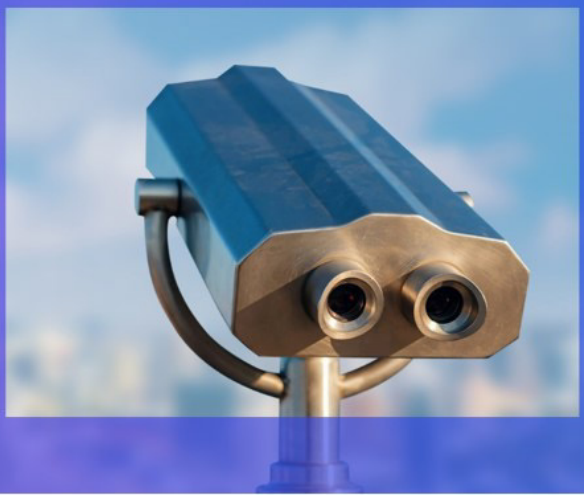
Inclusive Framework BEPS Agreement

Draft Pillar 2 legislation refined and government responses to public feedback released



Draft Pillar 2 legislation refined and government responses to public feedback released

The **Inland Revenue (Amendment) (Minimum Tax for Multinational Enterprise Groups) Bill 2024** (the Bill)[1] was gazetted on 27 December 2024. The Bill contains the draft legislation for implementing the GloBE rules and Hong Kong minimum top-up tax (HKMTT) in the Hong Kong SAR (Hong Kong). For a discussion of the Bill and our key observations, please refer to our previously issued Hong Kong BEPS publication.

Based on the submissions on the Bill and other feedback received from stakeholders, the HKSAR Government has proposed numerous amendments[2] (as Committee Stage Amendments or CSAs) to the Bill and provided its responses[3] to the submissions received.

This publication highlights (1) the key amendments to the Bill and (2) the more important points / clarifications mentioned in the government's responses.

Key amendments to the Bill

The key amendments to the Bill previously gazetted are summarised below. For a full list of CSAs proposed by the government, please refer to the Legislative Council paper issued by the government[2].

1. Removal of the "main purpose test"[4]

The "main purpose test" as the general anti-avoidance rule (GAAR) for Pillar 2 purposes has now been **removed.** The existing GAAR in section 61A of the Inland Revenue Ordinance (IRO) (i.e. the "**sole or dominant purpose**" test) will apply instead with certain modifications – i.e. to include the following as the additional matters for consideration when determining whether the transaction was entered into for the sole or dominant purpose of obtaining a tax benefit:

- whether there is any change in (i) the top-up tax liability of a Part 4AA entity[5] or (ii) the overall top-up tax liability of an MNE group that has resulted, will result or may reasonably be expected to result from the transaction; and
- whether the result that has been achieved, will be achieved or may reasonably be expected to be achieved by the transactions is inconsistent with the outcomes under the OECD's GloBE model rules.

KPMG observations: *We welcome the removal of the main purpose test as the GAAR for Pillar 2 purposes. Regarding the proposed modification that a change in the "overall top-up tax liability" of an MNE group will also be one of the matters for consideration in determining the applicability of the GAAR, further clarification on that will be welcomed – e.g. whether a decrease in the overall top-up tax liability of an MNE group globally without a change to, or*

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[1] The Bill can be accessed via this link: https://www.gld.gov.hk/egazette/english/gazette/file.php?year=2024&vol=28&no=52&extra=0&type=3&number=33

[2] A complete list of CSAs can be accessed via this link: https://www.legco.gov.hk/yr2025/english/bc/bc101/papers/bc101cb3-567-1-e.pdf

[3] The government's responses can be accessed via this link: https://www.legco.gov.hk/yr2025/english/bc/bc101/papers/bc101cb3-487-1-e.pdf

[4] Under the test, if the main purpose, or one of the main purposes, of entering into any arrangements by a person is to avoid any Pillar 2 obligations, the arrangements would be disregarded for Pillar 2 purposes.

[5] Part 4AA entity means a HK constituent entity, a HK standalone JV or a HK member of a JV group, or a Part 4AA stateless entity of an MNE group.

with an increase in, the top-up tax liability in Hong Kong will also be regarded as a relevant consideration for the purposes of section 61A.

