Bill on implementation of global minimum tax and Hong Kong minimum top-up tax gazetted

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Issue 21

In brief

As a member of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), Hong Kong is committed to implementing the global anti-base erosion (GloBE) rules under Pillar Two of BEPS 2.0.

Following the consultation outcome published in October 2024, a bill was gazetted on 27 December 2024 to implement the GloBE rules, which comprises the income inclusion rule (IIR) and undertaxed profits rule (UTPR), as well as the Hong Kong minimum top-up tax (HKMTT)[1].

The bill will be introduced into the Legislative Council for first reading on 8 January 2025. Subject to the passage of the bill, the GloBE rules and the HKMTT will take effect as follows:

Aspect	Effective date
IIR and HKMTT	For a fiscal year beginning on or after 1 January 2025
UTPR	To be specified by notice published in the Gazette
Definition of Hong Kong resident entity	Retrospectively from 1 January 2024

The Inland Revenue Department (IRD) has also published online guidance to explain the bill[2].

This news flash discusses the key features of the bill and provides our observations thereon.

In detail

Background

The GloBE rules consist of two interlocking rules, namely the IIR and the UTPR. The GloBE rules target multinational enterprise (MNE) groups with annual consolidated revenue of at least EUR 750 million in two or more of the preceding four fiscal years, and 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 domestic minimum top-up tax to preserve its own taxing right on profits derived from its jurisdiction. For more background and earlier developments of the GloBE rules (as well as other aspects of BEPS 2.0), please refer to our previous international tax news flashes[3].

While the GloBE model rules have been finalised based on international consensus with no room for deviation, the Government launched a three-month consultation on the implementation of the GloBE rules and the HKMTT in December 2023. In October 2024, the Government released the consultation outcome after considering stakeholders' feedback and consultation with the Organisation for Economic Co-operation and Development (OECD)[4]. The Inland Revenue (Amendment) (Minimum Tax for Multinational Enterprise Groups) Bill 2024 (Bill), which seeks to amend the Inland Revenue Ordinance (IRO) to implement the GloBE rules and the HKMTT, was gazetted on 27 December 2024.

Key features of the Bill

Overview

Adopting a hybrid legislative approach, the Bill directly incorporates the GloBE model rules into the IRO with limited modifications. To ensure consistency, the Bill includes a provision stating that the legislation will be construed in a way that is best consistent with the existing GloBE commentary and administrative guidance issued by the OECD. Additionally, the Government will incorporate future additional administrative guidance issued by the OECD through subsidiary legislation, which can be enacted more swiftly compared to the main legislation.

The top-up tax under the GloBE rules and the HKMTT will be treated as profits tax. However, given the distinctive nature of the top-up tax, the GloBE rules and the HKMTT will be incorporated under a new Part 4AA of the IRO (i.e. separate from the rules for normal profits tax under Part 4), with no application to the normal profits tax. Details of the operative provisions of the GloBE rules and HKMTT rules, as well as modifications to the existing administrative and penal provisions applicable to the GloBE and HKMTT obligations, are set out in the schedules proposed to be added to the IRO.

Definition of Hong Kong resident entity

Currently, the IRO does not contain a definition of ‘resident’ for general purposes as Hong Kong does not impose tax based on an entity’s residence. However, since the tax residence of an entity is crucial to the application of the GloBE rules and the HKMTT, the Bill provides that for the general purposes of the IRO, an entity will be a tax resident in Hong Kong if it is (i) incorporated/constituted in Hong Kong, or (ii) normally managed or controlled in Hong Kong if it is incorporated/constituted outside Hong Kong. The definition will apply retrospectively from 1 January 2024 to cater for MNE groups with parent entities located in jurisdictions that have already implemented the GloBE rules in 2024.

Scope

In general, the GloBE rules and the HKMTT will apply to Hong Kong constituent entities (HKCEs) of MNE groups that meet the revenue threshold test of EUR 750 million. Broadly, HKCEs comprise an MNE group’s entities and permanent establishments (PEs) located in Hong Kong. Nonetheless, governmental entities, international organisations, non-profit organisations, pension funds and investment funds or real estate investment vehicles that are ultimate parent entities (UPEs) of MNE groups (and certain holding vehicles of such entities) are excluded from these new rules.

