Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By email (beps@fstb.gov.hk)

20 March 2024

Our Ref.: C/TXG, M139347

Financial Services and the Treasury Bureau
(Treasury Branch)
24/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Attn: Mr Stephen Lo

Dear Sirs,

Consultation on the Implementation of Global Minimum Tax and Hong Kong Minimum Top-up Tax

The Hong Kong Institute of Certified Public Accountants ("the Institute") appreciates the opportunity to provide feedback on the Consultation Paper ("CP") regarding the implementation of the global minimum tax and Hong Kong minimum Top-up Tax ("HKMTT"). The Institute's Taxation Faculty Executive Committee ("TFEC"), supported by its International Tax Task Force, has considered the questions raised in the CP. We provide our general comments below and outline our responses to some of the specific questions raised in the Appendix for your consideration.

Please note that all documentary references are made to the Global Anti-Base Erosion Rules ("GloBE Rules") unless otherwise stated. All capitalised but undefined terms in this submission have the same meaning as those in the GloBE Rules.

General Comments

- **Resident definition** – The proposed introduction of the "resident" definition in the Inland Revenue Ordinance (Cap. 112) ("IRO") may not be sufficient to remedy all locational issues arising from Hong Kong's territorial regime. As no tax implications arise from meeting the definition, except those within the GloBE Rules and HKMTT, it may not be respected by other jurisdictions as part of Hong Kong's domestic tax system. We suggest the need for urgent consultation with the OECD in order to make provision in the GloBE Rules for jurisdictions that operate territorial regimes.

- **Retrospective application** – The retrospective application of the "resident" definition may not be respected by all jurisdictions. Certain jurisdictions could give effect to the definition upon implementation of the law, which could give rise to a mid-year change of residence. In any event, this proposal will need

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

to be seen in context of Article 10.3.6 of the GloBE Rules, which addresses the issue of the location of an entity that changes its location during the financial year. This compounds the potential uncertainty.

- **Certainty –**The complexity of these rules and the lack of a proposed binding mandatory multilateral dispute mechanism for taxpayers will create additional uncertainty for taxpayers. We understand that work on dispute resolution mechanisms continues to be undertaken by the OECD and we encourage the Government to continue to participate in those discussions. We list below specific areas where the Government can adopt policies and/or provide additional guidance which will give greater assurance to taxpayers, and promote Hong Kong's status as an international financial centre with a (relatively) simple tax system.

    - **Qualified Domestic Minimum Top-up Tax ("QDMTT") safe harbour** – There are pros and cons to the introduction of a QDMTT safe harbour. Multinational enterprise ("MNE") groups may benefit from additional certainty, but have the potential to pay additional Top-up Tax. The compliance implications of the QDMTT safe harbour will vary between groups.

    - **Transitional country-by-country reporting ("CbCR") safe harbour –** We support the adoption of the CbCR reporting safe harbour as a means for taxpayers to achieve certainty.

    - **Timely updates to Agreed Administrative Guidance ("AAG") references** – It should be ensured that the IRO, or relevant subsidiary legislation, is updated on a timely basis, such that MNE groups have certainty as to which AAG version applies at any given time.

    - **AAG per the date of the GloBE Rules and HKMTT** – It should be clarified that the AAG referenced in the IRO at the time a transaction is executed or takes place, should be the starting point for determining the treatment of that transaction, income or expense, etc.

    - **Use of local financial accounting standard –** To the extent the use of this rule is determined, clear guidance should be given on which local financial accounting standard to use when there are several available options, and clarity should be given in respect of how the accounts of a permanent establishment ("PE") should be prepared.

- **Legislative implementation** – The GloBE Rules and HKMTT should be included in the IRO, but we have concerns about treating them as a profits tax. The GloBE Rules are intended to interact with local tax rules and, therefore, should be legislated separately to the rules they interact with. It would be potentially circular and confusing to include the GloBE Rules and HKMTT rules as part of the profits tax rules and could lead to unintended outcomes. It is

also not clear that there is a benefit to having the rules included in comprehensive avoidance of double taxation agreements ("CDTAs"). The majority of jurisdictions have introduced their GloBE Rules and QDMTTs as separate taxes. We suggest Hong Kong consider taking a similar approach.

