IMPLEMENTATION OF GLOBAL MINIMUM TAX AND HONG KONG MINIMUM TOP-UP TAX

CONSULTATION PAPER

Financial Services and the Treasury Bureau
Inland Revenue Department
December 2023

FOREWORD

1. This paper is issued by the Financial Services and the Treasury Bureau ("FSTB") and the Inland Revenue Department ("IRD") for seeking views on the implementation of the global minimum tax and the domestic minimum top-up tax in Hong Kong.

2. FSTB and IRD welcome written comments on or before 20 March 2024 through any of the following means –

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

   Email: beps@fstb.gov.hk

3. FSTB and IRD may, as appropriate, reproduce, quote, summarise and publish the written comments received, in whole or in part, in any form and use without seeking permission of the contributing parties.

4. Names of the contributing parties and their affiliations may be referred to in other documents we publish and disseminate through different means after the consultation. If any contributing parties do not wish their names and / or affiliations to be disclosed, please expressly state so in their written comments. Any personal data provided will only be used by FSTB and IRD, other government departments / agencies for purposes which are directly related to this consultation.

TABLE OF CONTENT

LIST OF ABBREVIATIONS

BEPS	Base erosion and profit shifting
CbC report	Country-by-country report
CbCR	Country-by-country Reporting
CDTA	Comprehensive avoidance of double taxation agreement or arrangement
CFC	Controlled foreign company
DMTT	Domestic minimum top-up tax
ETR	Effective tax rate
GIR	GloBE Information Return
GloBE rules	Global anti-base erosion rules
HKMTT	Hong Kong minimum top-up tax
IF	OECD/G20 Inclusive Framework on BEPS
IIR	Income Inclusion Rule
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance (Cap. 112)
iXBRL	Inline eXtensible Business Reporting Language
JV	Joint venture
LegCo	Legislative Council
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
POPE	Partially Owned Parent Entity
QDMTT	Qualified Domestic Minimum Top-up Tax
QRTC	Qualified refundable tax credit
SBIE	Substance-based income exclusion
STTR	Subject to Tax Rule
STTR MLI	Multilateral instrument for implementing the STTR
UPE	Ultimate Parent Entity
UTPR	Undertaxed Profits Rule

INTRODUCTION

1. The Organisation for Economic Co-operation and Development ("OECD") announced in July 2021 the international tax reform framework of a two-pillar solution to tackle the base erosion and profit shifting ("BEPS") risks arising from digitalisation of the economy (commonly known as "BEPS 2.0"). In October 2021, over 130 jurisdictions in the OECD/G20 Inclusive Framework on BEPS ("IF") reached an agreement on the two-pillar solution.

2. Pillar One of BEPS 2.0 targets multinational enterprise ("MNE") groups with global revenue above EUR 20 billion and total profits greater than 10% of their global revenue, with the revenue threshold to be reduced to EUR 10 billion subject to a review beginning seven years after implementation. It provides jurisdictions in which consumers and users are located (i.e. market jurisdictions) a new taxing right over a portion of the residual profits of the largest and most profitable MNEs in the world.

3. Pillar Two of BEPS 2.0 targets MNE groups with annual consolidated revenue of or above EUR 750 million. It ensures that these MNEs pay a minimum tax of 15% in respect of the profits derived from every jurisdiction they operate in through two interlocking rules, the Income Inclusion Rule ("IIR") and the Undertaxed Profits Rule ("UTPR"), which are together referred to as the global anti-base erosion ("GloBE") rules. To preserve its own taxing right, a jurisdiction may also consider imposing a domestic minimum top-up tax ("DMTT"). This seeks to put a floor on competition over corporate income tax among jurisdictions.

4. According to its statement in October 2021 ("October Statement"), the OECD's original timeline for implementing Pillar Two was for jurisdictions to bring the global minimum tax into law in 2022 to be effective in 2023.

5. The Government has since June 2020 been engaging the relevant stakeholders and MNEs to inform them of the latest progress of

the formulation of the GloBE rules by the OECD and tap their views on the implementation of the GloBE rules in Hong Kong. While recognising the need to protect Hong Kong's taxing rights, the stakeholders generally considered that Hong Kong's MNE groups might be put at a disadvantaged position if Hong Kong was to implement the global minimum tax ahead of other jurisdictions.

6. The Financial Secretary announced in the 2023-24 Budget Speech that Hong Kong planned to apply the global minimum tax on in-scope MNE groups and implement the domestic minimum top-up tax (to be referred to as the Hong Kong minimum top-up tax or "HKMTT" in this paper) starting from 2025 onwards. Such implementation timeline has taken into account the progress of other jurisdictions in implementing the GloBE rules.

7. In implementing the GloBE rules, in accordance with the international consensus, and the HKMTT, the Government will adhere to the following guiding principles –

(a) applying the GloBE rules and the HKMTT to in-scope MNE groups (i.e. MNE groups with consolidated annual revenue of or above EUR 750 million) only;

(b) maintaining the territorial source principle of taxation and continuing to apply the broad guiding principle when determining the source of profits outside the context of the GloBE rules;

(c) upholding Hong Kong's simple, certain and low tax regime with due regard to tax competitiveness; and

(d) minimising the compliance burden of in-scope MNE groups while safeguarding Hong Kong's taxing rights.

8. We now invite views on the implementation of the GloBE rules as well as the introduction of the HKMTT to complement the GloBE rules. This consultation seeks to –

(a) explain the concepts of the GloBE rules for the sake of transparency;

(b) explain the Government's position and preferred approach with respect to certain issues of the GloBE rules;

(c) seek views on particular issues including the introduction of the HKMTT as set out in the paper; and

(d) invite stakeholders to indicate whether there are any uncertainties which could be further clarified.

9. As the GloBE rules have already been finalised based on the international consensus and there is no room for deviation, this consultation seeks to explain the policy rationale and the design features of the GloBE rules that are relevant to Hong Kong, and invite views on matters that are left for consideration by the implementing jurisdiction (i.e. administration framework of the GloBE rules as well as the design and administration of the HKMTT). Unless otherwise stated, the terms used in this consultation paper bear the same meaning as that provided under the GloBE rules promulgated by the OECD.

