

# Inclusive Framework BEPS Agreement

Update on Pillar 2 consultation outcome and implementation timeline in the Hong Kong SAR



## Update on Pillar 2 consultation outcome and implementation timeline in the Hong Kong SAR

The HKSAR Government launched a consultation exercise<sup>1</sup> on the implementation of the GloBE Rules and the Hong Kong Minimum Top-up Tax (HKMTT) in the Hong Kong SAR (Hong Kong) between December 2023 and March 2024. For more details of the government's proposals in the consultation paper, please refer to our [Hong Kong BEPS publication](#) issued in January 2024.

Following the consultation, the Financial Services and the Treasury Bureau and the Inland Revenue Department (IRD) jointly issued a Legislative Council briefing paper on the outcome of the consultation<sup>2</sup> (the LegCo Paper) on 30 October 2024. The LegCo Paper summarises the feedback received from stakeholders and set out the government's responses to the views received.

This BEPS publication highlights the key points contained in the government's responses as set out in the LegCo Paper.

### Key points of the government's responses

#### 1. The latest implementation timeline

- The government is finalising the legislative amendments to the Inland Revenue Ordinance (IRO) and now plans to introduce the relevant bill into the Legislative Council **by January 2025**.
- The Income Inclusion Rule (IIR) and the HKMTT will be implemented from 2025 while the implementation of the Undertaxed Profits Rule (UTPR) will be deferred to a date to be specified by the government at a later stage.
- The government will consider the position of in-scope MNE groups operating in Hong Kong after the implementation of the IIR and HKMTT as well as the practice of other jurisdictions before deciding on the UTPR implementation timeline.

***KPMG observations:** We welcome the deferral of the UTPR implementation in Hong Kong, which we proposed in our submission to the government. This would help reducing the compliance burden of in-scope MNE groups during the initial implementation stage and put Hong Kong on par with Singapore.*

#### 2. The legislative approach

- Given top-up tax will be treated as a profits tax but is with its own distinctive nature, the legislation on the GloBE Rules and HKMTT will be incorporated into the IRO but under a new Part that is separate from the existing Hong Kong profits tax rules.
- Further administrative guidance issued by the OECD in the future will be incorporated into the IRO through subsidiary legislation.

<sup>1</sup> The consultation paper can be accessed via this link: [https://www.fstb.gov.hk/tb/en/others/Consultation\\_paper\\_Global\\_minimum\\_tax\\_and\\_HKMTT\\_\(Eng\).pdf](https://www.fstb.gov.hk/tb/en/others/Consultation_paper_Global_minimum_tax_and_HKMTT_(Eng).pdf)

<sup>2</sup> The Legislative Council Paper can be accessed via this link: <https://www.legco.gov.hk/yr2024/english/panels/fa/papers/facb1-1409-1-e.pdf>

### 3. Definition of “Hong Kong resident entity”

- Having consulted the OECD, a definition of “Hong Kong resident entity”<sup>3</sup> will be introduced for the **general purposes** of the IRO instead of for Pillar 2 purposes specifically.
- The above definition will take effect retrospectively from 1 January 2024 given some jurisdictions have already adopted the GloBE Rules from 2024.

***KPMG observations:** While defining “Hong Kong resident entity” for the purposes of corporate income tax in general will be in line with the approach commonly adopted by other jurisdictions in defining “tax resident”, given the territorial source regime in Hong Kong, an entity that falls within the definition of Hong Kong resident entity may nevertheless be not liable to any profits tax in Hong Kong. Given this, it has yet to be seen whether the proposed “Hong Kong resident entity” definition would be respected by other jurisdictions for Pillar 2 purposes. On the other hand, further consideration will be required on how this general definition will interact with the specific definitions currently adopted in other parts of the IRO (e.g. for unified fund tax exemption, tax treaty application and transfer pricing purposes).*

### 4. The UTPR safe harbour

The transitional UTPR safe harbour<sup>4</sup> will be included in the upcoming Pillar 2 legislation.

### 5. Design of the HKMTT

Investment entities and insurance investment entities would be excluded from the scope of the HKMTT to preserve the tax neutrality for these entities.

***KPMG observations:** We welcome the clarification that insurance investment entities (in addition to investment entities) will also be excluded from the scope of HKMTT. Singapore, which is another popular investment fund hub in Asia, also offers similar exclusion under its domestic top-up tax regime.*

### 6. Tax compliance and administration

The table below summarises the government’s responses to comments received on the compliance and administration of the GloBE Rules and HKMTT.

