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Hong Kong Tax Analysis

How Global Minimum Tax implementation timelines could affect top-up tax liabilities

Introduction

On 22 February 2023, it was announced that from 2025, Hong Kong would implement the Global Anti-Base Erosion ("GloBE" or "Pillar Two") rules and a Qualified Domestic Minimum Top-up Tax ("QDMTT"). This implementation timeline is significant as it is 1 year later than many other jurisdictions, including the UK, most of Europe, Japan and Korea, all of which are expected to implement the GloBE rules from 2024. On 14 February 2023, Singapore also announced that it would implement the GloBE rules and a QDMTT from 2025. In practice, Singapore is therefore likely to implement in the same year as Hong Kong. Other jurisdictions, such as Mainland China, are yet to release a timeline and it remains to be seen whether others, such as the US, will implement the GloBE rules and a QDMTT at all.

Operation of the GloBE rules and QDMTTs

We explore some of the high level implications of the implementation timelines later in this article. However, firstly, it may be helpful to revisit the key differences between the GloBE rules and a QDMTT using several simple examples.

Both the GloBE rules and QDMTTs should operate in a similar fashion. Their overall goal is to ensure that multinational enterprise groups ("MNE Groups") have an effective tax rate ("ETR") of at least 15% in each jurisdiction in which they operate, based on a particular ruleset. The primary distinction between the GloBE rules and a QDMTT is in the scope of application and the allocation of taxing rights between different governments.

The GloBE rules apply to an entire MNE Group, based on its consolidated financial statements. Generally, priority to collect top-up tax will be granted to the jurisdiction of the ultimate parent entity ("UPE") of the MNE Group through a mechanism known as the Income Inclusion Rule ("IIR").

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The standard version of the IIR within the GloBE rules only applies to jurisdictions below the UPE jurisdiction. Accordingly, an MNE Group with its headquarters in Hong Kong should not be required to apply the IIR to any low taxed profits in Hong Kong and should only be required to apply the IIR to subsidiary jurisdictions outside of Hong Kong.

Where an MNE Group is headquartered in a jurisdiction other than Hong Kong, any low taxed profits in respect of the MNE Group's operations in Hong Kong could be subject to the IIR in the non-Hong Kong headquarters' jurisdiction. Accordingly, if only the IIR is considered and we focus on low taxed profits in Hong Kong, there should be a difference between the taxation of a Hong Kong headquartered MNE Group and a non-Hong Kong headquartered MNE Group. Put simply, the low taxed Hong Kong profits of the Hong Kong headquartered MNE Group would not be taxed, whereas those of a non-Hong Kong headquartered group should be taxed. These scenarios are illustrated below.

