Consultation on implementation of global minimum tax and Hong Kong minimum top-up tax launched

3 January 2024
Issue 1

In brief

As foreshadowed in the 2023-24 Budget announced in February 2023, Hong Kong will implement the 15% global minimum tax on in-scope multinational enterprise (MNE) groups and the domestic minimum top-up tax (DMTT) in Hong Kong (HKMTT) starting from 2025 onwards.

On 21 December 2023, the Government published its much-anticipated consultation paper on the implementation of the global minimum tax and the HKMTT in Hong Kong (Consultation Paper)[1]. The consultation is open until 20 March 2024, with the expectation that draft legislation will be published in the second half of 2024.

The proposed legislative framework for the global minimum tax and the HKMTT closely follows the global anti-base erosion (GloBE) rules promulgated by the Organisation for Economic Co-operation and Development (OECD). It is proposed that the global minimum tax and the HKMTT will take effect for a fiscal year beginning on or after 1 January 2025.

This news flash summarises the key features of the proposed global minimum tax and HKMTT as well as our observations.

In detail

Background

In July 2021, the OECD announced the international tax reform framework of a two-pillar solution to tackle the base erosion and profit shifting (BEPS) risks arising from digitalisation of the economy (commonly known as 'BEPS 2.0'). In October 2021, over 130 jurisdictions in the OECD/G20 Inclusive Framework on BEPS reached an agreement on the two-pillar solution.

The GloBE rules, which consist of two interlocking rules, namely (1) the Income Inclusion Rule (IIR) and (2) the Undertaxed Profits Rule (UTPR), are under Pillar Two of BEPS 2.0 which targets MNE groups with annual consolidated revenue of EUR 750 million or above. The GloBE rules ensure that these MNE groups pay a minimum tax of 15% in respect of the profits derived from every jurisdiction they operate in. An implementing jurisdiction may also consider imposing a DMTT to preserve its own taxing right on profits derived from its jurisdiction. This seeks to put a floor on competition over corporate income tax among jurisdictions.

To ensure coordinated implementation of the GloBE rules with consistent outcome, the OECD has published the GloBE Model Rules, commentaries thereto and administrative guidance thereon (collectively as 'GloBE Publications').

For more background and earlier developments of BEPS 2.0, please refer to our previous international tax news flashes[2].

Given the GloBE rules have already been finalised based on the international consensus without room for deviation, the Consultation Paper mainly seeks to explain the policy rationale and the design features of the GloBE rules that are relevant to Hong Kong, and invite views on matters that are left for consideration by Hong Kong as the implementing jurisdiction (i.e. administration framework of the GloBE rules as well as the design and administration of the HKMTT). The Consultation Paper covers the IIR, UTPR and HKMTT, but not the Subject To Tax Rule (STTR) under Pillar Two of BEPS 2.0 as STTR is a treaty-based rule whose implementation is subject to bilateral discussion with the treaty partners concerned.

On a separate but related matter, the Consultation Paper also seeks to consult stakeholders on the proposed application of mandatory electronic filing (e-filing) of profits tax returns to in-scope MNE groups.

Key features of the proposed global minimum tax and HKMTT

Legislative approach

Hong Kong will take a **hybrid legislative approach**[3] by incorporating the GloBE rules into the Inland Revenue Ordinance (IRO), with limited adaptions as far as practicable. The enacted GloBE rules will have to be read and applied in the way that is best consistent with the OECD's GloBE commentary and administrative guidance in force immediately before the enactment. Specific provisions may be added to deal with the interaction between the enacted GloBE rules and the existing IRO. However, the Consultation Paper is silent on whether and how subsequent GloBE Publications will be adopted in Hong Kong in order to mitigate any potential inconsistency between Hong Kong and other jurisdictions in the future.

The top-up tax under the GloBE and HKMTT rules will be regarded as **profits tax**. This will help maintain tax certainty by riding on existing tax administration mechanisms such as tax collection, objections and appeals. It will also allow in-scope MNE groups to resolve any cross-border disputes in relation to their top-up tax liabilities in Hong Kong under Hong Kong's tax treaties.

Outside the context of the GloBE rules, Hong Kong will maintain its **territorial source principle of taxation** and continue to apply the broad guiding principle when determining the source of profits.

The Government intends to introduce an HKMTT that will be assessed as a **qualifying DMTT** (QDMTT)[4] and satisfy the QDMTT safe harbour criteria. The justification is that tax arising under a QDMTT takes priority over the GloBE rules and directly reduces the amount of top-up tax arising under the GloBE rules, which would prevent the application of the IIR or UTPR by other jurisdictions in respect of the undertaxed profits derived by in-scope MNE groups in Hong Kong and preserve Hong Kong's primary right of taxation over such profits.