10. The key components and strategy for implementation of the global minimum tax in Hong Kong are summarised in **Chapter 1** of this paper. Our priority is to put in place the necessary legislative framework for the GloBE rules (**Chapters 2 to 6**) and HKMTT (**Chapter 7**) in Hong Kong, supported by applicable simplification measures (**Chapter 8**) as well as a tax compliance and administrative framework (**Chapter 9)**. Taking this opportunity, we will also consult stakeholders on the proposed application of mandatory electronic filing of profits tax returns to in-scope MNE groups **(Chapter 10)**.

11. Besides the GloBE rules, Pillar Two also comprises the Subject to Tax Rule ("STTR"), a treaty-based rule applicable when certain intra-group cross-border payments are subject to taxation below the STTR minimum rate of 9%. As a minimum standard, IF jurisdictions are required to include the STTR into their bilateral tax treaties with developing jurisdictions when requested to do so. A multilateral instrument ("STTR MLI") has been developed to

facilitate swift implementation of the STTR. The STTR MLI will, with respect to the existing tax treaties it covers, amend the treaties to include the STTR. Alternatively, the STTR may be incorporated into the relevant tax treaties through bilateral negotiations. Whilst Hong Kong is prepared to just implement the minimum standard of the STTR, whether the rule has to be included in a comprehensive avoidance of double taxation agreement or arrangement ("CDTA") is not solely decided by Hong Kong, but subject to bilateral discussion with the CDTA partners concerned. Hence, the STTR is not covered by this consultation.

12. The Government welcomes comments on this consultation by 20 March 2024. A full list of the consultation questions is set out in **Annex**. We will take into account views to be received when formulating the legislative amendments, with a view to developing the legislative proposal for submission to the Legislative Council ("LegCo") in the second half of 2024.

CHAPTER ONE – GENERAL OVERVIEW

The GloBE rules

1.1. The global minimum tax is a key component of the second pillar of the two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The GloBE rules are designed to ensure that large MNE groups pay a minimum level of tax in respect of the profits derived from each jurisdiction where they operate. This seeks to reduce the incentive to move profits to low or no tax jurisdictions and put a floor on excessive tax competition among jurisdictions.

1.2. To ensure coordinated implementation of the GloBE rules with consistent outcome, the OECD has published the GloBE Model Rules [1], Commentary to the GloBE Model Rules and Administrative Guidance on the GloBE Model Rules ("Model Rules", "Commentary" and "Administrative Guidance" respectively and "GloBE publications" collectively) [2] which provide for the detailed provisions of the GloBE rules and clarify the agreed interpretation and application of the rules. The GloBE Model Rules serve as the model legislation that jurisdictions implementing the GloBE rules are required to incorporate into their local laws.

1.3. A complete and coherent framework under the GloBE rules governs the application of the global minimum tax. The steps for charging the top-up tax are briefly summarised as follows –

Step 1: Determine whether an MNE group is in scope
Step 2: Determine the income and taxes of members of the group ("constituent entities")
Step 3: Calculate the group's ETR in the jurisdiction and determine the amount of top-up tax
Step 4: Allocate the top-up tax to the group's constituent entities within that jurisdiction

---

[1] The GloBE Model Rules released in December 2021 are accessible via this link.

[2] The Commentary released in March 2022 and the Administrative Guidance released in February 2023 and July 2023 are accessible via this link.

Step 5: Impose top-up tax under the IIR or UTPR in accordance with the agreed rule order

1.4. In gist, the GloBE rules apply to in-scope MNE groups (i.e. MNE groups with consolidated annual revenue of or above EUR 750 million). Taxpayers that either have no foreign presence or have less than EUR 750 million in consolidated annual revenue fall outside the scope of the GloBE rules. In-scope MNE groups calculate their ETR for each jurisdiction where they operate and pay top-up tax in respect of their constituent entities which are taxed at an ETR below 15% (i.e. low-taxed constituent entities) in the jurisdiction under the IIR or UTPR. The GloBE rules also contemplate the possibility that jurisdictions introduce their own DMTT based on the GloBE mechanics (referred to as the Qualified Domestic Minimum Top-up Tax or "QDMTT"), which will then be directly creditable against liabilities otherwise arising under the IIR and the UTPR.

1.5. The top-up tax is collected either by the low-tax jurisdiction itself under the QDMTT or where no QDMTT applies, by another implementing jurisdiction through the imposition of either –

(a) the IIR which imposes top-up tax on the parent entity of an in-scope MNE group in respect of its low-taxed constituent entities located outside the jurisdiction where the parent entity is located; or

(b) the UTPR which produces an increase on tax equivalent to the amount of remaining top-up tax not brought into charge under the IIR through denial of deduction or making an equivalent adjustment.

Alignment with GloBE rules required

1.6. The GloBE rules have the status of a common approach. This means that IF jurisdictions are not required to adopt the rules, but the jurisdictions that have chosen to adopt the GloBE rules, including Hong Kong, should implement and administer the rules in a way that is consistent with the outcomes provided for under

the GloBE rules, its Commentary and Administrative Guidance promulgated by the OECD.

1.7. Therefore, in implementing the GloBE rules in Hong Kong, the Government will closely follow the GloBE rules so as to ensure that the GloBE rules implemented by Hong Kong will be assessed as qualified rules in the OECD's peer review process. This seeks to ensure the effectiveness of the GloBE rules underpinned by the consistent application of the rules across jurisdictions.

1.8. With the implementation of the IIR in Hong Kong, it is expected that top-up tax attributable to foreign low-taxed constituent entities of Hong Kong-headquartered MNE groups will be charged on the ultimate parent entity ("UPE") in Hong Kong. In limited situations, the IIR will apply to Hong Kong intermediate parent entities of foreign-headquartered MNE groups where those entities are controlled by parent entities that are not located in a jurisdiction that has introduced the GloBE rules, or have more than 20% interest owned by minority investors.

Legislative approach

1.9. There are different approaches to transform the GloBE rules into the legal plane of Hong Kong. One approach is to enact our own provisions of the GloBE rules by adapting the contents of the GloBE publications and bringing them in line with the local drafting styles and practices[3]. Another approach is to legislate for a direct reference to the GloBE publications, with the effect that the contents of the publications (and subsequent changes thereto) will form part of our local law[4]. While the former approach might provide clarity of the law to taxpayers, Hong Kong might run the risk of failing in the OECD's peer review because of the adaptation. Under the latter approach, while strict consistency with the GloBE publications would be ensured, it could result in clarity issue in that taxpayers would need to refer

[3] The legislative approach adopted by the United Kingdom, Canada and Japan.
[4] The legislative approach adopted by New Zealand.

to various GloBE publications to understand the detailed requirements of the law.