- **Penalties for service providers and "filing entities"** – The proposed penalties for service providers and "filing entities" should be revisited during the initial phase of implementation of the GloBE Rules and HKMTT.

- **Competitiveness of Hong Kong** – The Government should consider how to maintain Hong Kong's competitiveness, as various existing tax incentives may become less effective after the introduction of the global minimum tax. In particular, Hong Kong should consider the introduction of Qualified Refundable Tax Credits, as a priority. Granting non-tax incentives should also be considered as an option to maintain Hong Kong's competitiveness.

Should you wish to discuss any aspect of this submission, please do not hesitate to contact Peter Tisman at peter@hkicpa.org.hk or Jonathan Culver, convenor of TFEC's International Task Force, at joculver@deloitte.com.hk.

Yours faithfully,

PMT/JC/SC/pk
Encl.

Appendix

Consultation on the Implementation of Global Minimum Tax and Hong Kong Minimum Top-up Tax

Detailed comments on specific questions

1. Proposed definition of "resident" (CP, Question 3)

The GloBE Rules rely on the concept of residency to determine the location of constituent entities ("CEs") for the purposes of computing the jurisdictional effective tax rate ("ETR") and collecting Top-up Tax. A residency-based system of taxation gives a jurisdiction the right to tax entities incorporated, established, formed or having their place of effective management in that jurisdiction. Certain aspects of the GloBE Rules place emphasis on the concept of residency.

It is internationally known that Hong Kong operates a territorial system, which imposes tax only on income or profits arising in, or derived from, a source in Hong Kong, or deemed as such. In principle, any income or profits arising outside Hong Kong fall outside the tax net. As a result, the IRO does not require a person to be resident in Hong Kong in order to impose tax, nor does it contain a definition of "resident" for general purposes.

As a consequence of the above, Hong Kong intends to introduce a definition of "resident" for purposes of the GloBE Rules and HKMTT in order to harmonise with the test for the location of CEs under the GloBE Rules. We understand that it is not intended for this definition to have general application and that it is intended to be applicable solely for the purposes of the GloBE Rules and HKMTT. The rationale is to enable CEs that are effectively managed or controlled in Hong Kong (but are incorporated or constituted elsewhere) to be treated as "resident" and, thus, located in Hong Kong for purposes of the GloBE Rules and HKMTT.

In principle, the GloBE Rules are applied by reference to an existing corporate tax system, but as a distinct and separate overlay to that system. There are numerous examples where the GloBE Rules refer to domestic tax laws, such as the reference to the concept of Covered Taxes that are recorded in the accounts and levied under an existing corporate tax system. Additionally, the GloBE Rules consider where persons are resident and where branches are located, based on domestic and international tax law. The GloBE Rules have clearly been designed to interface with existing corporate tax systems and a definition that is introduced exclusively for the GloBE Rules and HKMTT may, therefore, be seen as an adjustment to the GloBE Rules themselves, rather than an adjustment to the relevant domestic law which the rules are intended to reference.

If the "resident" definition has no consequences other than influencing the locational provisions of the GloBE Rules, other jurisdictions may challenge whether it satisfies the purpose that was intended when agreed by the Inclusive Framework.

Beyond the definition of "resident" itself, paragraph (b) of the definition of PE in the GloBE Rules makes reference to a place of business that is taxed on income attributable to it, in a manner similar to which the jurisdiction taxes its own residents.

While residents of Hong Kong may ultimately face a liability to profits tax, they do not face this liability as a consequence of their residency. Therefore, it could be argued that this aspect of the PE definition simply cannot apply in respect of Hong Kong.

These definitions are legislatively important and cannot be dealt with by tax authority guidance, as matters of location are not necessarily within Hong Kong's sole administrative control. For example, a jurisdiction could conclude that an entity is not resident in Hong Kong and, as a result, consider that Hong Kong does not have priority in imposing a QDMTT on it, or that it cannot benefit from the QDMTT safe harbour. The jurisdiction could, instead, choose to impose its GloBE Rules on that entity in order to collect Top-up Tax that might otherwise be available to Hong Kong.