The key features of the proposed global minimum tax and HKMTT are summarised below:

	Global minimum tax under GloBE rules	HKMTT
Scope	The GloBE rules will apply to MNE groups with annual **consolidated revenue of EUR 750 million or above** in at least two of the previous four fiscal years. In other words, small MNE groups and purely local groups are excluded from the scope of the GloBE rules. Hong Kong will adopt the common Euro threshold instead of an equivalent Hong Kong Dollar threshold.	The scope of HKMTT is consistent with that of the GloBE rules, irrespective of whether the MNE groups are headquartered in or outside Hong Kong.

Mechanics	**<u>IIR</u>** The IIR is the primary rule for imposing top-up tax under the GloBE rules, which generally requires the parent entity of an MNE group to pay the top-up tax for its low-taxed constituent entities in proportion to its ownership interests in those entities. The IIR is applied based on a **top-down approach** at the level of the ultimate parent entity (UPE) and works its way down the ownership chain. While generally a higher parent entity has higher priority to collect the top-up tax, in certain other circumstances, a partially-owned parent entity may have priority. **<u>UTPR</u>** The UTPR serves as a **backstop** to the IIR to ensure that any residual top-up tax that remains after applying the IIR will be allocated and collected. The GloBE rules provide that the UTPR may take the form of a denial of deduction for otherwise deductible expenses or an equivalent adjustment. The Consultation Paper proposes that Hong Kong will charge the UTPR top-up tax by way of an equivalent adjustment in the form of an **additional tax**. The Government explains that such an approach would ensure that a constituent entity that is liable to pay UTPR top-up tax for a fiscal year will have to incur a cash tax expense in the same amount as 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. The Government proposes that by default, the UTPR top-up tax will be allocated among Hong Kong constituent entities (HKCEs) of an in-scope MNE group based on their number of employees and value of tangible assets. Nonetheless, this default allocation mechanism will be disapplied if the group designates one or more HKCEs to pay the top-up tax.	The HKMTT will mirror all the requirements of the GloBE rules, subject to the permitted and optional variations within the OECD's framework. HKMTT will be imposed on the **whole amount of the total top-up tax** computed in respect of all HKCEs, JVs (as defined in the GloBE rules) and JV subsidiaries[5] of an in-scope MNE group, **irrespective of the ownership interest** held therein by any parent entity of the group. Under the default allocation mechanism, the HKMTT payable will be allocated among HKCEs of an in-scope MNE group pursuant to the formula adopted in the GloBE rules (i.e. based on the ratio of the GloBE income of the HKCE to the aggregate GloBE income of all HKCEs of the group). Alternatively, the group may designate one or more than one HKCE to pay the HKMTT.
Financial accounting standard	Generally, an acceptable financial accounting standard used in the preparation of the consolidated financial statements of the UPE should be used.	**Local financial accounting standard** must be used if all HKCEs prepare their financial accounts based on such standard. This is to secure the eligibility for the QDMTT safe harbour.
Residence	An entity is a Hong Kong resident entity for the purposes of the GloBE rules and HKMTT if it is: (i) incorporated/constituted in Hong Kong; or (ii) if incorporated/constituted outside Hong Kong, normally managed or controlled in Hong Kong. Given that some jurisdictions may implement the GloBE rules for a fiscal year beginning on or after 1 January 2024, the Government proposes that this definition will apply **retrospectively from 1 January 2024**.	

Minimum tax rate	15%	
Substance-based income exclusion (SBIE)	SBIE is a formulaic carve-out based on payroll costs and tangible assets, which seeks to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE rules.	An SBIE will be included to maintain consistency with the GloBE rules and reduce the tax burden of in-scope MNE groups.
De minimis exclusion	When a jurisdiction qualifies for de minimis exclusion[6], the top-up tax for the constituent entities located in that jurisdiction will be deemed to be zero. This means that there is no need for the MNE group to compute the effective tax rate of the constituent entities located in the jurisdiction. The exclusion applies on an annual basis and at the election of the filing constituent entity.	A de minimis exclusion will be included for the same reasons as including the SBIE as noted above.
Initial phase of international activity	The GloBE rules provide a temporary relief from the UTPR for groups which are in the initial phase of expanding internationally[7]. To reduce the risk of a Hong Kong-headquartered MNE group from abusing the relief by group inversion, it is proposed that Hong Kong will adopt the optional provision that the relief will not apply if Hong Kong is the reference jurisdiction of an in-scope MNE group. This temporary relief applies on an annual basis and expires after an MNE group has been in scope of the GloBE rules for five years starting at the time the UTPR comes into effect.	An exclusion for initial phase of international activity will be provided, but limited to in-scope MNE groups where no parent entity is required to apply qualified IIR with respect to HKCEs of the group (i.e. this exclusion is not available where the top-up tax of the HKCEs would otherwise be collected under the IIR in another jurisdiction). This is to avoid the QDMTT safe harbour switch-off rule being triggered[5].