1.10. Hong Kong will take a hybrid legislative approach by directly incorporating the Model Rules into the Inland Revenue Ordinance (Chapter 112) ("IRO") with limited adaptations as far as practicable. The enacted GloBE rules will have to be read and applied in the way that best secures consistency with the requirements and guidance in the Commentary and Administrative Guidance in force immediately before the enactment. Specific provisions may also be added to deal with the interaction between the enacted GloBE rules and the existing provisions of the IRO.

1.11. As the top-up tax under the GloBE or HKMTT regime is to be regarded as profits tax, it is logical that the provisions relating to the GloBE rules and HKMTT will be provided under the IRO rather than as an Ordinance separate from the IRO. Indeed, to regard the top-up tax as profits tax would help maintain tax certainty by riding on certain existing tax administration mechanisms such as tax collection, objections and appeals, etc. It would also enable in-scope MNE groups to resolve any cross-border disputes in relation to their top-up tax liabilities in Hong Kong under our CDTAs, under which profits tax is a covered tax.

Introduction of HKMTT

1.12. As explained above, a top-up tax liability may arise under the GloBE rules or QDMTT. If a jurisdiction implements a DMTT that is consistent with the outcomes of the GloBE rules and does not provide any benefits that are related to the rules, such DMTT will qualify as QDMTT and can be deducted from the top-up tax liability under the GloBE rules in respect of that jurisdiction. This agreed rule order allows a jurisdiction to preserve the primary right of taxation over profits derived from its jurisdiction. To safeguard our taxing rights, Hong Kong will seek to implement the HKMTT, the design of which must be consistent with the design of the GloBE rules and provide for the outcomes that are

consistent with the GloBE rules, such that the HKMTT can qualify as a QDMTT.

Effective fiscal year

1.13. The Government has announced in the 2023-24 Budget Speech that the global minimum tax (that is the IIR and UTPR) and HKMTT will take effect for a fiscal year beginning on or after 1 January 2025.

1.14. The following chapters will provide a more detailed explanation of how the GloBE rules operate and how the Government plans to implement and administer the HKMTT.

CHAPTER TWO – SCOPE OF THE GLOBE RULES

2.1. An MNE group must meet the revenue threshold before the GloBE rules applies. This chapter summarises the scope of the GloBE rules.

GloBE Rules Explained

The revenue threshold

2.2. The GloBE rules are designed to apply to MNE groups which have consolidated annual revenue of EUR 750 million or more, and when the revenue in their consolidated financial statements is greater than the threshold in at least two of the previous four fiscal years. The four-year test is intended to provide for more stable and predictable outcomes. The revenue threshold is broadly similar to that used for the purposes of Country-by-country Reporting ("CbCR"), and is estimated to cover over 90% of the global corporate income tax base. This limits the incremental compliance costs associated with the introduction of the GloBE rules.

2.3. Fiscal year means the accounting period with respect to which the consolidated financial statements are prepared. In the situation where the group does not prepare consolidated financial statements, for the purpose of coming up with the consolidated annual revenue of the group, the group will be assumed to have prepared the consolidated financial statements. In such case, the fiscal year means the calendar year.

2.4. The GloBE rules also cater for the calculation of the consolidated revenue threshold in the case of a merger or demerger and when the entities no longer have the same UPE.

MNE Group

2.5. According to the GloBE rules, a group is defined based on an accounting consolidation test. This test is determined based on

the consolidated financial statements prepared by the UPE. Therefore, the group comprises entities that are included in the consolidated financial statements of the UPE. The group also comprises entities that are not consolidated under the accounting standard because they are being held for sale, or excluded from consolidation solely based on size or material grounds.

2.6. A group will then be an MNE Group if it has one or more entities or permanent establishments ("PEs") located in a jurisdiction other than the UPE jurisdiction. A standalone entity, which is not part of another group, but has one or more PEs located in another jurisdiction will also be considered as an MNE Group.

2.7. The UPE is an entity that owns, directly or indirectly, a controlling interest in any other entity but is not controlled, directly or indirectly, by another entity.

Constituent entity

2.8. The concept of a constituent entity is essential as it is those group entities to be subject to the GloBE rules and the charge under the IIR or UTPR if they are treated as low-taxed constituent entities.

2.9. Each entity that is a member of a group is treated as a constituent entity. A PE is treated as a separate constituent entity from the entity that includes the PE in its financial statements. In other words, an entity with two PEs would be treated as three separate constituent entities. This seeks to ensure that the income earned through PEs in another jurisdiction and the tax imposed on that income is not blended with the income and tax of the entity holding the PE or another PE in a different jurisdiction, such that foreign subsidiaries and PEs of the MNE Group are treated fairly.

2.10. A constituent entity does not include an entity that is an excluded entity. Thus, excluded entities are outside the scope of the GloBE rules.

Excluded entity

2.11. Some entities are excluded from the definition of a constituent entity. The effect is that such entities are not subject to the operative provisions of the GloBE rules.

2.12. First, the IIR and the UTPR do not apply to excluded entities. This is to say that an excluded entity which is the UPE of an MNE Group is not required to apply the IIR, and the rule is to be applied by the next entity (which is a constituent entity) in the ownership chain. Second, the excluded entity is excluded from any computation of profits, losses and the ETR, etc., but its revenue is still taken into account for the purposes of the application of the revenue threshold mentioned above. Third, the excluded entity does not have any administrative obligations under the GloBE rules.

2.13. The following six types of entities are excluded entities:

(a) a governmental entity;
(b) an international organisation;
(c) a non-profit organisation;
(d) a pension fund;
(e) an investment fund that is a UPE; and
(f) a real estate investment vehicle that is a UPE.

2.14. Normally, the above entities would not be consolidated with other entities and therefore would not form part of an MNE group. However, a list of excluded entities is explicitly provided under the GloBE rules for the sake of completeness, consistency and certainty in terms of the outcome.

2.15. Investment funds and real estate investment vehicles which are the UPE of an MNE group are excluded from the GloBE rules to protect their status as tax neutral investment vehicles. However, investment funds and real estate investment vehicles which are not the UPE of an MNE group are constituent entities of an MNE group provided that the consolidation requirements are met.