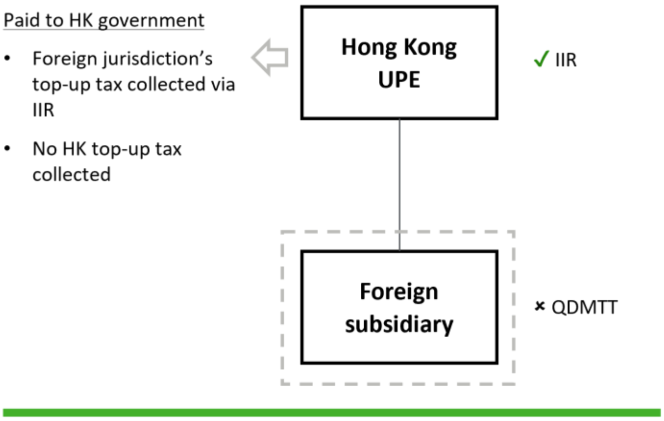

Illustration 1: General operation of IIR – HK UPE

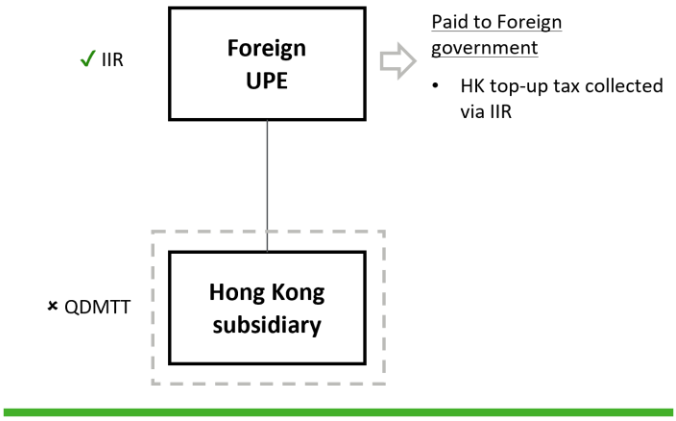

Illustration 2: General operation of IIR – Foreign UPE

The above situation can change when a QDMTT is considered, which has a different scope and application to the IIR. A QDMTT is a version of the GloBE rules that applies only domestically and requires top-up tax to be paid to the local government, instead of to the government of the UPE. A QDMTT applies in priority to the IIR, meaning that if a QDMTT does apply it is unlikely that the IIR will have a significant effect (this is reflected in Illustration 3 and 4 below). Another important design feature of a QDMTT is that unlike the GloBE rules a QDMTT is not required to take into consideration tax paid under a Controlled Foreign Companies ("CFC") regime when determining the top-up tax due. Accordingly, top-up tax payable under a QDMTT could be greater than under a normal application of the GloBE rules.

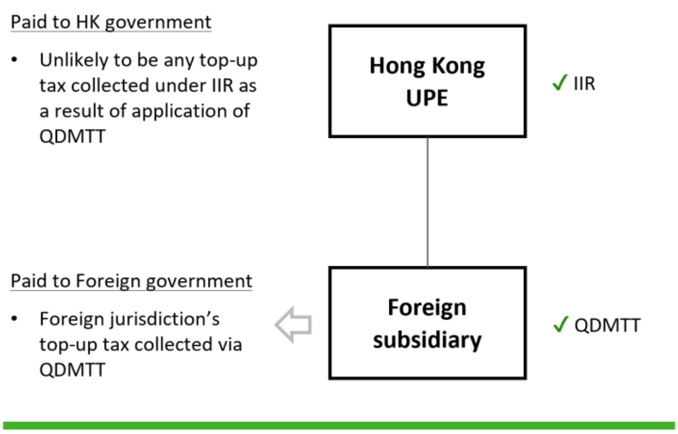

Illustration 3: Operation of IIR and QDMTT – HK UPE

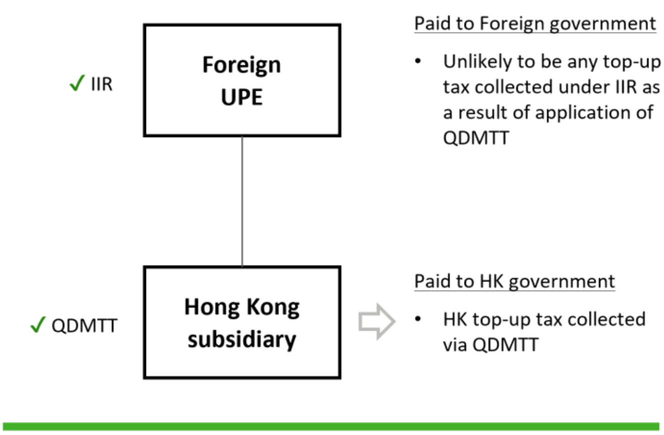

Illustration 4: Operation of IIR and QDMTT – Foreign UPE

A QDMTT will apply equally to the Hong Kong profits of both a Hong Kong headquartered and a non-Hong Kong headquartered MNE Group. This means that the difference between Illustration 1 and 2 above, where the IIR does not apply to the Hong Kong profits of a Hong Kong headquartered MNE Group, but does apply to the Hong Kong profits of a non-Hong Kong headquartered MNE Group would be eliminated as Hong Kong introduces a QDMTT. This is further illustrated below.