2. Amendments relating to top-up tax administration and compliance

	Key aspects of tax administration	Original proposals in the Bill	Proposed amendments
1.	Statutory time limit for raising additional assessments on top-up tax	• **6 years** after (i) the end of the relevant fiscal year or (ii) the time when the non-assessment or under-assessment has come to the assessor's knowledge, whichever is the later.	• **8 years** after the end of the year of assessment (YOA) in which the relevant fiscal year ends (for non-evasion cases). • Extended to **12 years** for cases involving fraud or willful evasion.
2.	Time limit for initiating prosecution proceedings against Part 4AA entities or service providers	• No later than the later of: ➢ The expiry of **6 years** after the day on which the offence was committed; or ➢ The expiry of **2 years** from the day on which the offence was discovered by the Commissioner.	• **8 years** after the day on which the offence was committed.
3.	Requirement to initiate prosecution in respect of an offence committed by Part 4AA entities	• Requirement in existing section 84 of the IRO not applicable.	• Prosecution can **only** be initiated with the **sanction of the Commissioner** (i.e. section 84 requirement).
4.	Time limit for filing a GloBE information return (GIR) in Hong Kong if the GIR information exchange mechanisms fail	• Within **30 days** after the date of the Commissioner's notice	• The later of: ➢ **60 days** after the date of the Commissioner's notice; or ➢ the date specified in the Commissioner's notice. • In addition, a Hong Kong constituent entity (HK CE) is not required to file a GIR if another HK CE of the group that is the ultimate parent entity or designated local entity has filed it.
5.	Definition of a "linked entity"[6]	• A linked entity is an entity that (i) is a HK CE of the assessed group when the notice demanding for payment of the unpaid top-up tax for a fiscal year (the taxable year) is issued and (ii) was at any time in the taxable year a HK CE of the assessed group.	• A linked entity is an entity that was at any time in the taxable year a HK CE of the assessed subgroup.
6.	Time limit for taxpayers to reopen top-up tax assessments to correct omissions or errors and claim a refund of the tax overpaid	• The later of (i) **6 years** after the end of the relevant YOA or (ii) **6 months** after the issuance date of the notice of assessment.	• The later of (i) **8 years** after the end of the YOA in which the relevant fiscal year ends or (ii) **6 months** after the issuance date of the notice of assessment.

[6] If a designated paying entity defaults in paying any HKMTT or UTPR top-up tax for a fiscal year, all linked entities become jointly and severally liable for the total amount of the HKMTT or UTPR top-up tax that is not paid.

	Key aspects of tax administration	Original proposals in the Bill	Proposed amendments
7.	Record-keeping period	• At least **12 years** after the completion of the transactions, acts or operations relevant to the computation of top-up tax liability.	• At least **9 years** after the completion of the transactions, acts or operations relevant to the computation of top-up tax liability.
8.	Penalty provisions on non-compliance for directors or officers	• Directors or officers are liable for an offence related to non-compliance of Pillar 2 tax obligations if the offence was committed with consent or connivance of the directors or officers.	• The penalty provisions for directors or officers have now been **removed**.

KPMG observations:

- *We are glad to see that the government has addressed the key concerns raised by stakeholders relating to top-up tax administration and has largely taken on board the suggestions made in various submissions on the Bill. This shows the government's effort in keeping the Pillar 2 compliance burden as minimal as required and maintaining Hong Kong's tax competitiveness in the post-Pillar 2 era.*

- *However, the revised definition of "linked entity" (i.e. removing the condition that the entity being a HK CE of the MNE group at the time the tax demand notice is issued) means that potential future liability for unpaid top-up tax will become an issue again for a HK CE intending to leave an in-scope MNE group. In this regard, the government has indicated that it will explore administrative arrangements for allowing a "clean exit". In considering what administrative arrangements could be put in place, it is important to ensure that the proposed measures are pragmatic and being able to give the much-needed tax certainty to the parties involved in merger and acquisition transactions.*

3. Definition of local accounting standard

For the purposes of the Local Financial Accounting Standard (FAS) Rule under the HKMTT regime, the local accounting standard was originally defined to mean the IFRS or HKFRS. The definition of local accounting standard is now expanded to mean the IFRS or **accounting standards prescribed by the HKICPA**.