2.16. Entities owned by excluded entities (such as asset holding entities) may also be excluded from the scope of the GloBE rules provided that certain conditions (e.g. ownership and activities tests) are met. The GloBE rules also provide for an option for electing not to treat these entities as excluded entities for five consecutive years, such that these entities will be subject to the GloBE rules as a constituent entity.

Implementation in Hong Kong

2.17. Hong Kong will strictly follow the revenue threshold of EUR 750 million. Hong Kong plans to only apply the IIR to Hong Kong-headquartered MNE groups reaching the EUR 750 million revenue threshold[5]. The Government does not propose to apply the IIR to smaller Hong Kong-headquartered MNE groups as we acknowledge the agreed view among jurisdictions that a relatively high threshold was necessary to ensure that the implementation of GloBE rules was proportionate. This would also prevent the imposition of unnecessary compliance burden on small MNE groups and reduce administrative costs.

2.18. While the GloBE rules cater for the situation where the revenue threshold is set in a currency other than the Euro, the Government considers that the common Euro threshold instead of an equivalent Hong Kong Dollar threshold should be adopted as this would enhance co-ordination amongst jurisdictions and avoid unnecessary discrepancies in the scope and operation of the GloBE rules arising from rebasing the threshold in a currency other than the Euro annually.

[5] The October Statement does not prevent jurisdictions from applying the IIR to MNEs headquartered in their jurisdiction even if they do not meet the revenue threshold.

CHAPTER THREE – CHARGING PROVISIONS

3.1. A liability to top-up tax for low-taxed constituent entities of an in-scope MNE group is chargeable under the two interlocking rules, the IIR and the UTPR, for ensuring that the right amount of top-up tax is collected when multiple IIRs and UTPRs are applied at the same time in different jurisdictions. The IIR is the primary rule. The UTPR works as a backstop to ensure that any residual amount of top-up tax that remains after the IIR applies will be allocated and collected.

3.2. This chapter sets out how the IIR and the UTPR operate and specifically seeks views on the Government's position on how Hong Kong is to charge top-up tax under the UTPR.

GloBE Rules Explained

Income Inclusion Rule: Top-down approach

3.3. The IIR is applied by a parent entity which is defined to be a UPE that is not an excluded entity, an intermediate parent entity or a partially-owned parent entity ("POPE"), in proportion to its ownership interests in those low-taxed constituent entities. The IIR is applied based on a top-down approach at the level of the UPE and works its way down the ownership chain. The UPE jurisdiction will usually have the first priority to collect the top-up tax. Other jurisdictions cannot generally apply their IIR to other parent entities in the group when the UPE is subject to a qualified IIR in the UPE jurisdiction. If the UPE is located in jurisdiction where it is not required to apply a qualified IIR, then under the top-down approach, the next intermediate parent entity down the ownership chain is required to apply the IIR.

3.4. It is possible that multiple intermediate parent entities have an interest in the low-taxed constituent entity. Where two or more intermediate parent entities are part of the same ownership chain and are required to apply the IIR in respect of the same low-taxed entity, the top-down approach will be applied to prevent instances

of double taxation. The IIR applied to the lower-tier entity will be turned off as the entity is controlled by an upper-tier entity subject to a qualified IIR.

3.5. However, if an intermediate parent entity is not controlled by another intermediate parent entity, the IIR will not be turned off and it can be applied to more than one intermediate parent entity in the same MNE group. The top-up tax of the upper-tier entity will be reduced by the amount of the top-up tax that has been brought into charge by the lower-tier entity.

Exception: Split ownership rules

3.6. There are cases where low-taxed constituent entities have a significant (i.e. more than 20%) minority interest holder outside an in-scope MNE group. The split ownership rules operate as an exception to the top-down approach. An intermediate parent entity which has more than 20% of the ownership interests held directly or indirectly by persons outside the group is a POPE, and it has priority to apply the IIR irrespective of whether the UPE is also applying a qualified IIR. This exception rule is to address the potential tax leakage under the GloBE rules without imposing a disproportionate tax burden on the group in respect of the low-taxed income which is beneficially owned by the minority.

3.7. To avoid double taxation, the UPE or the next intermediate parent entity applying the IIR will reduce its top-up tax liability having regard to the portion of the top-up tax charged to the POPE under a qualified IIR.

Allocation of top-up tax under IIR

3.8. A parent entity subject to the IIR pays tax in an amount equal to its "allocable share" of the top-up tax. The allocable share is the amount of top-up tax owned in respect of a low-taxed constituent entity, determined by reference to the parent entity's ownership interest in the income of the low-taxed constituent entity.

Undertaxed Profits Rule: Backstop to IIR

3.9. The UTPR is the second charging mechanism under the GloBE rules. The top-up tax computation under the UTPR and the IIR is the same to improve coordination between the GloBE rules in each jurisdiction and reduce implementation and compliance costs and ensure that the rules do not result in over-taxation. Having a single computation also enables the UTPR to operate as a backstop to the IIR.

3.10. It is expected that in most cases, the UTPR will be disapplied (i.e. when the UPE is subject to a qualified IIR or when all of the interests in the low-taxed constituent entities are held by parent entities subject to a qualified IIR). The UTPR will apply when all of the interests of a low-taxed constituent entity are not held by parent entities which are required to apply a qualified IIR. However, the UTPR top-up tax will be reduced by the amount of top-up tax charged under an IIR for ensuring that the IIR takes priority.

3.11. The UTPR also ensures that low-taxed constituent entities in the UPE jurisdiction are also subject to top-up tax to prevent distortions and level playing field concerns.

Allocation of top-up tax for UTPR

3.12. Unlike the IIR which allocates the top-up tax amount based on ownership percentage, the UTPR top-up tax amount is allocated among jurisdictions implementing a qualified UTPR ("UTPR jurisdictions") based on quantitative factors that are aggregated at the jurisdictional level. The allocation is based on the proportion of the value of tangible assets and the number of employees in each UTPR jurisdiction as they are considered the most appropriate factors for reflecting a consistent measure of substance in jurisdictions. It is expected that the jurisdictions where the MNE group has more substance will have more tax capacity to absorb adjustments under the UTPR.

3.13. The quantitative factors are available in CbC reports. Such approach facilitates co-ordination between UTPR jurisdictions and minimises the risk of disputes.

