

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

31 October 2024
Issue 18

In brief

Further to the consultation paper published in December 2023 on the implementation of the global minimum tax and the Hong Kong minimum top-up tax (HKMTT) (Consultation Paper)¹, the Government released the consultation outcome on 30 October 2024, summarising stakeholders' feedback and the Government's follow-up (Consultation Outcome)².

We are pleased that the Government has carefully considered the constructive comments provided by various stakeholders including PwC, and thoroughly consulted the Organisation for Economic Co-operation and Development (OECD).

As previously announced, the Government will implement the Income Inclusion Rule (IIR) and HKMTT for 2025. The Consultation Outcome also sets out a number of positive responses from the Government, including:

- The postponement of the implementation of the Undertaxed Profits Rule (UTPR) to a later date;
- The introduction of a definition for 'Hong Kong resident entity' for the general purposes of the Inland Revenue Ordinance (IRO);
- The exclusion of investment entities and insurance investment entities from the scope of HKMTT;
- Allowing annual designation of one or more than one paying entity for top-up tax, and the possibility of exploring a 'clean exit' mechanism in relation to the top-up tax liability; and
- The extension of the payment due date and objection period in relation to the top-up tax.

This news flash discusses the Consultation Outcome and provides our observations thereon.

In detail

Background

As a member of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS), Hong Kong is committed to implementing Pillar Two of BEPS 2.0 – the global anti-base erosion (GloBE) rules³. While the GloBE model rules have been finalised based on international consensus with no room for deviation, the Government launched a consultation on the implementation of the global minimum tax and the HKMTT in December 2023 to seek stakeholders' views on the design and administration of the HKMTT.

Key responses in the Consultation Outcome

On 30 October 2024, the Government released the Consultation Outcome after considering stakeholders' feedback and consultation with the OECD. The Government's responses are summarised as follows:

UTPR

Noting that certain jurisdictions have opted to postpone the implementation of the UTPR to a later date, the Government considers it appropriate for Hong Kong to also postpone such implementation. The timeline will be decided after having considered relevant factors such as the position of in-scope multinational enterprise (MNE) groups operating in Hong Kong after the implementation of the IIR and HKMTT, as well as the practice of other jurisdictions.

Our observations: *The UTPR, which serves as a backstop under the GloBE rules, is intended to capture profits not otherwise taxed under the IIR or a Qualified Domestic Minimum Top-up Tax (QDMTT). Many jurisdictions have already adopted or plan to adopt the IIR or a QDMTT to avoid ceding taxing rights to another jurisdiction that implements the UTPR. As such, the likelihood of Hong Kong having to invoke the UTPR is low. Nonetheless, it is expected that the relevant UTPR provisions, which form part of the GloBE model rules, will still be included in the upcoming amendment bill, which will only come into operation upon announcement. This is a wise approach which would allow Hong Kong to monitor developments in other jurisdictions and respond promptly, given that the legislative provisions are already in place.*

Legislative approach

The Government maintains that it should be more appropriate to provide for the GloBE and HKMTT rules under the IRO as opposed to legislating them under a separate ordinance as suggested by some stakeholders, since treating the top-up tax as a profits tax has the benefit of being able to apply various existing tax administration provisions (e.g. those in relation to tax collection and objections/appeals) to the top-up tax, as well as to resolve any cross-border disputes in relation to top-up tax liabilities through Hong Kong's comprehensive avoidance of double taxation agreements or arrangements.

Having said that, given the distinctive nature of the top-up tax, the rules will be added under a new part of the IRO separate from the rules for normal profits tax under Part 4, with no application to the normal profits tax.

Definition of Hong Kong resident entity

A definition for 'Hong Kong resident entity' for the general purposes of the IRO (rather than only for the purposes of the GloBE and HKMTT rules as originally proposed) will be introduced, with retrospective effect from 1 January 2024 to cater for MNE groups with parent entities located in jurisdictions that have already implemented the GloBE rules in 2024.