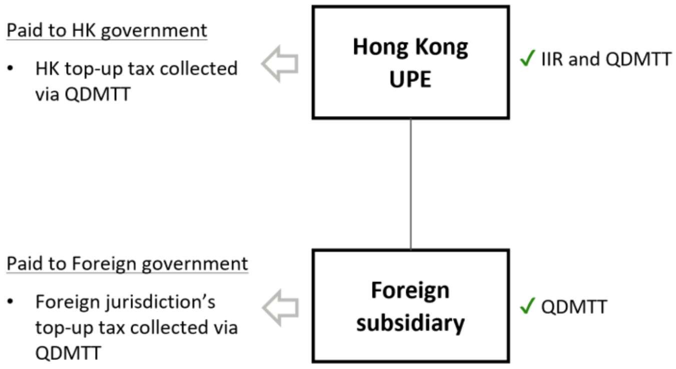

Illustration 5: Operation of QDMTT – HK UPE

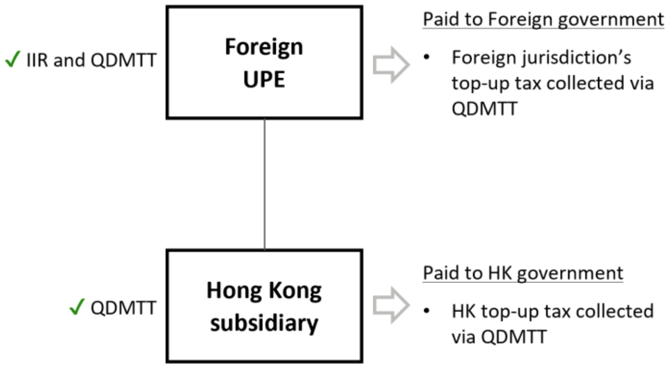

Illustration 6: Operation of QDMTT – Foreign UPE

While Hong Kong is planning to introduce both an IIR and a QDMTT, a delayed implementation timeline versus other jurisdictions will have a number of implications. For example, Hong Kong will collect less tax than if it had implemented the rules in 2024. Some of the forgone tax will simply be collected by governments elsewhere, whereas in some circumstances less tax will be paid overall as Hong Kong's delay could mean certain MNE Groups are not required to pay top-up tax at all. We have outlined a number of these scenarios below, which should also be relevant to other jurisdictions with delayed implementation timelines, such as Singapore.

Implications of delayed implementation timelines

In the circumstance where the UPE jurisdiction does not implement an IIR, the right to apply an IIR should be transferred to the next subsidiary jurisdiction in the ownership chain. An example of this is provided in Illustration 7 below. Hong Kong, being the jurisdiction of the UPE, will not apply the IIR in 2024, as a result, the immediate subsidiary jurisdiction, which is the UK, has the right to apply the IIR. Assuming Singapore does not implement a QDMTT in 2024, the UK government should collect top-up tax in respect of any low taxed profits in Singapore. The UK government would also collect any top-up tax in respect of its own low taxed profits under its QDMTT.

In 2025, assuming both the IIR and QDMTT are in effect, each jurisdiction should independently collect its own top-up tax via a QDMTT. Both of these scenarios are illustrated below.