Options for bringing UTPR top-up tax into charge

3.14. The GloBE rules provide that the UTPR may take the form of a denial of deduction for otherwise deductible expenses in an amount sufficient to result in the constituent entities located in the UTPR jurisdiction having an additional cash tax expense equal to the UTPR top-up tax amount allocated to that jurisdiction. Alternatively, the UTPR may take the form of an adjustment that is equivalent to a denial of a deduction. The GloBE rules do not prescribe how a jurisdiction shall bring the UTPR top-up tax into charge but the outcome must be to produce an additional cash tax expense in the jurisdiction equal to the top-up tax allocated to it, either in the current year or in a future year under the carry-forward mechanism.

3.15. The denial of deduction approach increases the cash tax expense for a constituent entity by denying a deduction that is arrived at by dividing the UTPR top-up tax amount allocated to Hong Kong by the corporate profits tax rate of Hong Kong.

3.16. However, denying deductions will not result in additional cash tax expense when the relevant Hong Kong constituent entity is in a loss position or does not have sufficient deductions in the year available for denial, leaving the uncollected portion of the top-up tax to be carried forward and collected in subsequent years. Denying deductions may not achieve the purpose of ensuring the maximum amount in terms of UTPR adjustment is collected from the constituent entities as early as possible. As any item of expenses may be denied under this approach, the interaction between the denial of deduction approach under the GloBE rules and existing deduction rules under the IRO may give rise to uncertainty and even unintended outcomes.

3.17. As regards the approach of making an equivalent adjustment, the GloBE rules provide that it could take the form of an additional tax charged directly on a constituent entity in an amount equal to the allocated UTPR top-up tax amount.

Allocation of UTPR top-up tax among Hong Kong constituent entities

3.18. The GloBE rules do not prescribe how the UTPR top-up tax amount is allocated among the constituent entities that are located in the UTPR jurisdiction. The allocation should be addressed under the UTPR jurisdiction's local law. The UTPR jurisdiction may provide in its local law that the UTPR adjustment is imposed on only one constituent entity or several constituent entities.

Location of an entity

3.19. The location of an entity is important for jurisdictional blending and for determining where the top-up tax has to be paid. Under the GloBE rules, an entity is located in: (a) a jurisdiction where it is a tax resident based on its place of management, place of creation or similar criteria; or (b) in other cases, a jurisdiction where it was created.

Implementation in Hong Kong

3.20. While there are two ways of charging the UTPR top-up tax, the Government proposes adopting the approach of charging top-up tax under the UTPR by way of an equivalent adjustment which takes the form of an additional tax. This approach ensures that a constituent entity which is liable to pay top-up tax under the UTPR for a fiscal year will have to incur a cash tax expense in the same amount to the UTPR top-up tax, regardless of its own local tax position. As such, any carry-forward of UTPR top-up tax (where loss is sustained) will not be necessary. The calculation of the additional tax under this approach is simple and would enhance tax certainty. This approach also avoids complicated provisions to deal with the interaction with the existing profits tax rules.

3.21. As regards the allocation of UTPR top-up tax among Hong Kong constituent entities, the Government proposes that the UTPR top-up tax will, by default, be allocated among Hong Kong constituent entities of an in-scope MNE group based on their respective number of employees and value of tangible assets. This default allocation mechanism will be disapplied if the group designates one or more than one Hong Kong constituent entity to pay the top-up tax as described in paragraph 9.16.

3.22. It is crucial to determine whether an entity is located in Hong Kong for the purpose of collecting top-up tax. Hong Kong adopts the territorial source principle of taxation and does not impose tax based on an entity's residence. Hence, the IRO does not contain a definition of "resident" for general purposes. Noting the test for location of constituent entity under the GloBE rules and the fact that quite a number of entities are created outside Hong Kong but carry on a business or managed and controlled in Hong Kong, the Government proposes to provide, for the purposes of the GloBE rules and HKMTT, that an entity is a Hong Kong resident entity if –

(a) in the case where an entity is a company - the entity is incorporated in Hong Kong or, if incorporated outside Hong Kong, normally managed or controlled in Hong Kong; or

(b) in any other case – the entity is constituted under the laws of Hong Kong, or if otherwise constituted, normally managed or controlled in Hong Kong.

3.23. Given that some jurisdictions may implement the GloBE rules for a fiscal year beginning on or after 1 January 2024, it is further proposed that the above **meaning of Hong Kong resident entity will apply retrospectively from 1 January 2024**.

Views sought:

1. Do you have any views on the proposed equivalent adjustment approach to bring the UTPR top-up tax into charge? (para 3.20)

2. Do you have any views on the proposed allocation and payment mechanism for the UTPR top-up tax? (para 3.21)

3. Do you have any views on the proposed approach to deal with the issue relating to the location of an entity and the proposed meaning of Hong Kong resident entity for the purposes of the GloBE rules and HKMTT? (para 3.22)

4. Do you have any views on the retrospective application of the meaning of a Hong Kong resident entity from 1 January 2024 (para 3.23)?

CHAPTER FOUR – CALCULATION OF EFFECTIVE TAX RATE

4.1. The GloBE rules operate to charge a top-up tax on an in-scope MNE group in respect of its low-taxed constituent entities. This is achieved by calculating in-scope MNE group's ETR for each jurisdiction where they operate, and imposing top-up tax for the difference between their ETR per jurisdiction and the minimum rate. The calculation of ETR for a jurisdiction requires first a calculation of the income, and second a calculation of the tax on that income.

GloBE Rules Explained

Identify the constituent entities in a jurisdiction

4.2. The GloBE rules identify the pools of low-taxed income on a jurisdictional basis and calculate the ETR for a jurisdiction as a whole. It is therefore essential to identify which constituent entities are in the jurisdiction.

4.3. The rules to determine where an entity is located are set out in chapter 10 of the GloBE rules. Most constituent entities will be located in the jurisdiction where they are tax resident. Whether a constituent entity is a resident of a jurisdiction depends on the local law of each jurisdiction. Where a constituent entity is not a tax resident in a jurisdiction, it will be located in the jurisdiction where it was created.