Our observations: *We applaud the Government's revised proposed approach with regard to the definition of Hong Kong resident entity, after having considered stakeholders' (including PwC's) suggestions and consulted the OECD. In particular, the original narrow application of the definition could heighten the degree of uncertainty, for instance, whether overseas jurisdictions (including those that enact minimum tax rules that mimic GloBE rules but do not qualify as GloBE rules) would be prepared to respect this narrow-scope residence definition. While whether an overseas jurisdiction would accept an entity as a Hong Kong resident would still be subject to that jurisdiction's decision, the revised approach provides a more robust basis for defence against a potential challenge.*

Qualified refundable tax credit (QRTC)

Many stakeholders, including PwC, have advocated for the introduction of a QRTC regime (i.e. a tax credit that must be refundable in cash or cash equivalent within four years), which would have a reduced downward effect on the effective tax rate calculated under the GloBE rules as compared to other tax incentives. While the Government has not indicated any clear decision to introduce such a regime or otherwise, it appears open to consider such a possibility.

Our observations: *We fully appreciate the Government's prudence in considering the feasibility of introducing a QRTC regime, particularly given the current fiscal position of the Government. As many other jurisdictions including our neighbouring ones have already introduced such regimes, we believe that it is imperative for the Government to actively explore this possibility, as part of its ambition to develop Hong Kong as a competitive international innovation and technology hub.*

Investment entities and insurance investment entities

To preserve tax neutrality for investment funds and their asset holding vehicles, the Government agrees to exclude investment entities and insurance investment entities from the scope of the HKMTT, having regard to the practice adopted by other jurisdictions.

Transitional UTPR safe harbour

While the transitional UTPR safe harbour is not applicable to Hong Kong headquartered MNE groups since the statutory corporate profits tax rate of Hong Kong is below 20%, the transitional UTPR safe harbour will be included in Hong Kong's legislation to allow 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.

Allocation and payment of top-up tax liability

The Government clarifies that under the default allocation mechanism for top-up tax under the UTPR and the HKMTT, each constituent entity is only liable for its share of top-up tax. An MNE group may dis-apply the default mechanism and designate one or more constituent entities to pay the top-up tax (such designation may be made on a year-by-year basis). If the MNE group dis-applies the default allocation mechanism and the designated entity or entities do not pay the top-up tax payable, then joint and several liability will apply to all the Hong Kong constituent entities for the whole amount of the top-up tax payable by the group. Meanwhile, the Government is prepared to explore a 'clean exit' mechanism as an administrative arrangement, where a constituent entity of an MNE group intending to leave the group would no longer be jointly and severally liable for the top-up tax of the group.

The payment due date of the top-up tax will be extended from the originally proposed two weeks to one month after (i) the expiry of the return filing deadline or (ii) the date of the notice of assessment, whichever is the later.

Our observations: *We are pleased to see the Government's openness in exploring a 'clean exit', as suggested by PwC, which, if designed effectively, will provide MNE groups with more certainty in merger and acquisition deals. We also commend the Government's proposal to allow MNE groups the option to allocate their top-up tax liabilities within the group based on their specific requirements, which eases their administrative burden and provides greater flexibility in tax management. This is an exemplary measure that can serve as a reference for other jurisdictions.*

Raising assessments and objections

Having regard to the possible need for re-calculating an in-scope MNE group's top-up tax payable for a previous fiscal year, instead of the normal six-year time limit for raising assessments, the Government suggests setting a time limit for issuing a top-up tax assessment as six years from (i) the end of the fiscal year or (ii) the time when the non-assessment or under-assessment has come to the assessor's knowledge, whichever is the later.

The objection period to a top-up tax assessment will be extended to two months after the date of the notice of assessment.

Our observations: *The Government's suggestions on these tax compliance and administration measures appear sensible. That said, it is important that the provisions are drafted in a way that does not result in the unintended effect of an open-ended time limit.*

Anti-avoidance and penalties

The Government agrees that the general anti-avoidance provisions, i.e. sections 61 and 61A of the IRO, should not apply in the context of the GloBE and HKMTT regimes. Instead, a main purpose test will be introduced as a general anti-avoidance rule for the regimes. As this test will require an objective evaluation of all relevant facts and circumstances for its application, there will be no grandfathering for transactions entered into prior to 1 January 2025.