Hong Kong headquartered MNE Groups

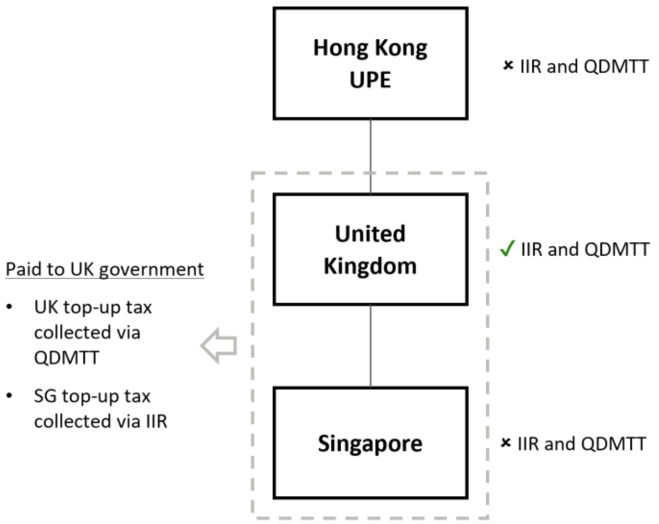

Illustration 7: Top-up tax for Hong Kong headquartered MNE group in 2024

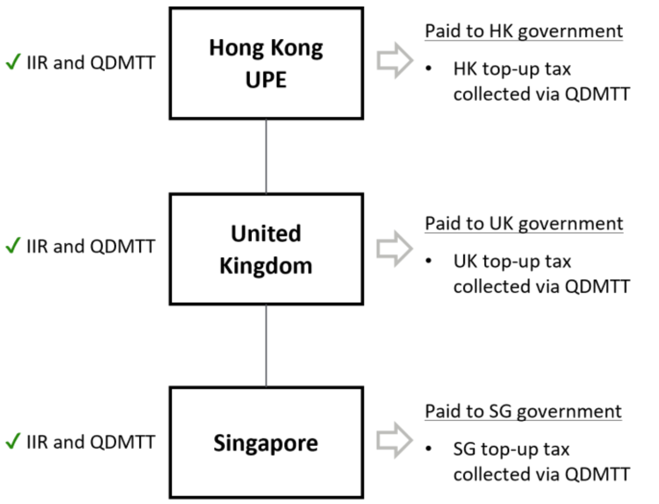

Illustration 8: Top-up tax for Hong Kong headquartered MNE group in 2025

Generally, a QDMTT is not expected to result in a lower amount of tax payable than under the GloBE rules. However, as discussed above, tax collected under CFC rules is not expected to be factored into top-up tax payable under a QDMTT. Therefore, the top-up tax payable under a QDMTT may be greater than would have been payable under the GloBE rules.

In the event that a computation of top-up tax under a QDMTT results in less top-up tax being payable than is due under the GloBE rules, the difference could be collected under an IIR. However, this possibility has not been reflected in the illustrations for simplicity.

UK, Europe[1], Korea and Japan headquartered MNE Groups

For MNE Groups with a UPE in a jurisdiction that would be implementing an IIR from 2024, the amount of top-up tax to be paid to the UPE jurisdiction would depend on whether the subsidiaries of the MNE Group are located in jurisdictions that have implemented a QDMTT. In Illustration 9, the MNE Group has operations in Hong Kong where an IIR and QDMTT should not be in force until 2025. As such, the entirety of the top-up tax in respect of the Hong Kong profits should be collected by the UPE jurisdiction in 2024. The MNE Group also has operations in APAC, if we assume no QDMTT has been implemented in the APAC jurisdictions in 2024, the UPE would also have the right to apply the IIR in respect of low taxed profits in these jurisdictions. In 2025, when Hong Kong implements a QDMTT, Hong Kong will have priority in collecting the top-up tax in respect of any low taxed Hong Kong profits. To the extent APAC jurisdictions also implement QDMTTs from 2025, they would similarly have priority to tax in respect of their own low taxed profits. (Illustration 10).