4.4. Transparent entities and PEs are treated as constituent entities in the GloBE rules and their resident location is determined by special rules. If a transparent entity is the UPE of an MNE group or is required to apply the IIR, the entity is located in the jurisdiction where it was created. In other cases, the entity is treated as a stateless entity. This means that the ETR of the entity is calculated separately and no jurisdictional blending with the income or tax with other entities is required. PEs are generally located in the jurisdiction where they are treated as a PE and is

taxed under the applicable tax treaty or local law. There are however other rules to address more exceptional situations.

4.5. The GloBE rules also provide for tie-breaker rule in the event that a constituent entity would otherwise be located in more than one jurisdiction.

Calculate GloBE income of each constituent entity

4.6. The next step is to calculate a constituent entity's GloBE income. It is determined by making certain adjustments to the entity's financial accounting net income or loss. The adjustments aim to better align the tax base for the global minimum tax with those that are typically applied for local tax purposes.

Financial accounting net income or loss

4.7. The computation of GloBE income or loss begins with the financial accounting net income or loss of the constituent entity. The general rule is to determine such income based on the accounting standard used in the preparation of the consolidated financial statements of the UPE, which should be prepared in accordance with an acceptable financial accounting standard.

4.8. If it is not reasonably practicable to use the financial accounting standard adopted by the UPE in preparing its consolidated financial statements, the constituent entity is permitted under the GloBE rules to calculate the accounting profit based on another acceptable accounting standard or authorised financial account standard to prepare its own financial statements, subject to three conditions. These include the financial accounts are maintained based on that accounting standard; the information contained in the financial accounts is reliable; and adjustment be made for any permanent differences in excess of EUR 1 million between the constituent entity's accounting standard and the one adopted by the UPE.

Adjustments to determine GloBE income or loss

4.9. Certain adjustments are required to be made to the financial accounting net income or loss of a constituent entity for reflecting the permanent differences between accounting and tax measures of profit. Separate rules are set out later in this chapter to address the issue of temporary differences.

4.10. These adjustments include:

(a) adding back covered taxes accrued as an expense;

(b) removing dividends or other distributions where the MNE group holds 10% or more of the ownership interest in the issuer, or the constituent entity has held full economic ownership of the ownership interest for a period of 12 months or more;

(c) removing gains or losses from changes in fair value of an ownership interest;

(d) removing profit or loss arising from an equity interest accounted for under an equity method accounting;

(e) removing gains or losses arising from a sale of ownership interest in any entity where the MNE group holds 10% or more of the ownership interests at the time of the transfer;

(f) including any revaluation gains or losses that are reported in other comprehensive income;

(g) removing gains or losses in relation to a reorganisation where the gain or loss is deferred for local tax purposes;

(h) including adjustments to deal with foreign exchange gains or losses that arise due to differences between the functional currency for accounting and tax purposes;

(i) removing any deductions for illegal payments including bribes and kickbacks, and expenses for fines and penalties greater than or equal to EUR 50,000;

(j) including adjustments for prior period errors and changes, provided that the error correction does not require a corresponding substantial decrease in the tax liability in a previous year;

(k) including adjustments to address differences between the tax and accounting treatment of pension expenses provided through a pension fund.

Elective adjustments

4.11. For the purpose of computing GloBE income or loss, an MNE group may make elections for certain items.

(a) Replace the accounting expenses in relation to stock-based payments with the deduction for local tax purposes. The election is applicable for five years and consistently applies to the stock-based payments of all constituent entities in the same jurisdiction.

(b) Include gains and losses on assets and liabilities subject to fair value or impairment accounting on a realisation basis. The election is applicable for five years and applies to all constituent entities located in the jurisdiction to which the election is made.

(c) Offset a net realised gain on local tangible assets against a net realised loss on local tangible assets in the four preceding years, and spread any remaining net realised gain equally by the constituent entities in the same jurisdiction over a period of up to five years. This election should be useful for jurisdiction that does not tax capital gains by allowing untaxed gains to set off untaxed loss and spread the remaining gains over a period of five years. It provides a better measure of

whether an MNE group has been subject to a minimum level of tax during the look back period.

4.12. Intra-group transactions must be priced consistently with the arm's length principle and recorded at the same price for GloBE purposes for all constituent entities that are parties to the transaction. For transactions between constituent entities located in the same jurisdiction, adjustments in general are not required as the effect will be eliminated under the jurisdictional blending rule. However, adjustments will be required for same jurisdiction intra-group transactions if the sale or other transfer of an asset produces a loss and the loss is included in the computation of GloBE income or loss, or transactions between minority-owned constituent entity and other constituent entities of the same group.

4.13. There is a specific anti-avoidance rule to counter intra-group financing arrangements to prevent MNE groups from engaging in transactions that are intended to increase the ETR in a low-tax jurisdiction by reducing the GloBE income without resulting in a commensurate increase in the taxable income of the high-taxed counterparty.

Qualified refundable tax credit

4.14. There is a rule on the treatment of certain refundable tax credits which are government incentives delivered via the tax system.

4.15. A qualified refundable tax credit ("QRTC") is a tax credit designed in a way such that it must be refundable in cash or cash equivalents within four years from the year in which the constituent entity satisfies the conditions for receiving the credit.

4.16. QRTCs are not ordinary refunds of tax paid but rather incentives for taxpayers to engage in certain activities. They are treated in the same way as government grants that form part of an entity's income, and therefore the full amount is treated as GloBE income. Adjustments must be made where a non-qualified refundable tax credit was treated as income in the financial accounts.

International shipping income

4.17. International shipping income is excluded from the computation of GloBE income or loss. This is because the international shipping industry has long been subject to industry-specific tax rules. A substance criterion is imposed such that a constituent entity must demonstrate that the strategic or commercial management of all ships concerned is effectively carried on from within the jurisdiction where the entity is located to qualify for the exclusion.

Allocate income and loss between jurisdictions

4.18. For a PE which does not maintain separate financial accounts, there are rules to ensure that the right amount of financial accounting net income or loss is allocated between the PE and its main entity. The net income or loss that can be attributed to the PE is that being attributed to the PE in accordance with the tax treaty or local law of the source jurisdiction. Generally, the financial accounting net income or loss of a PE will not be included in the GloBE income or loss of its main entity.

4.19. As regards flow-through entities, the financial accounting net income or loss has first to be reduced by the amount attributable to the owners that are not members of the MNE group. Then, if the financial accounting net income or loss of a PE is included in the financial accounting net income or loss of a flow-through entity because the business of the latter is carried out through the former, such amount has to be subtracted from the flow-through entity's financial accounting net income or loss. Any remaining amount will then be allocated to the constituent entity-owner (if the flow-through entity is a tax transparent entity other than the UPE) or the entity (if the flow-through entity is a reverse hybrid entity or a tax transparent entity which is the UPE of the group).