KPMG observations: *According to note 69 in Annex A of the Legislative Council paper setting out the CSAs[2], the expanded definition will reduce compliance burden of in-scope MNE groups. The expanded definition seems to include Hong Kong Accounting Standards, HKFRS for Private Entities Accounting Standards and the Small and Medium-sized Entity Financial Reporting Framework and Financial Reporting Standard, etc. issued by the HKICPA as local accounting standard.*

4. Reimbursement for top-up taxes

The originally proposed new section 25A of the IRO specified that reimbursement for Hong Kong Undertaxed Profits Rule (UTPR) top-up tax or HKMTT made by a CE to a designated paying entity within an MNE group is not taken into account by either entity (i.e. not taxable/deductible) for the purposes of profits tax in Part 4 of the IRO (Part 4 profits tax).

The section is proposed to be amended with the following effects:

- the section applies in relation to reimbursements for all types of top-up taxes imposed in Hong Kong as well as foreign Income Inclusion Rule (IIR) top-up tax, foreign UTPR top-up tax and foreign domestic minimum top-up tax (DMTT); and

- the total amount of reimbursements for top-up tax(es) under IIR, UTPR, foreign DMTT and HKMTT received by a CE that has an obligation to pay such top-up tax(es) is limited to the actual top-up tax liability of that CE.

KPMG observations*: The government indicated in its responses to submissions on the Bill that the limit of reimbursement is relaxed. Further clarification on whether it means the amount of top-up tax reimbursement payment made by a particular CE is no longer limited to the amount of top-up tax allocated to it according to the GloBE Rules will be welcomed as that is not absolutely clear from the wording of the proposed amendments.*

5. Deduction of foreign top-up taxes

Deduction of foreign taxes under section 16(1)(c) of the IRO - The Bill is further amended to allow a deduction of qualified domestic minimum top-up tax (QDMTT) paid in a foreign jurisdiction in respect of the interest, gains or profits that are (i) deemed as taxable in Hong Kong under section 15(1) of the IRO and (ii) income of a permanent establishment (PE) located in that foreign jurisdiction. Any IIR or UTPR top-up tax paid in a foreign jurisdiction is not tax deductible as originally proposed.

Deduction of foreign taxes on gross income under section 16(1)(ca) of the IRO – The Bill is further amended to clarify that no deduction is allowed under this section for any foreign IIR top-up tax, foreign UTPR top-up tax or foreign DMTT paid.

KPMG observations:

- *As QDMTT is a form of corporate income tax (CIT), allowing a deduction of foreign QDMTT paid on the income/profits deemed taxable under section 15(1) is in line with the policy intent of section 16(1)(c). However, it appears to us that deduction should also be granted for any foreign DMTT paid that is not a QDMTT. In this regard, further elaboration from the government on the reason of requiring the DMTT to be a qualified one would be welcomed.*

- *As the rule order is for the IIR and UTPR to be imposed after the domestic CIT, it follows that deduction of any foreign IIR or UTPR top-up tax paid is not allowed for Part 4 profits tax purposes under section 16(1)(c).*

- *For deduction of foreign taxes under section 16(1)(ca), it should largely refer to withholding taxes imposed by a foreign jurisdiction on gross income paid to non-residents (i.e. a Hong Kong company) so it seems unlikely that such income will be subject to a DMTT in that foreign jurisdiction.*

6. Foreign tax credit for foreign QDMTT payable

The Bill is further amended to provide for the following:

- Only profits tax in Part 4 (and not top-up tax in Part 4AA) of the IRO can be offset by a foreign tax credit;

- no foreign tax credit is allowed in respect of a foreign IIR or UTPR top-up tax;

- QDMTT payable in a foreign jurisdiction is eligible for a bilateral or unilateral tax credit against the Part 4 profits tax payable in the following **two situations only**:

  (i) the foreign QDMTT is payable in respect of profits of a PE in a foreign jurisdiction and the same profits are chargeable to Part 4 profits tax as assessable profits of the main entity in Hong Kong (i.e. the HK CE); or

  (ii) the foreign QDMTT is payable in respect of a foreign investee entity's underlying profits out of which dividend is (1) paid to a HK CE and (2) chargeable to Part 4 profits tax in Hong Kong.

