The impact of BEPS on tax incentives in Asia Pacific

A Hong Kong SAR tax perspective

Impact of Pillar Two on tax incentives

As of 4 November 2021, 137 out of 141 member jurisdictions of the G20/OECD Inclusive Framework on BEPS ("IF") have agreed to the statement issued by the IF on 8 October 2021, which sets out the building blocks and key rates for Pillar One and Pillar Two of the BEPS 2.0 reform. Our previous tax alert includes a detailed discussion of the IF's 8 October 2021 statement with Hong Kong considerations.

Many jurisdictions across the ASPAC region, including the Hong Kong SAR, offer a range of tax incentives to attract business and investment. However, the introduction of a global minimum tax of 15% under Pillar Two raises questions as to the appeal and future of such tax incentives. The global minimum tax may reduce the effectiveness of tax incentives and disincentivize jurisdictions to introduce tax concessions if another jurisdiction can claw back that benefit.

Please refer to a recent KPMG publication entitled "The impact of BEPS on tax incentives in Asia Pacific" which discusses the following:

— a survey conducted by KPMG which found that more than 40 tax incentives or concessionary regimes across the ASPAC region may be potentially impacted by Pillar Two,

— the mitigating factors that may reduce the impact of Pillar Two on tax incentives for some MNE groups,

— the potential policy responses of governments in view of the potential neutralization of the benefits of tax incentives under Pillar Two; and

— what MNE groups should be thinking about.

Key considerations for the Hong Kong SAR

Although the headline corporate tax rate in Hong Kong is 16.5%, Hong Kong offers a wide range of income exclusions/exemptions, tax incentives and enhanced deductions which could reduce a group's Hong Kong jurisdictional effective tax rate below the agreed 15% global minimum tax rate under BEPS Pillar 2. These include: (1) non-taxation of foreign-sourced income under the territorial tax system, (2) non-taxation of capital gains, (3) tax exemptions for bank interest income and profits from qualifying debt instruments, (4) a concessionary tax rate of 8.25% for qualifying profits earned by taxpayers in specific sectors (e.g. insurance, aircraft leasing and corporate treasury centres), (5) a concessionary tax rate of 0% for certain ship leasing and carried interest income and (6) enhanced tax deductions for qualifying research and development expenditure.

For large foreign-headquartered MNE groups with a presence in Hong Kong, the tax incentive benefits enjoyed by their Hong Kong entities may be neutralised by (1) the adoption of the Income Inclusion Rule (IIR) by the

© 2021 KPMG Tax Services Limited, a Hong Kong limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

parent jurisdiction or (2) a possible introduction of a domestic minimum regime (“DMT”) in Hong Kong. For those large Hong Kong headquartered MNE groups that have group entities enjoying a tax incentive in Hong Kong or in an overseas jurisdiction, the benefits from such tax incentives may be neutralised by the possible introduction of a DMT and the adoption of the IIR in Hong Kong respectively. That said, out-of-scope MNE groups can continue to enjoy the benefits from tax incentives offered by Hong Kong.

Both Hong Kong and foreign headquartered MNE groups with cross-border related party payments made to Hong Kong entities will also need to consider the possible impact of the Subject to Tax Rule if the gross amounts of such payments are taxed at a rate below the agreed nominal rate of 9%.

In addition to the significant changes expected to be brought to the Hong Kong tax system as a response to the OECD’s BEPS 2.0 reform, the inclusion of Hong Kong in the European Union’s tax ’grey-list’ following its review of Hong Kong’s territorial source regime also means changes will need to be made to the regime in respect of passive income.

Affected businesses will need to start modelling and assessing the impact of all these upcoming changes and consider whether any business restructuring will be desirable. Opportunities may arise to relocate operations from other foreign jurisdictions with high taxed profits to Hong Kong to blend with any pre-existing Hong Kong low taxed profits. This may result in simplified group structures or transaction flows while preserving pre-existing Hong Kong tax incentive benefits.

© 2021 KPMG Tax Services Limited, a Hong Kong limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Contacts

Global Tax Policy Leadership Group

Grant Wardell-Johnson
Global Tax Policy Leader and Chair
E: gwardelljohn@kpmg.com.au

Conrad Turley
Asia Pacific Regional Tax Policy Leader
E: conrad.turley@kpmg.com

Manal Corwin
Americas Regional Tax Policy Leader
E: mcorwin@kpmg.com

Chris Morgan
Responsible Tax Project Leader
E: christopher.morgan@kpmg.co.uk

Vinod Kalloe
EMA Regional Tax Policy Leader
E: kalloe.vinod@kpmg.com

Regional contacts

John Timpany
Head of Tax, Hong Kong SAR
E: john.timpany@kpmg.com

Ivor Morris
Hong Kong SAR BEPS 2.0 Project Leader
E: ivor.morris@kpmg.com

Anita Tsang
Director, Tax Policy and Knowledge Management
E: anita.tsang@kpmg.com

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com/cn/socialmedia

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2021 KPMG Tax Services Limited, a Hong Kong limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. Printed in Hong Kong, China.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.