Determine taxes attributable to income of a constituent entity

4.20. The next step in terms of the ETR computation is to determine the amount of taxes that are to be associated with the GloBE income or loss. They are referred to as covered taxes, which are broadly defined to include taxes on income or profits and do not include taxes such as indirect taxes, excise and stamp duty, etc. The focus is on the underlying character of the tax, while the name of the tax or the mechanism used to collect it is not determinative of its character. For example, withholding taxes and other taxes which are imposed in lieu of corporate income tax will qualify as covered taxes.

4.21. To avoid circular computation, top-up taxes accrued under a qualified IIR, qualified UTPR and QDMTT are excluded from covered taxes.

4.22. The starting point is to look at the current tax expense based on the financial accounts to determine the amount of covered taxes paid, followed by adjustments required under the GloBE rules. These adjustments include, for example, excluding taxes that are not related to the GloBE income or loss, and adding back to the measure of covered taxes any accrued tax liability that was reported as an ordinary expense instead of income tax expense in the financial accounts. As explained above, a QRTC is treated as GloBE income. It follows that if a QRTC has been reflected as a reduction to the current tax expense, the amount of the QRTC needs to be added back to covered taxes.

Assign taxes to a jurisdiction

4.23. Following the pattern of the income allocation rules, covered taxes are generally assigned to the constituent entity which includes the corresponding income in the computation of its GloBE income or loss.

4.24. Covered taxes paid by a constituent entity in respect of the income of a PE are allocated to the PE. Similarly, covered taxes arising

under a controlled foreign company ("CFC") tax regime are allocated to the CFC. For the situation where a constituent entity is a hybrid entity, covered taxes of the constituent entity-owner on the income of the hybrid entity under the fiscal transparency rule are allocated to the hybrid entity. Covered taxes imposed on a tax transparent entity's income (and not attributable to any PE) are assigned to the constituent entity-owner of the tax transparent entity.

4.25. There is a limitation on the "push-down" of taxes that are attributable to passive income of the CFC or hybrid entity to cap the total covered taxes on such passive income, so as to ensure that the ETR on passive income of the constituent entity is not higher than the 15% minimum rate.

4.26. Withholding taxes and net basis taxes on dividends and distributions paid to other constituent entities are assigned to the distributing entity.

Temporary differences

4.27. Temporary differences arise when income or loss is recognised in a different year for financial accounting and tax purposes. The GloBE rules adopt deferred tax accounting mechanism to match taxes to the period when the income or expenses are recognised for accounting purposes. The tax expense is shifted from the year the tax is paid (or tax deduction is received) to the year in which the income or expenditure is recognised in the financial accounts. This means that the covered taxes are adjusted by the constituent entity's deferred tax income or expense in the period.

4.28. The deferred tax accounts maintained by the constituent entity are subject to certain adjustments under the GloBE rules. For example, the constituent entity needs to recast the deferred tax expenses at the 15% minimum rate if the applicable tax rate is above the minimum rate. The GloBE rules also exclude certain types of deferred tax movements in respect of any item that is

excluded from the computation of GloBE income or loss, as well as deferred tax from uncertain tax positions.

4.29. There is a recapture rule for any deferred tax liabilities ("DTLs") that do not reverse within five years. The DTLs are recaptured in the year in which it was originally recorded. The ETR for that year needs to be recalculated without the DTLs. If the revised ETR results in a top-up tax, it is added to the top-up tax in the current year.

4.30. Some temporary differences are exempt from the recapture rule. They are common among jurisdictions and are typically tied to substantive activities in a jurisdiction or differences that are not prone to taxpayer manipulation. For example, cost recovery allowances on tangible assets are exempt as such temporary differences are certain to reverse over the life of the asset, even if such period takes longer than five years.

Losses

4.31. The deferred tax accounting mechanism also applies to the timing difference due to losses. Covered taxes are reduced in the year the local tax loss arises and a deferred tax asset ("DTA") is recognised. In subsequent year when the loss is utilised, covered taxes are increased and the DTA is unwound.

4.32. As the DTA is based on the tax loss available under the tax rules of the local jurisdiction, there are further rules to ensure that appropriate relief is provided.

4.33. DTA could be based on an economic loss which would also be recognised in the GloBE income or loss. These losses are rightly recognised in the GloBE rules to prevent top-up taxes being applied when the MNE group has not made any economic profit. The loss could also be created by timing difference between the accounts and local tax system, in which case both a DTA and DTL will be recognised in the accounts.

4.34. However, the local tax loss could also be caused by certain features of a jurisdiction's tax rules. For example, if a jurisdiction exempts certain streams of income from tax or provides enhanced deduction in excess of the cost incurred. These items are not recognised in the GloBE base and would ordinarily reduce the ETR when there was net GloBE income in the jurisdiction. Special provision under the GloBE rules requires to tax the excess benefit resulting from the permanent difference in the year it is created at the minimum rate but to allow the constituent entity to follow the local tax rules and apply the excess DTAs arising for local tax purposes to shelter income in future year, without giving rise to adverse outcome under the GloBE rules.

4.35. There is also an election available in zero-tax jurisdictions, where an MNE group would not benefit from a system based on deferred tax. It allows an MNE group to create a DTA for the purposes of the GloBE rules based on the GloBE loss in the jurisdiction multiplied by the minimum rate.

Post-filing adjustments and tax rate changes

4.36. There are rules provided for the treatment of adjustments to covered taxes for a previous financial year recorded in the financial accounts. An increase in covered taxes in previous fiscal years is treated as current year tax increases for the purpose of the GloBE rules. A decrease in covered taxes generally requires a recalculation of the ETR and top-up tax for the fiscal year to which the tax adjustment relates, but an immaterial decrease, being an aggregate decrease of less than EUR 1 million, in covered taxes may be treated as a reduction to covered taxes in the current year if an election is made by the filing constituent entity.

4.37. When there is a reduction to the applicable local tax rate below the minimum rate, the deferred tax expense previously claimed as a covered tax is adjusted to the correct value in the previous fiscal year. On the other hand, the deferred tax expense, when paid, that has resulted from an increase to the applicable local tax rate is

treated as an adjustment to a constituent entity's covered taxes for a previous fiscal year, provided that the amount was originally recorded at a rate less than the 15% minimum rate.

