposal is to provide a level playing field between a Hong Kong-headquartered MNE group and a foreign-headquartered MNE group, and to prevent Hong Kong-headquartered MNE groups from abusing the relief for initial phase of international activity by group inversion.

Scope and features of the HKMTT

HKMTT to qualify as a QDMTT

The government proposes that the HKMTT will be designed so that it qualifies as a qualified domestic minimum top-up tax (QDMTT). To this end, the HKMTT will mirror all the requirements of the GloBE rules subject to the permitted and optional variations within the OECD's framework. In addition, the HKMTT will be designed to produce a liability for top-up tax that is equivalent to the top-up tax liability that would have arisen under the GloBE rules.

Other features of the HKMTT

Other proposed features of the HKMTT include:

- (i) imposed on the whole amount of the total top-up tax computed in respect of all Hong Kong constituted entities of an in-scope MNE group, irrespective of the ownership interest held in the constituent entities by any parent entity of the group;
- (ii) apply only to MNE groups with an annual consolidated revenue of or above EUR 750 million. Small MNE groups and purely local groups are excluded from the scope of the HKMTT
- (iii) in-scope MNE groups, whether headquartered in or outside Hong Kong will be covered
- (iv) all Hong Kong constituted entities of such groups, as well as joint ventures (JV) and JV subsidiaries held by the groups, will be subject to the HKMTT regardless of the ownership interest of the ultimate parent entity (UPE) or partially owned parent entity (POPE) in the entities concerned

- (v) the HKMTT attributable to the JVs and their subsidiaries of an in-scope MNE group will be directly imposed on the JVs and JV subsidiaries concerned instead of being allocated to other Hong Kong constituent entities of the group. This is to secure the availability of the QDMTT safe harbor, as permitted under the Administrative Guidance issued by the OECD
- (vi) the HKMTT payable will, by default, be allocated among Hong Kong constituent entities of an in-scope MNE group pursuant to the formula adopted in Article 5.2.4 of the GloBE rules, i.e., based on the ratio of the GloBE income of the Hong Kong constituent entity to the aggregate GloBE income of all Hong Kong constituent entities of the group. However, this default allocation mechanism will be disapplied if the group designates one or more Hong Kong constituent entities to pay the HKMTT
- (vii) subject to meeting the QDMTT accounting standard, the use of local financial accounting standard for the HKMTT computation will be allowed since it should provide additional flexibility and simplification
- (viii) substance-based income exclusion will be included
- (ix) the minimum tax rate will be set at 15%, and not higher even it is permitted
- (x) the same de minimis exclusion provided under Article 5.5 of the GloBE rules will be included
- (xi) the HKMTT will not apply during the initial phase of international activity of an MNE group where no parent entity is required to apply qualified IIR with respect to Hong Kong constituent in-scope MNE groups

Simplification for a full computation of the top-up tax under the GloBE rules available

The government proposes to provide the transitional country-by-country reporting (CbCR) safe harbor for the purposes of the GloBE rules and the QDMTT safe harbor in the legislation.

Tax compliance, administration and the general anti-avoidance provisions

Filing of top-up tax returns and notifications

The Inland Revenue Department (IRD) will put in place a dedicated tax administration framework to implement the GloBE rules and the HKMTT. The framework will cover requirements in relation to the filing of notifications and returns, payment of top-up tax, record-keeping and penalty for non-compliance etc.

An in-scope MNE group, whether headquartered in Hong Kong or outside will be allowed to designate one Hong Kong constituent entity to file the top-up tax return to the IRD such that all other Hong Kong constituent entities will be relieved from their notification and filing obligations.

The government proposes that (i) a top-up tax notification will be required to be filed within six months after the end of the fiscal year; and (ii) subject to the transitional year, a top-up tax return be filed no later than 15 months after the last day of the reporting fiscal year. The filing deadline for the transition year is extended to 18 months.

Penalties

Failure to file the top-up tax return or top-up notification as required without reasonable excuse will be a Level 5 offence. In case of a continuing offence after conviction, a further fine of HK\$500 will be imposed for each day of offence. Failure to comply with a court order to rectify such an offence will be liable on conviction to a fine at Level 6.

The penal consequence of failing to file a top-up tax return or top-up notification or filing an incorrect top-up tax return or top-up tax notification without reasonable excuse will essentially be equivalent to failing the same in respect of a profits tax return under the existing provisions of the IRO, including that for service providers who file such returns or notifications for their clients.

However, the factors mentioned in the OECD's publication regarding transitional penalty relief if an MNE group has taken reasonable measures to ensure the correct application of the GloBE rules in the initial years, will be taken into account by the IRD when considering whether there is any reasonable excuse for the wrongdoings.

Information required in a top-up tax return

For an in-scope MNE group which is (a) headquartered in Hong Kong; or (b) a non-Hong Kong headquartered jurisdiction that is unable to exchange GloBE Information Return (GIR) with Hong Kong under a qualifying competent authority agreement, the top-up tax return will include the data points required in the GIR. The GIR information reported in the top-up tax return of a Hong Kong headquartered MNE group will be exchanged with other relevant jurisdictions which have a qualifying competent authority agreement in place with Hong Kong.