Framework for top-up tax rules

Under the GloBE rules and the HKMTT rules, the top-up tax is applied under one of three charging rules:

- The IIR will apply to in-scope MNE groups that are parented in Hong Kong. If the effective tax rate (ETR) of the MNE group’s entities in any foreign jurisdiction is below 15%, a top-up tax will be imposed using a top-down approach to bring the ETR to 15%.

- The UTPR will work as a backstop to ensure that any residual amount of top-up tax not brought into charge under the IIR will be allocated to jurisdictions where the MNE group has presence based on a prescribed formula.

- The HKMTT rules will apply to the HKCEs (as well as standalone joint ventures (JVs) or members of JV groups in Hong Kong) of in-scope MNE groups and HKMTT will be payable if the group’s ETR in Hong Kong is below 15%. The HKMTT, designed with the intention to achieve ‘qualified status’ under the OECD peer review process (i.e. qualified domestic minimum top-up tax (QDMTT)), will be creditable against liabilities otherwise arising under the IIR and the UTPR. In other words, the HKMTT is imposed in priority to the IIR (and UTPR) to generally allow Hong Kong to preserve its taxing rights over low-taxed profits in Hong Kong. Subject to the application of the QDMTT safe harbour, this credit mechanism will be replaced with an exemption (see discussion below).

IIR and UTPR

As part of the policy decision, the IIR will apply to a fiscal year beginning on or after 1 January 2025, while the UTPR will take effect from a date to be specified by notice published in the Gazette.

Nonetheless, the Bill includes the relevant UTPR provisions and adopts the following approach, which is at the discretion of the implementing jurisdiction:

- The UTPR will take the form of an adjustment equivalent to a denial of deduction, namely an additional tax imposed directly on the HKCEs of an MNE group in an amount equal to the UTPR top-up tax allocated to Hong Kong.
- The UTPR top-up tax allocated to Hong Kong will be allocated to the HKCEs using a formula based on their respective number of employees and value of tangible assets.
- The exclusion from UTPR for MNE groups in their initial phase of international activity for up to five years will not apply if Hong Kong is the reference jurisdiction (i.e. the jurisdiction where the group has the highest total value of tangible assets for the fiscal year in which the group originally comes within the scope of the GloBE rules). In such case, the UTPR top-up tax of the MNE group arising in low-taxed jurisdictions other than Hong Kong will be fully allocated to Hong Kong during that initial phase.

Safe harbours

The Bill incorporates all the safe harbours available under the GloBE rules. Subject to annual elections, the following safe harbours will be provided to reduce the compliance burden of an in-scope MNE group from performing full GloBE calculations when certain conditions are met:

Safe harbour	Key features
Transitional country-by-country reporting (CbCR) safe harbour	• The top-up tax for a jurisdiction will be deemed to be zero if, among other things, one of the following tests is met for the fiscal year: (i) de minimis test – the MNE group has (i) total revenue of less than EUR 10 million and (ii) profit before income tax of less than EUR 1 million (or loss before income tax) in that jurisdiction; (ii) simplified ETR test – the simplified ETR (as defined) in that jurisdiction is at least 16% for a fiscal year starting in 2025 or 17% for a fiscal year starting in 2026; (iii) routine profits test – the profit before income tax does not exceed the substance-based income exclusion (SBIE) for that jurisdiction. These tests will generally be computed using data from a qualified country-by-country (CbC) report. • The safe harbour will apply to a fiscal year in the transition period (i.e. fiscal years beginning on/before 31 December 2026 and ending on/before 30 June 2028). • The safe harbour will include some special rules. In particular, consistent with the administrative guidance issued by the OECD in December 2023, there will be specific rules for hybrid arbitrage arrangements entered into after 15 December 2022 (i.e. the release date of the original safe harbour guidance). • An MNE group that has not made an election to apply the safe harbour in respect of a jurisdiction in a fiscal year cannot benefit from it for that jurisdiction in a subsequent fiscal year.
Transitional UTPR safe harbour	• The UTPR top-up tax for the jurisdiction of the UPE will be deemed to be zero if the nominal corporate income tax rate of the jurisdiction is at least 20%. • The safe harbour will apply to a fiscal year not exceeding 12 months that begins on/before 31 December 2025 and ends before 31 December 2026.

