HONG KONG TAX

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HONG KONG BEGINS PUBLIC CONSULTATION TO IMPLEMENT THE GLOBAL MINIMUM TAX AND HONG KONG MINIMUM TOP-UP TAX

SUMMARY

- In the 2023/2024 budget, the HKSAR Government announced plans to implement the global minimum effective tax rate of 15% on in-scope MNE groups
- On 21 December 2023, a consultation paper was issued which sets out how Hong Kong will implement the global anti-base erosion (GloBE) rules and seeks public views on various implementation aspects. The consultation period lasts till 20 March 2024
- The consultation covers the introduction of the Income Inclusion Rules (IIR),the Undertaxed Profits Rule (UTPR) and the Hong Kong minimum top-up tax (HKMTT). The Subject to Tax Rule (STTR) is not included
- Since a key objective is to ensure that the rules in Hong Kong (in particular the HKMTT) is viewed as a Qualified Domestic Minimum Tax by the Organisation for Economic Co-operation and Development (OECD), the proposed rules are largely consistent with the model OECD GloBE rules. This means that:
  - MNE groups with consolidated annual revenue of or above EUR 750 million in at least two of the previous four fiscal years are in scope
  - Hong Kong Constituent entity(s) of an in-scope MNE group will be required to electronically file an annual top-up tax notification and a top-up tax return within respective stipulated statutory deadline
  - The rule will take effect for accounting periods beginning on or after 1 January 2025
  - Transitional and permanent safe harbours, as well as transition provisions are available
  - Penalties will apply to a filing entity (and its service provider if one is engaged) for failure in filing, or incorrect filing without reasonable excuse
- In-scope MNE groups should carefully, and proactively, assess the impact of the proposed rules on their business and assess the long-term suitability of their existing international tax structures in Hong Kong and around the world

Background and context

The Organisation for Economic Co-operation and Development (OECD) announced in July 2021 the international tax reform framework of a two-pillar solution to tackle the base erosion and profit shifting risks arising from digitalisation of the economy (commonly known as BEPS 2.0).

In Hong Kong, the Financial Secretary previously announced in the 2023-24 Budget the plan to implement the global minimum effective tax rate of 15% on in-scope multinational enterprise (MNE) groups in accordance with the OECD's BEPS 2.0 Framework.

On 21 December 2023, the consultation paper on the implementation of global minimum tax and Hong Kong minimum top-up tax (consultation paper) was issued by the Hong Kong SAR Government. The consultation paper sets out the Government's position and preferred approach to implement the global anti-base erosion (GloBE) rules and the domestic minimum top-up tax in Hong Kong (HKMTT), and to seek public views on the administration framework of the GloBE rules as well as the design and implementation of the HKMTT.

The consultation period lasts for three months till 20 March 2024.

In-scope MNE groups

MNE groups with consolidated annual revenue of or above EUR 750 million (denominated in Euros rather than Hong Kong dollar equivalent) in at least two of the previous four fiscal years are in scope of the GloBE rules and the HKMTT. Smaller MNE groups and purely local groups are excluded.

All Hong Kong resident entities of an in-scope MNE group whether headquartered in or outside Hong Kong, which are or would have been included in the group consolidated financial statements, will be subject to the HKMTT.

Effective fiscal year

The global minimum tax and HKMTT will take effect for a fiscal year beginning on or after 1 January 2025.

Definition of Hong Kong resident

For the purposes of the GloBE rules and HKMTT, the Government proposes that an entity incorporated/ constituted in Hong Kong or, if incorporated/ constituted outside Hong Kong yet normally managed or controlled in Hong Kong is a Hong Kong resident entity, with retrospective application of meaning from 1 January 2024.

Hybrid legislative approach

The Government will adopt a hybrid legislative approach by directly incorporating the GloBE rules into the Inland Revenue Ordinance (Chapter 112) (IRO) with limited adaptations as far as practicable. The enacted GloBE rules will have to be read and applied in the way that best secures consistency with the requirements and guidance in OECD's Commentary and Administrative Guidance in force immediately before the enactment.

The GloBE rules and Hong Kong Government's positions on implementation of top-up tax

The Government will closely follow the GloBE rules so as to ensure that the GloBE rules implemented by Hong Kong will be assessed as qualified rules in the OECD's peer review process. The steps for charging the top-up tax are briefly summarised as follows:

Step 1: Determine whether an MNE group is in scope

Step 2: Determine the income and taxes of members of the group (constituent entities, or CEs)

Step 3: Calculate the group's effective tax rate in the jurisdiction and determine the amount of top-up tax in that jurisdiction

Step 4: Allocate the top-up tax to the group's CEs within that jurisdiction

Step 5: Impose top-up tax under the Income Inclusion Rule (IIR) or Undertaxed Profits Rule (UTPR) in accordance with the agreed rule order