2. Retrospective nature of definition of "resident" (CP, Question 4)

The proposed definition of "resident" is intended to have retrospective application, effective from 1 January 2024. However, it is uncertain to what extent jurisdictions will respect the retrospective nature of this provision. It is possible that some jurisdictions will respect the ability of Hong Kong's legislature to override its own rules and deem an entity to have been resident in Hong Kong at a time before the local implementation of the GloBE Rules and HKMTT, rather than another jurisdiction. However, other jurisdictions might give effect to a change in residency only as of the date Hong Kong implements its rules. Others may disregard the retrospective nature, or, as discussed above, even the change in residency entirely. There could be problematic consequences to each outcome. In any event, this proposal will must be seen in context of Article 10.3.6 of the GloBE Rules which states: *Where an Entity has changed its location during the Fiscal Year, it shall be located in the jurisdiction where it was located at the beginning of that year*. This only adds to the potential uncertainty.

Therefore, we would urge the Government to engage with the Inclusive Framework, as a matter of priority, to address how territorial regimes can be catered for under the GloBE Rules and how the issue of retrospectivity can be properly addressed, in a manner that offers the certainty of international agreement.

3. Adoption of a QDMTT safe harbour (CP, Question 15)

The Government has expressed its intention to draft the HKMTT in a way that ensures it is eligible for the QDMTT safe harbour. Given this proposal, we outline the advantages and disadvantages of introducing the HKMTT in a manner that satisfies the QDMTT safe harbour.

(a) Varying impact on compliance burden

The QDMTT safe harbour aims to prevent MNE groups from undertaking two separate Top-up Tax computations in respect of the same CE by deeming the Top-up Tax amount to be nil where a QDMTT safe harbour applies. In theory, this mitigates the need for a computation to be completed under the GloBE

Rules. However, it is debatable whether this leads to a decrease or increase in compliance burden.

One potential benefit of embedding a QDMTT safe harbour within the HKMTT framework is that MNE groups will theoretically only be required to undertake one computation in respect of their Hong Kong CEs without a further computation under the GloBE Rules. This concession, added to the proposed ability to use the local accounting standard under the HKMTT, could alleviate the compliance burden for certain MNE groups.

To the extent a local accounting standard is used, provided no adjustments are required to that standard, the HKMTT may also be easier for the Inland Revenue Department ("IRD") to administer, as they are less likely to receive tax returns using divergent accounting standards (i.e., profits tax using one set of generally accepted accounting principles ("GAAP") and HKMTT in another GAAP).

However, the QDMTT safe harbour could be problematic. In practice, many in-scope MNE groups have already begun developing systems to centrally prepare the GloBE Information Return ("GIR") based on the GAAP of the ultimate parent entity ("UPE"). The introduction of a QDMTT safe harbour could inadvertently necessitate a second computation under the HKMTT, which may differ in a nuanced manner to the GloBE Rules computation. Under these circumstances, MNE groups may, in practice, perceive a QDMTT safe harbour as increasing their compliance burden in Hong Kong.

(b) Treatment of controlled foreign company ("CFC") and PE taxes

Under the GloBE Rules, CFC and PE taxes are generally allocated to the CFC entity or the PE concerned, as Covered Taxes. These taxes are taken into account when calculating the jurisdictional ETR of the MNE groups. In contrast, CFC and PE taxes are mandatorily excluded from Covered Taxes under a QDMTT.

Consequently, the implementation of a QDMTT (including a QDMTT safe harbour) would potentially increase the tax burden of certain MNE groups, depending on whether relief was offered for that QDMTT in the relevant parent jurisdiction.

(c) Increased revenue for Hong Kong

Under the GloBE Rules, an entity that is required to account for Top-up Tax is generally taxed on its allocable share of the low-tax entity's Top-up Tax. The allocable share is determined using an inclusion ratio. In contrast, QDMTT liability is not calculated based on an inclusion ratio and, therefore, Top-up Tax levied under a QDMTT may be higher than that arising under an ordinary application of the GloBE Rules.