	• An MNE group cannot elect for both the transitional CbCR safe harbour and transitional UTPR safe harbour for the same jurisdiction for a fiscal year. ***Our observations:*** *An MNE group that qualifies for more than one transitional safe harbour may choose which safe harbour to apply for that jurisdiction. When an MNE group qualifies for both a transitional CbCR and a UTPR safe harbour in a jurisdiction in the first fiscal year in which it becomes in scope, it may be preferable for the MNE group to elect to apply the transitional CbCR safe harbour instead of the UTPR safe harbour to avoid potentially losing the benefit of the transitional CbCR safe harbour in a subsequent fiscal year.*
QDMTT safe harbour	• This permanent safe harbour will deem the top-up tax of a jurisdiction outside Hong Kong to be zero if the jurisdiction has a QDMTT that meets the additional standards developed by the OECD (which are further explained in the section on HKMTT below). In other words, no top-up tax calculation will be required in Hong Kong for CEs of an MNE group located in that jurisdiction. • For a foreign jurisdiction with the following restrictions, an MNE group to which any of the restrictions applies will not be able to benefit from the QDMTT safe harbour in relation to either all or a subset of its CEs in that jurisdiction, and will be switched to the credit method for relieving double taxation under the GloBE rules in respect of the foreign QDMTT: (i) flow-through parent entities are not subject to QDMTT; (ii) the QDMTT provides a transitional exclusion for MNE groups in their initial phase of international activity (i.e. similar to the exclusion under the UTPR) without limitation; or (iii) the QDMTT is not imposed on (1) standalone JVs or members of JV groups (as the case requires) or (2) investment-related entities. • The safe harbour will not apply if the QDMTT is subject to a judicial or administrative challenge.
Simplified calculations safe harbour for non-material constituent entities (NMCEs)	• This safe harbour will allow an MNE group to elect for 'simplified calculations' for an NMCE, which broadly refers to a CE that has not been consolidated in the UPE's consolidated financial statements solely due to size or materiality. • The top-up tax (other than additional current top-up tax) for a jurisdiction will be deemed to be zero for a fiscal year if one of the following tests is met using 'simplified calculations': (i) de minimis test – the MNE group has (i) an average GloBE revenue of less than EUR 10 million, and (ii) an average GloBE profit of less than EUR 1 million (or loss) in that jurisdiction; (ii) ETR test – the ETR in that jurisdiction is at least 15%; (iii) routine profit test – the GloBE profit does not exceed the SBIE in that jurisdiction. • For the purpose of the three tests above, the revenue, profit and adjusted covered taxes of the NMCEs will be determined by reference to the relevant CbC regulations. ***Our observations:*** *The safe harbour for NMCEs is developed as part of the simplified calculations safe harbour to address concerns about significant additional compliance costs for including subsidiaries excluded from consolidated financial statements due to the materiality test. The OECD will review the methodology used in these 'simplified calculations' no later than*

2028 to evaluate whether in practice they meet the conditions of the permanent safe harbour.

HKMTT

The HKMTT is intended to qualify as a QDMTT and be eligible for the QDMTT safe harbour. This is achieved by mirroring all the requirements of the GloBE model rules subject to permitted variations within the OECD framework, and fulfilling additional standards developed by the OECD concerning the accounting standards adopted, consistency with the GloBE rules and ongoing monitoring. As a result, MNE groups can benefit from the QDMTT safe harbour (i.e. the top-up tax for Hong Kong that may be imposed by foreign jurisdictions will be deemed to be zero).