KPMG observations: *Similar to our comments on the deduction of foreign top-up taxes above, it appears to us that foreign tax credit should be granted regardless of whether the foreign DMTT is a QDMTT of not. For the same reason as for the non-deductibility of foreign IIR or UTPR top-up tax mentioned above and also that the taxpayers for the Part 4 profits tax and foreign IIR or UTPR top-up tax will be different, no foreign tax credit is allowed for any foreign IIR or UTPR top-up tax payable.*

7. Amendments related to the OECD's Administrative Guidance issued in June 2024 and January 2025

Various amendments are made to the Bill to reflect the additional guidance provided in the Administrative Guidance issued by the OECD in June 2024 and January 2025[7] - e.g. (i) treatment of deferred tax expenses attributable to the reversal of certain pre-regime deferred tax assets and liabilities for transitional country-by-country reporting (CbCR) safe harbour calculations and (ii) disapplication of the QDMTT safe harbour in a jurisdiction for an MNE group having a securitisation entity in that jurisdiction that is not subject to the QDMTT in that jurisdiction.

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[7] For more details on the Administrative Guidance, please refer to the KPMG publications via the below links:
https://assets.kpmg.com/content/dam/kpmg/cn/pdf/en/2024/06/agreed-administrative-guidance-on-the-globe-model-rules-pillar-two.pdf
https://assets.kpmg.com/content/dam/kpmgsites/xx/pdf/2025/01/oecd-release-article-16-jan.pdf

8. Interaction between foreign top-up taxes and the foreign-sourced income exemption (FSIE) regime

Section 15N of the IRO is amended to clarify the interaction between top-up taxes chargeable in a foreign jurisdiction and the "subject to tax" condition under the participation requirement of the FSIE regime:

- the "subject to tax" condition is regarded as met if the specified foreign-sourced income (e.g. the underlying profits of the foreign-sourced dividends) is subject to a tax similar to Part 4 profits tax or **a QDMTT in that foreign jurisdiction**;
- any IIR or UTPR top-up tax chargeable in a foreign jurisdiction is **not** taken into account for the purposes of the "subject to tax" condition; and
- the top-up tax percentage related to any top-up tax paid/payable in a foreign jurisdiction will be disregarded in determining the "applicable rate". That is, the "applicable rate" remains to be the headline rate (i.e. the highest corporate tax rate or the highest stipulated tax rate in a special tax legislation where applicable) of the foreign jurisdiction.

Amendments are also made to the Bill to provide for the situations where a QDMTT payable in a foreign jurisdiction is allowed as a tax credit against Part 4 profits tax payable in respect of a specified foreign sourced income (as discussed in item 6 above).

KPMG observations: *The proposed amendments to section 15N require that the specified foreign-sourced income be subject to a QDMTT (instead of DMTT) in a foreign jurisdiction. Given the rationale of the "subject to tax" condition, it appears to us that being subject to a DMTT in a foreign jurisdiction should be sufficient for meeting the condition. Further elaboration from the government on the reason of requiring the DMTT to be a qualified one would be welcomed. The above proposed tax treatments of foreign taxes are similar to those in Singapore under its FSIE regime as set out in the e-Tax Guide on Multinational Enterprise top-up Tax and Domestic Top-up Tax[8] issued by the IRAS.*

9. Mandatory e-filing of profits tax returns

Other than the provisions for implementing Pillar 2 in Hong Kong, the Bill now also includes an amended **section 51AAB** of the IRO and a new **Schedule 65** which specify that all Part 4AA entities[5] of an MNE group that is within the scope of Pillar 2 for a fiscal year beginning on or after 1 January 2025 are required to file their profits tax returns for the **YOA 2025/26 and all subsequent YOAs** electronically, regardless of whether the MNE group is in-scope of Pillar 2 in any other subsequent YOAs.