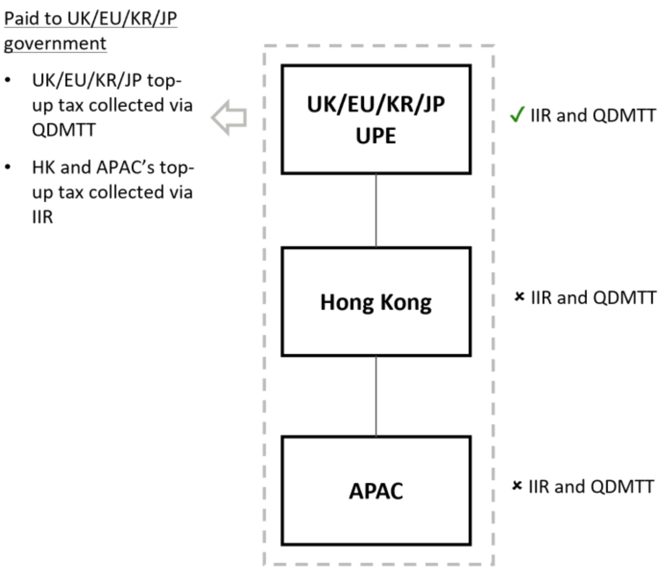

Illustration 9: Top-up tax for UK/EU/KR/JP headquartered MNE group in 2024

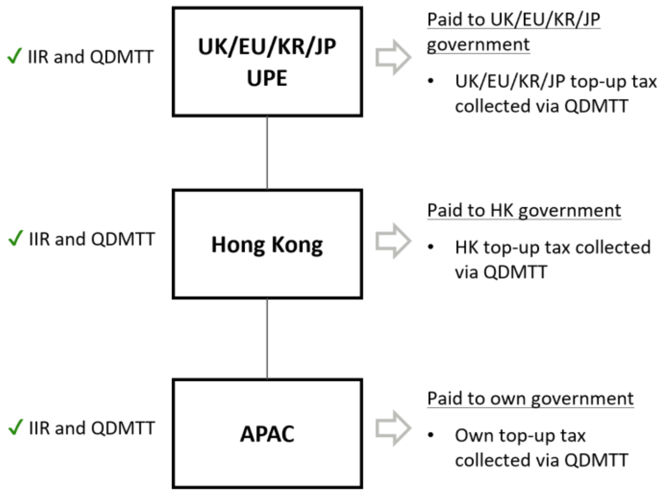

Illustration 10: Top-up tax for UK/EU/KR/JP headquartered MNE group in 2025

US headquartered MNE Groups

Some jurisdictions may not implement the GloBE rules or have uncertain status with regard to implementation; for example, the US, certain African countries and various haven jurisdictions. If these jurisdictions do not implement the GloBE rules, depending on the MNE Group structure and jurisdictions in which they operate, the MNE Group could avoid top-up tax entirely, at least in 2024 (Illustration 11). However, if the MNE Group has operations in jurisdictions that have implemented the GloBE rules, these MNE Groups may be subject to a QDMTT, IIR and / or Under Taxed Payments Rule ("UTPR"). In Illustration 12, which is assumed to occur in 2025, Hong Kong should act as the intermediate parent entity and be granted the right to apply the IIR in respect of any low taxed profits of APAC. The amount of top-up taxes to be collected by the Hong Kong government will depend on whether the APAC jurisdictions with otherwise low taxed profits operate a QDMTT or not.

The recently issued agreed administrative guidance to the GloBE rules clarified that the US Global Intangible Low-Taxed Income ("GILTI") regime is to be treated as a CFC regime for the purposes of the GloBE rules and tax charged under the GILTI regime may be allocated to jurisdictions based on a specified methodology. This should generally reduce top-up tax calculated under the GloBE rules. However, as discussed above, the allocation of CFC taxes from a parent should be ignored for the purposes of computing top-up tax under a QDMTT. Accordingly, even though the guidance with regard to the allocation of GILTI tax may have been considered as providing significant clarity for US headquartered groups, it could be largely obviated by jurisdictions not taking into consideration GILTI tax when computing top-up tax under a QDMTT.