Step 5	Income Inclusion Rule (IIR)	Undertaxed Profits Rule (UTPR)
General taxing mechanism	Top-up tax on the parent entity of an in-scope MNE group in respect of its low-taxed CEs located outside of parent entity's jurisdiction	A backstop which collects residual top-up tax after IIR through denial of deduction or making an equivalent adjustment
The Government's position on implementation in Hong Kong	• Top-up tax to be charged on the ultimate parent entity (UPE) in Hong Kong attributable to foreign low-taxed CEs of Hong Kong-headquartered in-scope MNE groups, with exception that may apply in limited situations	• The Government proposes an equivalent adjustment in the form of an additional tax allocated among Hong Kong CEs of an in-scope MNE group • The group can also designate one or more than one Hong Kong CE to pay the top-up tax
Basis of tax allocation	Ownership percentage	Proportion of the value of tangible assets and the number of employees aggregated at the jurisdictional level

Introduction of HKMTT

The Government plans to implement the HKMTT to safeguard its taxing rights and to alleviate the in-scope MNE groups from compliance burdens of paying top-up tax under the IIR or UTPR in respect of every operating jurisdiction. The HKMTT is intended to be a Qualified Domestic Minimum Top-up Tax (QDMTT) and satisfy the QDMTT safe harbour.

Hong Kong minimum top-up tax (HKMTT)	
General taxing mechanism	A jurisdictional based tax directly creditable against liabilities otherwise arising under the IIR and the UTPR. The top-up tax payable in respect of that jurisdiction under the GloBE rules will be deemed to be zero if the QDMTT safe harbour in respect of a jurisdiction is met
Implementation in Hong Kong	• To design the HKMTT to produce a top-up tax liability that is equivalent to that would have arisen under the GloBE rules subject to the permitted and optional variations within the OECD's framework • To include Substance-based income exclusion (SBIE), a formulaic carve-out from the net GloBE income based on payroll costs and tangible assets, for substantive activities within Hong Kong • To adopt the local financial accounting standard is required if specified conditions are met. Otherwise, to adopt the financial accounting standard of the UPE's consolidated financial accounts • The group can designate one or more than one Hong Kong CE to pay the HKMTT
Tax rate	15%
Basis of tax allocation	Ratio of the GloBE income of the Hong Kong CE to the aggregate GloBE income of all Hong Kong CEs of the group

Transition rules, safe harbours and simplifications

The Government proposes to adopt optional transition provisions under the GloBE rules which apply for a period of time when an MNE group first become in scope, covering topics of losses and timing differences, higher SBIE, filing deadline, etc.

The Government also proposes to provide a transitional Country-by-Country Reporting (CbCR) safe harbour for the purpose of the GLoBE rules and a permanent QDMTT safe harbour in the legislation to reduce the burden in complying with the detailed computational requirements of the GloBE rules.

Tax compliance

The Government proposes that for a reporting fiscal year starting on or after 1 January 2025, each Hong Kong CE of an in-scope MNE group will be required to:

- Electronically file an annual notification (top-up tax notification) relating to its obligation of filing top-up tax return within six months after the end of the fiscal year.
- Electronically furnish a single top-up tax return for the purposes of the GloBE rules and HKMTT (top-up tax return) no later than 15 months after the last day of the reporting fiscal year (extended to 18 months within the transition year).
- An in-scope MNE group can designate one Hong Kong CE (designated local entity) to file the top-up tax notification and top-up tax return to the Inland Revenue Department (IRD).

An electronic platform will be developed by the IRD to allow submission of notifications and returns.

A notice of assessment of the top-up tax will be issued based on the information filed and contained in the top-up tax return. No provisional top-up tax will 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.

Administration and penalties

For the purposes of GloBE rules and HKMTT, the existing administrative provisions of the IRO, with necessary modifications, to deal with the record keeping, objection procedures, collection and recovery of tax, and anti-avoidance issues, etc, will apply. Similarly, penalties under the existing IRO administrative provisions can apply to a filing entity, as well as to a service provider engaged, for:

- Failure to file the top-up tax return or top-up notification; or,
- Filing an incorrect top-up tax return and top-up tax notification without reasonable excuse or wilfully with intent to evade tax (imprisonment also applies to latter);

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.

Consultation questions

The consultation paper contains 22 specific questions which seek views or asks stakeholders to help identify uncertainties that could be clarified in law or the IRD's administrative guides in areas of: charging provisions; calculation of effective tax rate and top-up tax; transition and simplification rules; design of HKMTT, tax compliance and administration; and mandatory electronic filing of profit tax returns through a designated computer system for a year of assessment beginning on or after 1 April 2025. Detailed consultation questions can be found in the Annex of the consultation paper.

BDO observations

The adoption of the GloBE rules and introduction of the HKMTT represents a significant change in Hong Kong's tax system. The final regulations will need to consider how certain aspects of the GloBE rules interact with Hong Kong's existing territorial basis of taxation.

Additionally, the GloBE rules are both complex in its current form, and are evolving through the issuance of updated administrative guidance by the OECD. Hong Kong will have to consider how to efficiently incorporate international rules (including future guidance) into the IRO.

We welcome the Government's willingness to adopt (transitional and permanent) safe harbours and other simplification provisions which will ease compliance burden on taxpayers. Additional guidance related to the application of penalties and other practical measures to help provide taxpayers with certainty would also be welcomed.

Given the introduction of these rules in Hong Kong as well as in other jurisdictions, we recommend that in-scope MNE groups carefully, and proactively, assess the initial impact of the proposed rules on their business and assess the long-term suitability of their existing international tax structures.

BDO's tax experts are actively involved in this consultation process and are available to assist.

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