KPMG observations: *Given that the timeline of launching the mandatory e-filing of profits tax returns for MNE groups that are within the scope of Pillar 2 has now become definite (i.e. from the YOA 2025/26), such MNE groups should take actions to get prepared for the e-filing requirement. These include reviewing the existing financial reporting system, tax compliance process and data readiness and making necessary changes for a smooth transition from paper to electronic filing. Considerations should also be given on how to achieve a greater integration between the filing processes of profits tax return and top-up tax return.*

Key points / clarifications in the government's responses

We set out below the more important points / clarifications mentioned in the government's responses to the submissions on the Bill.

1. Application of the GAAR for Pillar 2 purposes

- The Inland Revenue Department (IRD) will publish guidance on the application of the GAAR for Pillar 2 purposes on its website. In particular, the guidance will specify that the GAAR will not apply to transactions entered into **on or before 30 November 2021** in general.

[8] For more details, please refer to the IRAS e-Tax Guide in this link: https://www.iras.gov.sg/media/docs/default-source/e-tax/e-tax-guide-mtt-and-dtt.pdf?sfvrsn=e95bc2a9_7

- The OECD has yet to publish a list of specified avoidance or abusive arrangements for the purposes of the GloBE model rules. The IRD will make reference to the OECD list to be published when applying the GAAR.

2. Application of the penalty provisions for non-compliance

The IRD will take reference to the OECD's transitional penalty relief when considering whether prosecution or penal action has to be initiated against a non-compliance action. The IRD will provide more guidance in this regard.

3. The Local FAS Rule

To facilitate compliance with the requirements of the Local FAS Rule under the HKMTT regime, the notes and instructions to profits tax returns for the YOA 2025/26 and onwards will require HK CEs of in-scope MNE groups to submit their profits tax returns together with financial accounts prepared in accordance with the local accounting standard if such accounts have been prepared, subject to the approval of the Board of Inland Revenue. This will enable in-scope MNE groups to fulfil the relevant requirement under the Local FAS Rule without having to perform an external financial audit on the financial accounts of the HK CEs.

4. Application of the transitional CbCR safe harbour

An election by an MNE group for applying the transitional CbCR safe harbour for a fiscal year is available for a jurisdiction not implementing the GloBE rules for that fiscal year.

5. Application of the HKMTT administrative provisions to joint ventures (JVs)

For a JV company that is chargeable with HKMTT and jointly held by MNE Group A (in-scope of Pillar 2) and MNE Group B (out of scope of Pillar 2), the JV partner from MNE Group B would not be subject to penalty provisions in respect of the JV's or MNE Group A's non-compliance of HKMTT filing or payment obligations (if any) as it is not a HK CE of the assessed subgroup of an in-scope MNE group.

6. A redomiciled company being a "Hong Kong resident entity" for Pillar 2 purposes

A company redomiciled to Hong Kong (which is not normally managed or controlled in Hong Kong) will be regarded as a Hong Kong resident entity for Pillar 2 purposes from the date of re-domiciliation (i.e. the issuance date of the certificate of re-domiciliation), even if the company has not yet completed the deregistration process in its original place of incorporation.

The next step

The HKSAR Government's proposal on refining the Bill represents a positive step taken by it in addressing the stakeholders' concerns about the Pillar 2 implementation in Hong Kong. Moving forward, it is important for the IRD to issue timely guidance on the interpretation and application of the Pillar 2 rules in various uncertain areas. This will provide the much-needed clarity and certainty for in-scope MNE groups from the Hong Kong domestic compliance perspective. In addition, the data requested in the single top-up tax return to be filed by in-scope MNE groups in Hong Kong should be limited to those that are absolutely required to minimise the compliance burden.

In-scope MNE groups should understand the amendments to the Bill and take note of the clarifications provided by the government in its responses. The Bill would likely be enacted or regarded as substantially enacted for the purposes of financial reporting in the second quarter of 2025 with the IIR and HKMTT applying retrospectively to fiscal years beginning on or after 1 January 2025 in Hong Kong. Although the filing of the GIR / HKMTT return for fiscal year 2025 would only be due in 2027, in-scope MNE groups need to get prepared for the Pillar 2 current tax provision in respect of Hong Kong for the 2025 interim financial reporting, which includes an assessment of the eligibility to the transitional CbCR safe harbour and/or QDMTT safe harbour in Hong Kong and/or other foreign jurisdictions in which the groups operate.

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