While the imposition of a QDMTT potentially gives Hong Kong the opportunity

to collect additional tax, it could also risk further eroding Hong Kong's fiscal advantage, depending upon which other jurisdictions, in the region and internationally, also introduce a QDMTT and, where they do, the scope and complexity of that QDMMT.

(d) Certainty for MNE groups

A QDMTT safe harbour provides additional certainty for MNE groups that tax authorities in other jurisdictions would not contest their filing position in a particular jurisdiction. As a result, MNE groups would be able to anticipate their tax obligations under the HKMTT in advance. This is likely to assure MNE groups that there would be less likelihood of disputes arising.

Overall, the question of whether or not to introduce a QDMTT safe harbour is nuanced and different MNE groups will have different views.

4. Legislative implementation of the GloBE Rules and HKMTT (CP, Question 21)

We suggest that the GloBE Rules and HKMTT be introduced into the IRO as a separate Top-up Tax distinct from profits tax. The rationale for this suggestion is outlined below.

(a) Proper ordering and clarity of terms

The complexity of the GloBE Rules, and by extension the HKMTT, cannot be overstated. These rules are designed to reference financial accounts and outcomes generally contemplated under domestic and international tax rules. The profits tax liability recorded in the accounts of an entity is included within the contemplated reference points.

Including HKMTT as a profits tax is likely to cause a degree of confusion and necessitate *an original amount of profits tax* and *an amount of profits tax including HKMTT*. This would basically lead to a "profits tax A" figure and a "profits tax B" figure. As a simple matter of naming convention, having two taxes that are calculated on entirely different bases but are given the same name will result in additional complexity.

Incorporation of the GloBE Rules and HKMTT into the profits tax framework has the capacity to introduce issues with ordering. An example is the proposed definition of "resident". As discussed above, and as evidenced by the need to consult on this definition, the appropriate placement of this definition and its effectiveness are far from clear. Inserting the definition within the profits tax legislation, but making it applicable to only the aspect of the profits tax that is computed in respect of the GloBE Rules and HKMTT, may not work and will almost certainly create uncertainty.

(b) Application of anti-avoidance rules (sections 61 and 61A of the IRO)

Including the GloBE Rules and HKMTT in the profits tax legislation will make

both automatically subject to Hong Kong's general anti-avoidance provisions under sections 61 and 61A of the IRO, which could be onerous and complex. We note that not all jurisdictions have adopted this approach. While we are not suggesting that, as a general principle, in-scope entities should be beyond all forms of anti-avoidance rules, Hong Kong should take a more considered approach to the design of any anti-avoidance rules in the context of the GloBE Rules, so that they do not impose a burden not imposed by other jurisdictions, and do not have a negative effect on Hong Kong's competitive position.

(c) Retention of territoriality

The decision to incorporate the GloBE Rules and HKMTT into the profits tax regime could be interpreted as effectively ending the territorial basis of profits tax, at least for in-scope MNEs. This, added to the impact of the newly introduced refined foreign-sourced income exemption regime, which also affect smaller groups, would cast further doubt on whether Hong Kong's tax regime can continue to be regarded as a territorial-based system. That is in contrast to the stated aims of the CP and Hong Kong's general fiscal policy intentions.

(d) Comprehensive avoidance of double taxation agreements

There appears to be a belief that implementing the GloBE Rules and HKMTT as profits tax is necessary and/or helpful from a treaty perspective.

As a starting point, it is questionable whether it is preferable for the GloBE Rules and HKMTT to be subject to CDTAs and how those CDTAs would operate.

As discussed above, the locational provisions and coordination provisions within the GloBE Rules already refer to the existing international tax framework. For example, rules on residency and PE location refer to scenarios where a CDTA does and does not exist.

The GloBE Rules and HKMTT effectively offer a tax credit for certain overseas withholding taxes through an increase in Covered Taxes that would increase Hong Kong's jurisdictional ETR. At the same time, those withholding taxes might be creditable against the ordinary profits tax liability (before application of the additional profits tax liability) which would be reflected in the accounts and feed into the HKMTT computation. If Hong Kong then chose to impose an amount of HKMTT, it would not necessarily be desirable for Hong Kong to be required to reduce that amount by crediting an amount of foreign tax against it.