Notice of assessment to be issued

A notice of assessment demanding the top-up tax will be issued based on the information declared electronically upon filing of the top-up tax return. No provisional top-up tax will however be charged. The date for the payment of the top-up tax will probably be set two weeks from the date of the notice of assessment.

Other general provisions including the potential application of the anti-avoidance provisions

The government proposes to ride on the existing general and administrative provisions of the IRO, with necessary modifications, for the purposes of the GloBE rules and HKMTT to deal with the record keeping requirements, objection procedures, collection and recovery of tax, and anti-avoidance issues etc.

Sharing or charging top-up taxes among constituent entities be tax neutral

The top-up tax under the IIR will be charged on the UPE. In respect of the UTPR or HKMTT regime, to accord flexibility for payment of top-up tax, an in-scope MNE group will be allowed to decide on how the tax payable is to be allocated among its Hong Kong constituent entities. The MNE group can designate one or more paying entity, save that all Hong Kong constituent entities of the MNE group will be jointly and severally liable for the whole amount of the top-up tax payable.

Tax payments made by a paying entity on behalf of other Hong Kong constituent entities of the MNE group will not be allowed as deductions in calculating the income, profits or losses of the paying entity for profits tax purpose. Similarly, reimbursements for payments towards the top-up tax will not be treated as taxable receipts for profits tax purposes.

E-filing of top-up tax returns and notifications

Following the implementation of the GloBE rules and the HKMTT, in-scope MNE groups will need to file their top-up tax returns and top-up tax notifications electronically for a reporting fiscal year beginning on or after 1 January 2025.

In addition, the Commissioner of Inland Revenue intends to issue a gazette notice under section 51AAB of the IRO to require Hong Kong constituent entities of in-scope MNE groups to also file their profits tax returns electronically for a year beginning on or after 1 April 2025.

A full list of the 22 consultation questions on which views are sought is reproduced in the Annex to this alert.

Clients who have any comments on the implementation of the global minimum tax and the HKMTT in Hong Kong as outlined above or any views on the consultation questions can contact their executive.



Annex - Consultation questions

1. Do you have any views on the proposed equivalent adjustment approach to bring the undertaxed profits rule (“UTPR”) top-up tax into charge?
2. Do you have any views on the proposed allocation and payment mechanism for the UTPR top-up tax?
3. Do you have any views on the proposed approach to deal with the issue relating to the location of an entity and the proposed meaning of Hong Kong resident entity for the purposes of the global anti-base erosion (“GloBE”) rules and Hong Kong minimum top-up tax (“HKMTT”)?
4. Do you have any views on the retrospective application of the meaning of a Hong Kong resident entity from 1 January 2024?
5. Are there any uncertainties that could be clarified in Inland Revenue Department’s (“IRD”) administrative guidance regarding the following –
 - (a) adjustments made to the financial accounting net income or loss;
 - (b) the rules relating to covered taxes;
 - (c) the mechanism to address temporary timing differences;
 - (d) post-filing adjustments?
6. Are there any uncertainties that could be clarified in IRD’s administrative guidance regarding the process for calculating top-up tax, in particular the de minimis exclusion and substance-based income exclusion (“SBIE”)?
7. Are there any uncertainties in relation to the operation of the transition rules that may need to be clarified in law or IRD’s administrative guidance?
8. Do you have views on the proposed adoption of the optional provision relating to the relief for initial phase of international activity under Article 9.3.5 of the GloBE rules?
9. Do you have views on the scope of the HKMTT?
10. Do you have views on the allocation rules of HKMTT liability?
11. Do you agree with the adoption of the local financial accounting standard for the purposes of the HKMTT?
12. Do you have views on the proposed optional variations in the design of HKMTT, namely the inclusion of a SBIE, the tax rate of 15%, and the inclusion of the same de minimis exclusion?
13. Do you agree to allow the exclusion of initial phase of international activity under the HKMTT but limit its application to in-scope multinational enterprise (“MNE”) groups where no parent entity is required to apply qualified Income Inclusion Rule with respect to Hong Kong constituent entities of the group?
14. Do you have views on whether the transitional country-by-country reporting safe harbour should be adopted? If not, why not?
15. Given additional standards need to be met, do you have views on whether the Qualified Domestic Minimum Top-up Tax (“QDMTT”) safe harbor should be adopted? If not, why not?
16. Do you have views on whether the switch-off mechanism under the consistency standard should be adopted for implementing the QDMTT safe harbor? If not, why not?
17. Do you have any views on the proposed arrangements for the filing of top-up tax return and top-up tax notification?
18. Do you have any views on the proposed arrangements for the assessment and payment of top-up tax?
19. Do you have views on the proposed penalties for wrongdoing and noncompliance in relation to the GloBE rules and HKMTT?
20. Do you have any views or comments on the proposed compliance and administration framework for the GloBE rules and HKMTT?
21. Do you have any views on the necessary modifications of the existing administrative provisions of the Inland Revenue Ordinance to deal with the record keeping requirements, objection procedures, collection and recovery of tax, anti-avoidance issues, etc.?
22. Do you have any views on the proposed application of mandatory e-filing of profits tax returns to in-scope MNE groups from the year of assessment 2025/26?

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