In terms of penalties, the Inland Revenue Department (IRD) will set out in its guidance that the factors mentioned in the OECD's guidance on transitional penalty relief will be taken into account when determining whether penal action should be taken against a wrongdoing in relation to the GloBE or HKMTT rules. As for penalties imposed on service providers in relation to the filing of top-up tax returns or notifications, a similar approach to the one currently used for filing tax returns will be adopted.

Administrative guidance

The Government will incorporate future additional administrative guidance issued by the OECD through subsidiary legislation. The IRD will also publish its own guidance on the implementation issues that are of common interest to in-scope MNE groups on its website.

Legislative timeline

The Government plans to introduce an amendment bill into the Legislative Council by January 2025. It is expected that different aspects of the amendment bill will take effect as follows:

Aspect	Effective date
Definition of Hong Kong resident entity	Retrospectively from 1 January 2024
IIR and HKMTT	Retrospectively for a fiscal year beginning on or after 1 January 2025
UTPR	At a later stage to be decided

The takeaway

Hong Kong's approach to implementing the GloBE rules aligns with global trends, aiming to maintain its tax competitiveness while adhering to the agreed framework. We are particularly pleased that the Government has adopted several favourable recommendations from stakeholders, after making efforts in consulting the OECD, demonstrating its responsiveness to stakeholder concerns and facilitating a smooth transition for in-scope MNE groups while ensuring that Hong Kong's proposed regimes remain compliant.

With the establishment of the overall direction and approach to the local implementation of the global minimum tax and the HKMTT, Hong Kong is now one step closer to the finalisation of the new regimes. As the amendment bill will only be introduced into the Legislative Council by January 2025 (as opposed to the end of 2024 as originally planned), this may be welcome news to in-scope MNE groups with December year-ends in terms of financial statements disclosure.

Meanwhile, some stakeholders, including PwC, raised several technical taxation issues during the consultation exercise. We are grateful for the IRD's engagement with us to discuss and resolve these issues, and will continue to work closely with the IRD and provide our full support as Hong Kong navigates these significant global tax reforms.

Please stay tuned for more updates and contact us if you have any questions or comments regarding the Consultation Outcome.

Endnotes

1. The Consultation Paper and our news flash thereon can be accessed via the following links:
[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%20Global%20minimum%20tax%20and%20HKMTT%20(Eng).pdf)
<https://www.pwchk.com/en/hk-tax-news/2024q1/hongkongtax-news-jan2024-1.pdf>
2. The Consultation Outcome can be accessed via this link:
<https://www.legco.gov.hk/yr2024/english/panels/fa/papers/facb1-1409-1-e.pdf>
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/oced-beps.html>

Let's talk

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

PwC's Corporate Tax Leaders based in Hong Kong

Jeremy Ngai
+852 2289 5616
jeremy.cm.ngai@hk.pwc.com

Jeremy Choi
+852 2289 3608
jeremy.choi@hk.pwc.com

Rex Ho
+852 2289 3026
rex.ho@hk.pwc.com

Cecilia Lee
+852 2289 5690
cecilia.sk.lee@hk.pwc.com

Jenny Tsao
+852 2289 3617
jenny.np.tsao@hk.pwc.com

Kenneth Wong
+852 2289 3822
kenneth.wong@hk.pwc.com

PwC's BEPS 2.0 Pillar Two team based in Hong Kong

Jesse Kavanagh
+852 2289 1100
jesse.kavanagh@hk.pwc.com

Flora Chan
+852 2289 6903
flora.fhl.chan@hk.pwc.com

Ingrid Lau
+852 2289 3649
ingrid.il.lau@hk.pwc.com

Ivan Lam
+852 2289 3057
ivan.wm.lam@hk.pwc.com



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For more information, please contact:

Long Ma
+86 (10) 6533 3103
long.ma@cn.pwc.com

Charles Chan
+852 2289 3651
charles.c.chan@hk.pwc.com

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