Below are some key policy decisions made in the design of the HKMTT:

- The HKMTT will be imposed on the whole amount of the total top-up tax in respect of all HKCEs of the MNE group, irrespective of the ownership interest held in the HKCEs by the group. Hong Kong JVs and Hong Kong members of JV groups held by an MNE group (collectively 'HK JV entities') will also be in scope.
- The financial accounting net income or loss of an HKCE of an MNE group must be determined in accordance with a local accounting standard when certain conditions are met, such as the HKCEs of the MNE group having the same financial year as the UPE. Local accounting standard is defined to mean the International Financial Reporting Standards (i.e. IFRS) or the Hong Kong Financial Reporting Standards (i.e. HKFRS).
- It is intended that eligible MNE groups in their initial phase of international activity will be relieved from HKMTT for up to five years if none of the ownership in an HKCE is held directly or indirectly by a parent entity subject to a qualified IIR.
- As revealed in the consultation outcome, investment entities and insurance investment entities will be excluded from the scope of HKMTT to preserve the tax neutrality for these entities.
- The HKMTT chargeable on an HK JV entity will be subject to the following special rules:

  (i) The HKMTT may be charged on (1) the HK JV entity directly or (2) an HKCE upon the HK JV entity's election and with the HKCE's consent. Under situation (2), the HKMTT charged will be recoverable from both the HK JV entity and the HKCE.

  (ii) A relief against double HKMTT will be available whereby:

    (1) if the entity is an HK JV entity of two MNE groups and the HKMTT is chargeable on the entity in respect of both MNE groups, the HKMTT so charged will be reduced by 50%; and

    (2) if the entity is an HK JV entity of an MNE group and is also an HKCE of another MNE group, and the HKMTT is chargeable on the entity in respect of both MNE groups, a relief will be provided in a reasonable manner.

No foreign tax relief on top-up tax paid under an IIR or UTPR

No foreign tax deduction or credit will be available for any top-up tax paid under an IIR or UTPR outside Hong Kong, regardless of whether or not it is a qualified IIR or qualified UTPR.

Our observations: *The Bill does not specify whether QDMTT paid in foreign jurisdictions will be eligible for tax credit like other foreign taxes paid under the existing rules although the wording implies such a possibility. On the other hand, it appears that QDMTT and top-up tax paid under an IIR or UTPR outside Hong Kong may not be taken into account for the purpose of the 'subject to tax' condition under certain interest deduction provisions as well as the participation requirement of the foreign-sourced income exemption (FSIE) regime. As a reference, Singapore has amended its tax act to clarify the treatment of the taxes imposed by other jurisdictions under Pillar Two. Specifically, a tax credit may be given for QDMTT in specified situations. Additionally, QDMTT will be considered when determining eligibility for the 'subject to tax' condition under Singapore's FSIE regime, although the effect of the QDMTT will be disregarded when determining the headline foreign tax rate. On the other hand, top-up tax paid under an IIR or UTPR is not allowed for tax credit and is disregarded for the purposes of Singapore's FSIE regime. It would be preferable for Hong Kong to include legislative provisions in the IRO to provide certainty.*

Anti-avoidance provision

While the existing general anti-avoidance provisions in the IRO will have no application with respect to the GloBE rules and the HKMTT, a main purpose test will be introduced, whereby an arrangement will be disregarded if the main purpose (or one of the main purposes) of entering into that arrangement is to avoid any GloBE or HKMTT obligations.

Our observations: *We appreciate the intention of subjecting the GloBE rules and HKMTT rules to the newly proposed anti-avoidance provision to safeguard their integrity. However, the current drafting, which focuses solely on the top-up tax liabilities in Hong Kong without considering the overall tax liabilities of an in-scope MNE group, may lead to unintended consequences. Specifically, if taxpayers undertake arrangements that result in higher top-up tax in other jurisdictions (as part of an appropriate Pillar Two response) but eliminate potential top-up tax in Hong Kong, the proposed anti-avoidance provision would seemingly be triggered. There appear to be justifiable grounds that the provision might not need to be triggered if the MNE groups' overall tax liabilities are not less than what they would have been without such arrangements.*

Tax compliance and administration

- The following table summarises the compliance obligations of the HKCEs of an in-scope MNE group under the GloBE rules and the HKMTT:

