Hong Kong (SAR) Tax Alert

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An update on BEPS 2.0 Pillar 2 implementation in Hong Kong

Summary

In a recent tax webinar, the Deputy Commissioner of Inland Revenue provided an update on implementing Pillar 2 of BEPS 2.0 in the Hong Kong SAR (Hong Kong). This tax alert highlights the key implementation proposals of the government as discussed in the webinar.

The Deputy Commissioner of Inland Revenue recently spoke at a tax webinar on BEPS 2.0 implementation in Hong Kong. While the public consultation paper on BEPS 2.0 implementation in Hong Kong is expected to be released soon, the webinar highlighted some of the areas to be covered in the consultation paper and the government's proposals on various aspects of implementing (i) the GloBE Rules and (ii) a domestic minimum top-up tax (DMTT) in Hong Kong.

Key points on implementing the GloBE Rules and DMTT revealed in the webinar

- **The consultation paper** on implementing the GloBE Rules and a DMTT in Hong Kong (HKMTT) is expected to be released within December 2023.

- **Implementation timeline** – The plan is for the GloBE Rules (i.e. the Income Inclusion Rule (IIR) and Undertaxed Profits Rule (UTPR)) and the HKMTT to come into operation in 2025 in Hong Kong – i.e. apply to **accounting periods commencing on or after 1 January 2025**.

- **Legislative approach** – It is proposed that the GloBE Rules will be incorporated into the Inland Revenue Ordinance (IRO) as far as practicable with some necessary adaptations for Hong Kong.

- **Implementation approach:**
  - to apply the GloBE Rules by closely following the OECD's GloBE Model Rules, Commentary and Administrative Guidance; and
  - top-up taxes under the GloBE Rules and Hong Kong Minimum Top-up Tax (HKMTT) will be treated as profits tax.

- A definition of "**Hong Kong resident entity**" will be added to the IRO for the purposes of the GloBE Rules and HKMTT and **apply retrospectively from 1 January 2024** (given some jurisdictions will implement IIR starting from 2024). An entity incorporated / constituted in Hong Kong or an entity incorporated / constituted outside Hong Kong but normally managed or controlled in Hong Kong will be regarded as a Hong Kong resident entity.

- **Core design of the HKMTT**:
  - to make the HKMTT (i) a qualified DMTT (QDMTT) and to ensure it (ii) qualifies for the QDMTT safe harbour;
  - to apply the HKMTT to both Hong Kong and foreign-headquartered groups applying the annual consolidated revenue threshold as under the GloBE Rules (i.e. EUR 750 million or more);
  - the HKMTT will be imposed on **100%** of the total top-up tax computed for all the Hong Kong constituent entities (CEs), irrespective of whether they are wholly owned or partially owned;
  - the top-up tax under HKMTT will be allocated based on the ratio of the GloBE income of a particular Hong Kong CE to the total GloBE income of all Hong Kong CEs. Alternatively, the MNE group could **designate one or more Hong Kong CEs as the paying entities** but in such case, all Hong Kong CEs will **be jointly and severally liable** for the whole amount of the top-up tax payable;
  - propose to **allow** the use the **local financial accounting standard** for the HKMTT computation [Note: If the HKMTT is to qualify for the QDMTT safe harbour, it must require the use of the local accounting standard when the specified conditions are met. The MNE groups will not be given an option to choose between the local accounting standard or the accounting standard adopted by the ultimate parent entity]; and
  - propose to provide the CbCR safe harbour and QDMTT safe harbour in the domestic legislation.

- **Filing obligations and compliance** under the GloBE Rules and HKMTT:
  - in addition to filing of **a top-up tax return**, there will be an obligation to file an **annual notification on top-up tax filing obligation;**
  - in-scope MNE groups (Hong Kong or foreign headquartered) will be allowed to designate one Hong Kong CE to file the top-up tax return / notification;
  - in-scope MNE groups will file **a single top-up tax return** for the purposes of the GloBE Rules and HKMTT;
  - filing deadlines for (i) the top-up tax notification will be no later than **6 months** after the end of the fiscal year and (ii) the top-up tax return will be no later than **15 months** after the end of the fiscal year (extended to **18 months** in the first / transitional year);
  - the same “assessment first audit later” approach will be adopted for top-up tax;
  - no provisional top-up tax will be charged; and
  - the current administrative provisions in the IRO (e.g. anti-avoidance rules, objection procedures, record keeping, collection and recovery of tax, penalties, etc.) will apply.

KPMG observations

In-scope MNE groups in Hong Kong should closely monitor any future developments on Pillar 2 implementation in Hong Kong, especially the further details about the government’s proposals on the design and administrative framework of the HKMTT to be set out in the upcoming consultation paper. We will provide further update when the consultation paper is issued and discuss our comments on the government proposals in the paper.

Given Hong Kong plans to implement the GloBE Rules and HKMTT in 2025 and some foreign jurisdictions (e.g. Australia, Japan, Korea, the UK and Vietnam) will implement the IIR and/or DMTT in 2024, in-scope MNE groups in Hong Kong should get prepared for the new pre-regime disclosure requirement / post-regime current tax provision in respect of Pillar 2 top-up tax in the financial statements as well as the new compliance obligations under Pillar 2.

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