Tax compliance and administrative measures	Government’s responses/latest proposals
1. Designation of UTPR / HKMTT top-up tax paying entities	<ul style="list-style-type: none"><li>• The designation can be made on an annual basis via an annual election.</li><li>• The <b>joint and several liability</b> for the top-up tax arising from the designation will only be triggered if the designated paying entity <b>defaults</b> in payment of top-up tax.</li><li>• The government will explore a “clean exit” administrative arrangement in respect of the joint and several liability of the constituent entities that are intended to leave the MNE group, subject to fulfilment of the specified conditions.</li></ul>
2. Payment due date of top-up tax	<ul style="list-style-type: none"><li>• Extended to <b>one month</b> after (1) the expiry of the top-up tax return filing deadline or (2) the issuance date of the notice of assessment (NOA), whichever is the later.</li></ul>
3. Objection period	<ul style="list-style-type: none"><li>• Extended to <b>two months</b> after the issuance date of the NOA</li></ul>

<sup>3</sup> The proposed definition of “Hong Kong resident entity” is (1) an entity incorporated/constituted in Hong Kong or (2) an entity incorporated/constituted outside Hong Kong but normally managed or controlled in Hong Kong.

<sup>4</sup> This means that for an in-scope MNE group with the ultimate parent company (UPE) located in a jurisdiction with a corporate income tax rate of at least 20% (e.g. the US), Hong Kong will deem the UTPR top-up tax in respect of the UPE jurisdiction to be zero up to year 2026.

Tax compliance and administrative measures	Government's responses/latest proposals
<p><b>4. Limitation period for raising additional assessments</b></p>	<ul style="list-style-type: none"> <li>Set to be <b>six years</b> after (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<sup>5</sup>, whichever is the later.</li> </ul>
<p><b>5. General anti-avoidance provisions</b></p>	<ul style="list-style-type: none"> <li>The general anti-avoidance provisions (i.e. sections 61 and 61A of the IRO) are not applicable to the GloBE Rules and HKMTT.</li> <li>A main purpose test will be introduced as a general anti-avoidance rule for the GloBE Rules and HKMTT.</li> <li>The main purpose test would not provide general grandfathering of all transactions entered into before the implementation of GloBE Rules and HKMTT.</li> </ul>
<p><b>6. Penalty for non-compliance</b></p>	<ul style="list-style-type: none"> <li>The existing penalty approach under the IRO (e.g. the test on reasonable excuse) will be adopted in formulating the penalty provisions of the GloBE Rules and HKMTT.</li> <li>The IRD will set out in its guidance that the mitigating factors mentioned in the OECD's guidance on transitional penalty relief will be taken into account when considering whether penalty action is to be taken.</li> </ul>

## 7. Others

- The government needs to carefully consider the feasibility of implementing a qualified refundable tax credit regime in Hong Kong as there will be major policy and financial implications to the government (e.g. the cash outlay involved, the specific industries covered and the scope of qualifying activities).
- The IRD will publish its own guidance on the implementation issues that are of common interest to in-scope MNE groups on its website.

<sup>5</sup> An example is a decrease in the adjusted covered tax amount in a foreign jurisdiction for a previous year due to a post-filing adjustment, triggering the need for re-calculating the top-up tax payable by the MNE group in that jurisdiction for that previous year.

## The next step

We commend the HKSAR Government for considering the feedback received during the consultation exercise, accepting some of the suggestions made by stakeholders in their submissions (including those of KPMG) and seeking clarifications from the OECD on certain unclear issues on the application of the GloBE Rules.

As the next step, we look forward to the publishing of the draft Pillar 2 legislation in Hong Kong as soon as practicable. Given the complexity and novelty of the GloBE Rules, there are various areas in which clarifications of the interpretation and application of the rules would be necessary. These include, but not limited to, the application of the local financial accounting standard rule for HKMTT purposes, the treatments of mobile tangible assets and employees, the determination of Excluded Dividends from a practical perspective and the transitional rules for pre-regime deferred tax attributes. In this regard, the timely issuance of IRD's own guidance on common implementation issues would be helpful.

In-scope MNE groups should closely monitor the Pillar 2 developments at both the OECD level and domestic level (i.e. individual jurisdictions including Hong Kong). As far as Pillar 2 compliance work for fiscal year 2024 is concerned, they would need to consider the Pillar 2 tax provision and disclosure requirements under IAS 12 for the 2024 financial statements in addition to the various Pillar 2 registration / reporting requirements under the GloBE Rules and domestic top-up tax regimes.

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