	Entity responsible	Due date
Filing of top-up tax notification	• Each HKCE (subject to the designation of an HKCE to file the notification for the group)	• Six months after the end of the fiscal year
Filing of top-up tax return (the information required in the standardised GloBE information return (GIR) developed by the OECD must be included, unless the HKCE is headquartered in a foreign jurisdiction that is able to exchange GIRs with Hong Kong under a qualifying competent authority agreement)	• Each HKCE (subject to the designation of an HKCE to file the return for the group)	• Generally 15 months after the end of the fiscal year • Extended to 18 months for the transition year, which refers the first year that the MNE group is subject to (i) a qualified IIR or UTPR in Hong Kong or another jurisdiction or (ii) the HKMTT ***Our observations:*** *While a three-month extension to 18 months will be available to MNE groups that are subject to the GloBE rules for the first fiscal year, the extension will not apply to in-scope MNE groups operating in jurisdictions that have implemented the GloBE rules a year ahead of Hong Kong (i.e. for fiscal years beginning on or after 1 January 2024).*
Assessment and payment of top-up tax	• The HKCEs specified in the notice of assessment (NOA) • If an HKCE is chargeable to UTPR top-up tax or HKMTT but it no longer exists on the date of filing the top up tax return, the top-up tax chargeable will be allocated among the remaining HKCEs of the group	• An NOA will be issued based on the information declared upon the filing of the top-up tax return • No provisional tax will be charged • The payment due date will be one month after: (i) the expiry of the return filing deadline or (ii) the date of the NOA, whichever is the later
Record keeping	• Each HKCE	• The records should be retained for at least 12 years after the completion of the transactions, acts or operations to which those records relate ***Our observations:*** *The proposed retention period is much longer than the seven years for normal profits tax purposes.*

- The consequences for failure to comply with the above obligations without reasonable excuse are summarised in the table below:

<table>
<tr><th>Compliance obligation</th><th>Consequences for failure to comply without reasonable excuse</th></tr>
<tr><td>Filing of top-up tax notification or top-up tax return</td><td>If prosecuted, the entity will be subject to a fine of HK$10,000 and a further fine of treble the top-up tax undercharged
If the offence is committed with the consent of a director or other officer concerned in the management of the corporation, or any person purporting to act as such director or officer, such person also commits the offence and is liable on conviction to the penalties
Proceedings for the offence may be brought no later than (i) two years from the day of discovering the offence or (ii) six years after the day of committing the offence, whichever is the later

Our observations: This is different from certain other offences under the IRO (such as those related to CbCR), the proceedings for which may only be brought no later than six years after the day of committing the offence.
If no prosecution is made, the entity will be subject to an additional tax not exceeding treble the top-up tax undercharged</td></tr>
<tr><td>Payment of top-up tax</td><td>Subject to the below, the existing provisions on tax in default and recovery of tax under the IRO will apply
An MNE group may make an annual irrevocable election in writing to designate one or more HKCEs to pay the UTPR top-up tax or the HKMTT
If the designated entity fails to do so for a taxable year, all the linked entities will be jointly and severally liable for the total amount of top-up tax payable.
A notice will be issued to any linked entity demanding top-up tax in default (Notice). This Notice is not an NOA and therefore cannot be objected to or appealed against. However, the recipient can dispute the liability under the notice on the grounds that it is not a linked entity or that the amount specified exceeds the extent of its joint and several liability
A linked entity is an entity that is an HKCE of the assessed MNE group when the Notice is issued and was at any time in the taxable year an HKCE of that group

Our observations: An entity will not be considered a linked entity and will not assume joint and several liability of the unpaid top-up tax if (i) the entity is not part of the assessed MNE group when the Notice is issued (e.g. the entity was disposed of before the Notice was issued); or (ii) the entity was not an HKCE of the assessed group at any time during the taxable year in question (e.g. the entity was acquired after the taxable year ended or was disposed of before the taxable year began).</td></tr>
<tr><td>Record keeping</td><td>The existing penal provisions concerning record keeping under the IRO will apply, which includes being subject to a fine of HK$100,000</td></tr>
</table>

Our observations: *As mentioned in the consultation outcome, the IRD will in due course set out in its guidance the factors that will be taken into account when considering whether the transitional penalty relief mentioned in the OECD's publication should be granted in relation to a breach of the GloBE or HKMTT obligations during the initial transition years.*

- The compliance obligations and consequences mentioned above will equally apply to an HK JV entity (in which case the assessed group refers to the JV group or a standalone JV).