In the early stages of the design of the GloBE Rules, the discussion regarding the international treaty network involved the OECD attempting to justify why the Pillar 2 framework was not inconsistent with the broader treaty framework. It is not entirely clear if there are benefits to the treaty framework applying to the GloBE Rules and HKMTT.

We understand that the OECD is designing separate dispute relief mechanisms and Hong Kong should actively participate in the design of these. Ideally, mandatory binding arbitration should be introduced. Meanwhile, it may not be desirable or advantageous to incorporate the GloBE Rules and HKMTT into the profits tax regime in order to leverage on the dispute resolution arrangements under CDTAs.

If it were considered desirable, there is a mechanism within CDTAs to admit other taxes into the treaty framework. This mechanism would surely be relied upon by many other jurisdictions, should it be necessary to make the GloBE Rules and QDMTT rules subject to CDTAs.

It is also questionable whether introducing an entirely new tax and simply referring to it by name as "profits tax" is within the spirit of the CDTAs.

This is a complex area that should be considered in detail. Hong Kong's approach should be consistent with international practice and the outcomes should be known and deliberate.

(e) Approach of other jurisdictions and avoiding unintended consequences

The profits tax rules are becoming increasingly complex as new regimes and concessions are added into the IRO. Taxpayers are constantly grappling with new uncertainties that emerge from the introduction of new provisions and concessions. Incorporating the GloBE Rules and HKMTT directly into the profits tax regime is likely to compound this problem and lead to an array of unforeseen consequences resulting from the interactions of the various legislative provisions.

Globally, a trend has emerged where the majority of countries are opting to implement the GloBE Rules via separate pieces of legislation, independent from their main corporate tax legislation. The separate legislation deals exclusively with the GloBE Rules and generally incorporates administrative provisions relevant to the GloBE Rules.

We understand that it may be simpler to implement the GloBE Rules and HKMTT within the IRO, but this should be as tax separate from profits tax. This should reduce the chances of confusion and unintended outcomes.

5. Legislative approach to AAG – Timely updates to AAG (CP, paragraph 1.10)

The release of the GloBE Rules has been followed by frequent updates to the GloBE framework, as evidenced by the publication of the safe harbours and Penalty Relief guidance and the three iterations of AAG within the past year. The Inclusive Framework has committed to issue further AAG in the near future.

Given the rate at which the OECD releases AAG updates, Hong Kong will need to develop a strategy to ensure timely implementation of new amendments into

domestic law, particularly where more substantive changes to the interpretation of rules are made.

We suggest that the Government consider implementing further administrative guidance through subsidiary legislation, i.e., regulations. The main implementing legislation, should confer powers on the responsible official to make subsidiary legislation which will have to be published in the Gazette. The advantage is that regulations are generally not subject to the more detailed and rigorous legislative scrutiny that bills are generally subjected to. The sole procedural requirement would be to introduce the subsidiary legislation for consideration by the Legislative Council following its publication in the Gazette. Where necessary, the Legislative Council may pass a resolution to amend the subsidiary legislation. This approach is generally a quicker procedure, which is likely to enhance certainty, as taxpayers would not have to wait for extended periods to confirm whether new AAG would be incorporated into domestic provisions.

6. Legislative approach to AAG – Certainty of version of AAG (CP, paragraph 1.10)

The Government intends to implement the GloBE Rules in accordance with the prevailing AAG at the time of enactment of those rules, which is understandable from the point of view of Hong Kong retaining its own tax "sovereignty". However, this approach means that, as new of AAG is released, the relevant legislation will need to be updated, after determining whether to adopt the revised AAG, with or without modifications. The pace at which the AAG develops means MNE groups may be uncertain as to how they will be assessed. To reduce this uncertainty, the Government should expressly clarify that the version of AAG referenced in the law at the time that a relevant transaction occurs, amount of income or expense arises, etc., should be the starting point in terms of guidance when assessing the tax implications of such transaction income, expense, etc. Additionally, it should be made clear that any subsequent changes to the AAG would apply on a prospective basis.