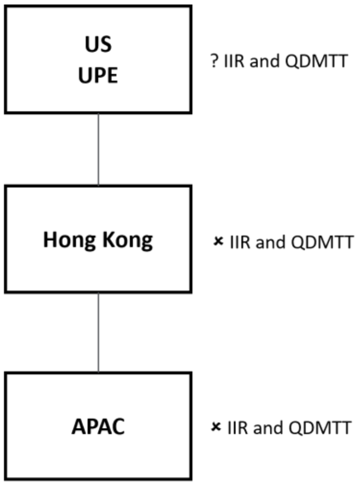

Illustration 11: No top-up tax for US headquartered MNE group in 2024

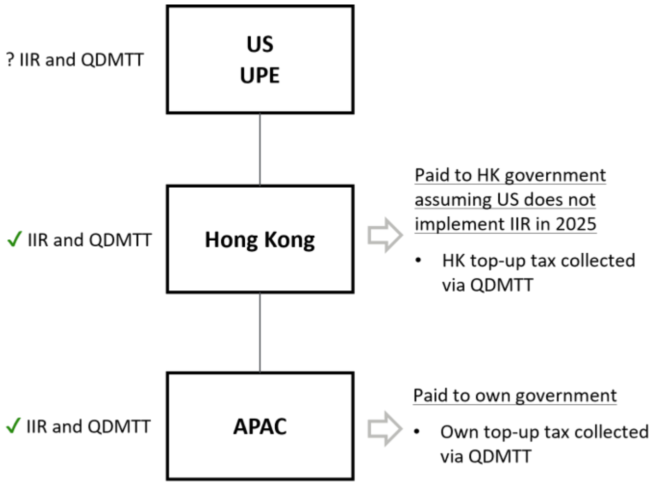

Illustration 12: Top-up tax for US headquartered MNE group in 2025

UTPR in Korea

Korea is the first jurisdiction to codify the UTPR in its domestic legislation. The UTPR is another top-up tax collection mechanism that serves as a backstop rule to the IIR. The UTPR broadly applies where top-up tax has not been collected either under a QDMTT or IIR. It is likely that the UTPR may apply where the headquarters jurisdiction does not operate a QDMTT or IIR and has low taxed profits. Where the UTPR applies, the top-up tax to be collected will be shared among subsidiaries in jurisdictions that have implemented a UTPR.

If Korea operates its UTPR from 2024, as it has announced, it could mean that Korea collects a substantial amount of top-up tax under the UTPR, particularly in respect of low taxed profits that are not yet subject to an IIR or QDMTT due to a delayed implementation.

Key takeaway

While the GloBE rules and QDMTTs are intended to apply in a consistent and uniform fashion, the transition from the status quo to the application of these rules will give rise to significant complexity and uncertainty. MNE Groups should carefully consider the interactions between the QDMTT, IIR, UTPR and CFC regimes based on the implementation timelines of different jurisdictions. Proper attention will need to be given to understanding the nuances of the various scenarios that could arise. The rules continue to change and develop at a rapid pace and require substantial expertise to properly understand. MNE Groups will need to ensure appropriate resources are committed to their implementation projects.

[1] While it is anticipated that the European Union jurisdictions will generally implement an IIR from 2024, only a limited number of jurisdictions have released draft law to confirm this.

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[Simplified Chinese]

P372/2023 – 2023 年 3 月 2 日
支柱二下的信息报告表和安全港规则
[Simplified Chinese]

P368/2022 - 2022 年 12 月 30 日
OECD 发布《支柱一金额 B 公众意见征询文件》
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P356/2022 - 2022 年 6 月 16 日
OECD 发布支柱一金额 A 立法模板系列之《支柱一金额 A 下的受监管金融服务业排除》
[Simplified Chinese] [Japanese]

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[Simplified Chinese] [Japanese]

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OECD 发布支柱一金额 A 立法模板系列之《税基确定立法模板草案》
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支柱二 – G20/OECD 包容性框架发布全球最低税立法模板
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P343/2021 – 12 July 2021
Global Minimum Tax Frequently Asked Questions (FAQ)
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在不断变化的国际环境中管理和规划知识产权的注意要点
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在不确定性中寻找机会——有关 OECD/G20 税基侵蚀和利润转移(BEPS) 计划以及全球税制重塑 2.0 的第七次年度全球调查
[Simplified Chinese] [Japanese]

P330/2021 – 11 January 2021
European Union – Mandatory Tax Reporting (DAC6) implemented
[Simplified Chinese] [English]

P327/2020 – 2020 年 11 月 19 日
OECD 就应对数字经济带来的税收挑战发布蓝图报告：支柱二之详细解读
[Simplified Chinese] [Japanese]

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[Simplified Chinese] [Japanese]

P323/2020 – 2020 年 10 月 22 日
变革与经济复苏下的全球税收政策导向
[Simplified Chinese]

P322/2020 – 2020 年 10 月 7 日
澳大利亚发布 2020-21 年预算：政策利好复苏
[Simplified Chinese]

P317/2020 – 27 July 2020
European Union - Mandatory Tax Reporting for certain cross-border arrangements
[Simplified Chinese] [English]

P311/2020 – 2020 年 2 月 14 日
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数字经济征税方案下"统一方法"与现行转让定价规则碰撞之初探
[Simplified Chinese]

P304/2019 – 2019 年 11 月 15 日
OECD 发布最新意见征询文件：全球防止税基侵蚀提案（支柱二）
[Simplified Chinese] [Japanese]

P302/2019 – 5 November 2019
OECD's public consultation document: Secretariat Proposal for a "Unified Approach" under Pillar One
[Simplified Chinese] [English] [Japanese]

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3 February 2023
OECD released administrative guidance on global minimum tax

21 December 2022
OECD Pillar Two: Information return and safe harbors published

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Hong Kong defers the implementation of Pillar Two

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[English]

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