- If the HKCE is not a corporation or is a PE, these obligations and consequences will apply to the person who acts for or manages the entity, and to the main entity, respectively.

Limitation period for assessments and objections

- An assessment for top-up tax under the GloBE rules and the HKMTT must be made within six years after the later of (i) the end of the fiscal year and (ii) the time when the non-assessment or under-assessment has come to the assessor's knowledge.

  Our observations: *The proposed limitation period is different from the normal statutory time limit, whereby an assessment must be made within the relevant year of assessment or within six years after the end of that year of assessment for cases not involving fraud or wilful evasion. While the Government has explained that this is to cater for situations where the IRD may not be timely informed of the adjustments initiated by other jurisdictions and they have taken into account the practices of other jurisdictions, this may create undue tax uncertainty for taxpayers as the wording appears to impose no actual time limit on the issuance of top-up tax assessments under the GloBE and HKMTT rules. As such, we hope that the Government would consider revisiting the drafting to address taxpayers' concerns. Ideally, the provision should set a clear time limit to provide clarity and predictability for taxpayers, mitigating the potential for indefinite tax exposure.*

- Subject to certain conditions, an HKCE that has filed the top-up tax return or an assessed entity may object to a top-up tax assessment within two months from the date of the NOA (as opposed to one month for normal profits tax purposes).

Reimbursement for top-up tax paid

As mentioned above, an MNE group may elect to designate an HKCE to pay the UTPR top-up tax or HKMTT for the group in Hong Kong subject to certain conditions. For normal profits tax purposes, any reimbursement made by an HKCE to the designated entity not exceeding that HKCE's share of the top-up tax will be disregarded when computing the assessable profits of either entity.

The takeaway

The Bill represents a significant step in aligning Hong Kong's tax framework with the international tax standards. The incorporation of all available safe harbours reflects Hong Kong's commitment to mitigating the compliance burdens of in-scope MNE groups.

The issuance of the Bill will offer some certainty for in-scope MNE groups, but it remains to be seen what challenges may arise from the interpretation and application of these rules given their complexity and novelty. MNE groups are encouraged to get prepared for the January 2025 implementation. Furthermore, MNE groups should be mindful of the accounting disclosure requirements concerning the GloBE rules. Please contact us if you require any assistance.

Besides the GloBE rules, Pillar Two also comprises the subject to tax rule (STTR), which is a treaty-based rule that allows source jurisdictions to impose an additional tax liability on certain intragroup payments if the recipient is subject to a nominal corporate tax rate below 9% in the residence jurisdiction. Hong Kong has previously indicated that it is prepared to adopt the minimum standard, i.e. the STTR will only be included in the bilateral tax treaties with developing jurisdictions when requested to do so. The OECD has developed a multilateral instrument to facilitate swift implementation of the STTR, but Hong Kong is currently not a signatory of the instrument. MNE groups that are potentially affected by the STTR should closely monitor the development in this regard.

Endnotes

1. The bill and the relevant Legislative Council brief can be accessed via these links:
   https://www.gld.gov.hk/egazette/english/gazette/file.php?year=2024&vol=28&no=52&extra=0&type=3&number=33
   https://www.legco.gov.hk/yr2024/english/brief/tsybr20080010c_20241224-e.pdf

2. The online guidance can be accessed via this link:
   https://www.ird.gov.hk/eng/tax/bus_beps.htm

3. 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

4. The consultation paper and outcome, together with our news flashes thereon, can be accessed via these links:
   https://www.fstb.gov.hk/tb/en/others/Consultation%20paper_Global%20minimum%20tax%20and%20HKMTT%20(Eng).pdf
   https://www.legco.gov.hk/yr2024/english/panels/fa/papers/facb1-1409-1-e.pdf
   https://www.pwchk.com/en/hk-tax-news/2024q1/hongkongtax-news-jan2024-1.pdf
   https://www.pwchk.com/en/hk-tax-news/2024q4/hongkongtax-news-oct2024-18.pdf

Let's talk

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