Simplification

To provide tax certainty and reduce the compliance burden of in-scope MNE groups from performing full GloBE calculations when certain conditions are met, the Government proposes to provide the **transitional country-by-country reporting (CbCR) safe harbour** for the purposes of the GloBE rules and include the **permanent QDMTT safe harbour** in the legislation.

The Consultation Paper notes that UTPR safe harbour is not applicable to Hong Kong headquartered MNE groups as the statutory corporate profits tax rate of Hong Kong is below 20%. However, to provide flexibility to in-scope MNE groups, we consider that it may be preferable for Hong Kong to include the transitional UTPR safe harbour which allows relief from the application of a UTPR to the jurisdiction of the UPE of a non-Hong Kong headquartered MNE group with a statutory corporate tax rate of at least 20% during the transitional period.

Tax compliance and administration

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

Dedicated electronic platform	To facilitate filing of notifications and returns by constituent entities of in-scope MNE groups, the IRD will develop a dedicated electronic platform to allow registration of account, submission of notifications and returns, sending and receiving messages, etc. A filing entity may engage a service provider to file a top-up tax return or top-up tax notification through this platform.

Filing of top-up tax return	*Filing entity* Each HKCE of an in-scope MNE group will be required to furnish a single top-up tax return for the purposes of the GloBE rules and HKMTT. Alternatively, the group may designate one HKCE (designated local entity) to file the top-up tax return such that all other HKCEs of the group will be relieved from their filing obligation. For a reporting fiscal year, the designated local entity for the filing of top-up tax return and that for the filing of top-up notification must be the same HKCE. *Filing deadline* The top-up tax return is due for filing 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. *Information required* The top-up tax return will require information necessary to determine the MNE group's top-up tax liabilities under the IIR, UTPR or HKMTT as appropriate. In addition, for an in-scope MNE group that is headquartered in (a) Hong Kong; or (b) a non-Hong Kong jurisdiction that is unable to exchange GloBE Information Returns (GIR) with Hong Kong under a qualifying competent authority agreement, the top-up tax return will include the data points required in the GIR (GIR information). The GIR information reported in the top-up tax return of a Hong Kong-headquartered MNE group will be exchanged with other jurisdictions that have a qualifying competent authority agreement in place with Hong Kong.
Filing of top-up tax notification	*Filing entity* Each HKCE of an in-scope MNE group will be required to file an annual top-up tax notification relating to its obligation of filing top-up tax return. Alternatively, the group may appoint one designated local entity to file a top-up tax notification to relieve other HKCEs from the filing obligation. *Filing deadline* The top-up tax notification is due for filing within six months after the end of the fiscal year. As compared to CbCR notification which has to be filed within three months after the end of the reporting period, the Government considers that a longer filing deadline is justifiable due to the complexity of the GloBE rules and HKMTT.
Assessment and payment of top-up tax	A notice of assessment demanding the top-up tax will be issued based on the information declared electronically upon the filing of the top-up tax return. No provisional top-up tax will be charged. Payment of top-up tax will be due some time (say two weeks) from the date of the notice of assessment. Post-assessment audit and compliance check will be performed to ensure that in-scope MNE groups properly discharge their obligations under the GloBE and HKMTT regimes, and the groups are correctly charged the top-up tax.
Joint and several liability	For the IIR, the top-up tax will be charged on the UPE. For the UTPR top-up tax or HKMTT, an in-scope MNE group may decide on how the tax payable is to be allocated among its HKCEs. While the group can designate one or more than one paying

	entity, all HKCEs of the group will be jointly and severally liable for the whole amount of the top-up tax payable. Payments made by a paying entity on behalf of other HKCEs of the group will not be allowed as deductions for profits tax purposes. On the other hand, if the paying entity is reimbursed for making a payment towards the top-up tax, the reimbursement will not be taxable for profits tax purposes.
Penalty	Failure to file a top-up tax return or top-up tax notification as well as making an incorrect top-up tax return or top-up tax notification without reasonable excuse are offences subject to penalties. The proposed penalties are similar to those for failure to file a tax return or making an incorrect tax return under the existing penal provisions of the IRO. A service provider engaged to file the top-up tax return or top-up tax notification for a filing entity will be subject to similar penalties. Instead of introducing a transitional penalty relief as recommended by the OECD, the IRD will adopt the existing mechanism under the IRO that a taxpayer can make representations before imposition of administrative penalty. The factors mentioned in the GloBE Publications will be taken into account when considering whether there is any reasonable excuse for the wrongdoings.
Other administrative provisions	To provide simplicity, certainty and continuity, the Government proposes to ride on the existing 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, anti-avoidance issues, etc.