7. Use of local accounting standard for HKMTT computation (CP, paragraph 7.11)

The Government plans to allow for the use of the local financial accounting standards for the purposes of HKMTT computation. The purpose being to enhance flexibility and simplicity for MNE groups. While we maintain a neutral stance regarding this proposal, we suggest that, if the local financial accounting standards are adopted, certainty be provided to MNE groups with regard to how that rule will be administered.

It will be important to provide guidance on when an MNE group may not use the local financial accounting standards and instead use the UPE GAAP. It will also be necessary to specify which local financial accounting standard must be used where the MNE group has a choice of more than one. We would also suggest additional guidance with respect to the accounts used for PEs. In particular, we suggest confirming that, where a head office draws up accounts under International

Financial Reporting Standards ("IFRS") or a standard aligned with IFRS, that those accounts will be accepted as HKFRS compliant.

8. Application of transitional UTPR safe harbour (CP, paragraph 8.18)

The CP has outlined that the transitional Undertaxed Profits Rule ("UTPR") safe harbour will not be applicable in Hong Kong, given that the domestic statutory profits tax rate is below 20%. While Hong Kong's position in this regard is well-known, we wish to emphasise that it will still be necessary to include this safe harbour in Hong Kong's legislative framework, such that other jurisdictions can obtain the benefit of the UTPR safe harbour should they qualify.

9. Extension of penalties to service providers (CP, paragraphs 9.19 - 9.21)

The GIR filings will be based on the application of overseas rules from various jurisdictions, making it challenging for Hong Kong service providers (e.g., tax representatives) to confirm with certainty that those rules have been applied correctly. The OECD anticipated these challenges and facilitated a "soft landing" for MNE groups, allowing time to familiarise themselves with the new rules, establish appropriate systems, and ensure compliance, without facing penalties for reasonable mistakes.

Given that both MNE groups and Hong Kong service providers will have to familiarise themselves with the GloBE Rules and QDMTTs of various jurisdictions, as well as the HKMTT, we suggest that the "filling entities" and service providers be given some leeway. In relation to the proposed penalties on tax representatives dealing with these matters, we suggest that they be applied in only in limited, more specific, situations (e.g., those involving wilfulness or recklessness) and, potentially, not applied at all during a transitionary period. In the same context, "reasonable excuse" should be given a fairly broad definition.

10. Competitiveness of Hong Kong

We understand from the previous engagement sessions held by the Government, that the IRD is currently reviewing the existing tax incentives in Hong Kong in light of the implementation of BEPS 2.0 in Hong Kong. Specifically, we suggest that the Government should consider how to maintain Hong Kong's competitiveness, as various tax incentives may become less effective after the introduction of the global minimum tax. For example, and as a matter of priority, the Government should assess the feasibility of modifying the existing enhanced tax deduction regime for research and development expenditures such that it would qualify as a Qualified Refundable Tax Credit, which has a low drag-down effect on the ETR. Providing non-tax incentives would be an alternative option to support Hong Kong's competitiveness.

11. Switch-off rule

The "switch-off" rule permits Hong Kong to effectively switch off the QDMTT safe harbour in respect of certain areas. Of particular relevance to Hong Kong are joint

ventures and investment entities. We anticipate that MNE groups may have a preference for setting up joint ventures and investment entities in jurisdictions where Top-up Tax is not imposed directly on those entities. Accordingly, we suggest Hong Kong take advantage of the switch-off rule.

Hong Kong could also implement the switch-off rule in respect of flow-through entities. However, to do so, Hong Kong should first adjust its domestic law in order to facilitate the flow-through treatment of entities that are commonly treated as fiscally transparent by other groups. This could be implemented by way of election.

12. Mandatory electronic filing ("e-filing") of profits tax returns (CP, Question 22)

We suggest that MNE groups that meet either the CbCR threshold (which is set at HK$6.8 billion) or the GloBE threshold (which is proposed to be EUR 750 million) be required to e-file their profits tax returns; and that a "once in, always in" approach should be adopted to avoid potential confusion.

Hong Kong Institute of CPAs
March 2024