Legislative timetable and effective date

The three-month consultation period will end on 20 March 2024. Subject to the views collected in the consultation, an amendment bill is planned to be submitted to the Legislative Council in the second half of 2024. It is proposed that the global minimum tax (both IIR and UTPR) and the HKMTT will take effect for a fiscal year (i.e. accounting period) beginning on or after 1 January 2025.

Mandatory e-filing of profits tax returns

Effective from April 2023, businesses can e-file their profits tax return on a voluntary basis. As the next step moving towards the e-filing era, mandatory e-filing will be implemented by phases. Based on the Consultation Paper, it is proposed that the first phase of mandatory e-filing will apply to in-scope MNE groups only. The IRD plans to issue a gazette notice to require all HKCEs of in-scope MNE groups to e-file their profits tax return through a designated computer system for the year of assessment 2025/26 and subsequent years.

The takeaway

We appreciate the Government’s effort in drawing up the comprehensive Consultation Paper which outlines many of the key issues that in-scope MNE groups will need to consider and address over the coming months prior to the implementation of the GloBE rules and HKMTT in Hong Kong. As the 2025 implementation date is fast approaching, MNE groups should begin to analyse the potential impact of the GloBE rules and/or HKMTT, if not already ongoing; consider whether their current data, systems, technology and processes can support the requirements of these complex new rules; and assess whether their HKCEs may qualify for the safe harbours.

While the Government will have very limited scope to diverge from the GloBE model rules regarding computation and allocation, the three-month consultation provides a valuable opportunity for stakeholders to express their views as regards the approach to implementing the GloBE rules and HKMTT into the IRO as efficiently as possible and provide any other recommendations or suggestions they may have. PwC is in the process of preparing a submission. Please feel free to contact us for a further discussion, whether on the Consultation Paper itself or on the consequential impact on your businesses.

Endnotes

1. The Consultation Paper can be accessed via this link:
https://www.fstb.gov.hk/tb/en/others/Consultation%20paper_Global%20minimum%20tax%20and%20HKMTT%20(Eng).pdf

2. Our previous international tax news flashes can be accessed from our dedicated BEPS 2.0 webpage via this link:
https://www.pwccn.com/en/services/tax/international-tax/oecd-beps.html

3. There are different approaches for a jurisdiction to transform the GloBE rules into its local law. One approach is to enact its own provisions of the GloBE rules by adapting the content of the GloBE Publications, which is adopted by the United Kingdom, Canada and Japan. Another approach is to legislate for a direct reference to the GloBE Publications, with the effect that the content thereof (and subsequent changes thereto) will form part of the local law, which is adopted by New Zealand.

4. A DMTT introduced by a jurisdiction qualifies as a QDMTT if it is functionally equivalent to the GloBE rules, which will be assessed by the OECD based on two guiding principles, namely (1) the DMTT must be consistent with the design of the GloBE rules; and (2) the DMTT must provide for outcomes that are consistent with the GloBE rules, including that the jurisdiction does not provide any benefits that are related to such rules.

5. To secure the availability of the QDMTT safe harbour and avoid the switch-off rule being triggered, the HKMTT attributable to JVs and their JV subsidiaries where separate calculation of the effective tax rate and top-up tax is required, will be directly imposed on the JVs and JV subsidiaries concerned instead of being allocated to other HKCEs of the group. An in-scope MNE group that is eligible for the QDMTT safe harbour in respect of a jurisdiction will only need to undertake one QDMTT calculation and can be relieved from applying the GloBE rules to that jurisdiction since the top-up tax payable in respect of that jurisdiction under the GloBE rules will be deemed to be zero. A QDMTT must meet an additional set of standards to qualify for the safe harbour. There are circumstances where the switch-off rule is triggered such that the relevant MNE group is required to switch to the credit method for QDMTT.

6. A jurisdiction qualifies for the de minimis exclusion if:
   (i) the average GloBE revenue of the MNE group in that jurisdiction for the current and two preceding fiscal years is less than EUR 10 million; and
   (ii) the average GloBE income or loss of the MNE group in that jurisdiction for the same period is a loss or less than EUR 1 million.

7. An MNE group is in its initial phase of its international activity if:
   (i) it has constituent entities in no more than six jurisdictions; and
   (ii) the sum of the net book values of tangible assets of all constituent entities located in all jurisdictions other than the reference jurisdiction does not exceed EUR 50 million.

   Reference jurisdiction of an MNE group is the jurisdiction where the MNE group has the highest total value of tangible assets for the fiscal year in which the MNE group originally comes within the scope of the GloBE rules.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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