4.38. There is also a requirement that the ETR and top-up tax for a jurisdiction must be recalculated to exclude an amount of unpaid current tax expense of more than EUR 1 million after three years from the fiscal year in which it was included as covered taxes.

Views sought:

5. Are there any uncertainties that could be clarified in IRD's administrative guidance regarding the following –
   (a) adjustments made to the financial accounting net income or loss;
   (b) the rules relating to covered taxes;
   (c) the mechanism to address temporary timing differences;
   (d) post-filing adjustments?

CHAPTER FIVE – CALCULATION OF TOP-UP TAX

5.1. A top-up tax is charged on an MNE group when its ETR in a jurisdiction is below the 15% minimum rate. The rate of top-up tax is the difference between the minimum rate and the ETR in the jurisdiction. The top-up tax percentage is applied to the net GloBE income in the jurisdiction, after applying the substance-based income exclusion ("SBIE").

GloBE Rules Explained

Identify the net GloBE income

5.2. The ETR of an MNE group for a jurisdiction with net GloBE income shall be calculated for each fiscal year. An ETR is not computed for a jurisdiction that has a net GloBE loss for the fiscal year. The net GloBE income or loss of a jurisdiction is determined by aggregating the GloBE income or loss of all constituent entities located in the same jurisdiction.

5.3. There is an exception to this rule when the jurisdiction qualifies for de minimis exclusion. If the exclusion applies, the top-up tax for the constituent entities located in a jurisdiction shall be deemed to be zero. This means that there is no need for the MNE group to compute the ETR of the constituent entities that are located in the jurisdiction. There are two conditions for a jurisdiction to be eligible for the de minimis exclusion. First, the average GloBE revenue of the MNE group in that jurisdiction for the current and two preceding fiscal years is less than EUR 10 million. Second, the average GloBE income or loss of the MNE group in that jurisdiction for the same period is a loss or less than EUR 1 million. The exclusion applies on an annual basis and at the election of the filing constituent entity.

Calculate the ETR

5.4. ETRs are generally calculated on a jurisdictional basis. The jurisdictional ETR is equal to the sum of the adjusted covered

taxes of each constituent entity located in the jurisdiction for the fiscal year divided by the net GloBE income (if any) of the jurisdiction. The jurisdictional blending approach avoids risks that would otherwise arise to the integrity of the GloBE rules from shifting income and taxes between constituent entities located in the same jurisdiction and also potential distortions caused by particular features of the local tax system.

5.5. There are specific exceptions to the calculation of the jurisdictional ETR involving the following entities:

(a) Investment entities and insurance investment entities: income and taxes of investment entities and insurance investment entities located in a jurisdiction are excluded from the ETR computation for that jurisdiction. In general, investment entities and insurance investment entities are required to calculate their ETR on a standalone basis without aggregating their results with other constituent entities in the jurisdiction. The ETR is the investment entity's or insurance investment entity's adjusted covered taxes divided by the MNE group's allocable share of the investment entity's or insurance investment entity's GloBE income.

(b) Minority-owned constituent entities: these are entities in which the UPE holds 30% or less of the ownership interests but nonetheless has a controlling interest in them. Separate ETR computations for these constituent entities are required if they are located in a jurisdiction with ordinary constituent entities.

(c) Stateless constituent entities: each is treated as a single constituent entity located in a separate jurisdiction. The ETR of each stateless constituent entity is calculated without blending with other entities.

(d) Joint Ventures ("JVs"): JVs and its subsidiaries (i.e. the JV group) are treated as if it were a separate MNE group and the JV were the UPE of that group. The GloBE income or loss

and taxes of the JVs and its subsidiaries are not blended with other constituent entities in the MNE group. This means the ETR of JV group is calculated separately from the rest of the MNE group to address the practical challenges both the MNE group and the JV would experience in computing a full jurisdictional ETR for entities both within and outside the JV.

The top-up tax percentage

5.6. The next step is to compute the top-up tax percentage. The percentage is calculated by subtracting the jurisdictional ETR from the 15% minimum rate. It is the rate needed to bring the tax rate in respect of low-taxed constituent entities for the jurisdiction up to the minimum rate.

5.7. The top-up tax percentage is applied to the excess profit, which is the amount of net GloBE income remaining after applying a SBIE.

Substance-based income exclusion

5.8. The SBIE is a formulaic carve-out based on payroll costs and tangible assets. It seeks to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE rules. The SBIE allows the GloBE rules to focus on excess income that is most susceptible to BEPS risks.

5.9. The SBIE is subtracted from the net GloBE income in the jurisdiction in order to arrive at a measure of excess profit. If the SBIE exceeds the net GloBE income of the jurisdiction for a fiscal year, there will be no excess profit and generally no top-up tax will be computed.

5.10. The SBIE applies by default to each jurisdiction in which the MNE group operates, but a group is permitted to opt out of the requirement to apply the SBIE on a jurisdiction-by-jurisdiction basis annually. Where an entity elects not to apply the SBIE,

the top-up tax percentage is applied to the net GloBE income for the jurisdiction.

5.11. The SBIE amount for a jurisdiction is the sum of the payroll carve-out and the tangible asset carve-out for each constituent entity. The payroll carve-out for a constituent entity located in a jurisdiction is 5% of its eligible payroll costs of eligible employees who perform activities for the MNE group in that jurisdiction. It recognises a constituent entity's payroll expense as an appropriate proxy for substantive activities carried out by employees of the MNE group in the relevant jurisdiction.

5.12. The tangible asset carve-out for a constituent entity located in a jurisdiction is 5% of the carrying value of eligible tangible assets located in that jurisdiction. A broad range of tangible assets are included in the carve-out. This acknowledges that all such relevant assets are indicative of substantive activities. Certain assets are however specifically excluded from the carve-out, including property held for investment, sale or lease as an MNE group should not be allowed to generate a larger carve-out by purchasing investment property in a jurisdiction. Instead, they should have genuine physical activities in the jurisdiction.

Compute the top-up tax for the jurisdiction

5.13. The top-up tax for the jurisdiction is determined by multiplying the excess profit by the top-up tax percentage. The product of that computation is then increased by any additional current top-up tax for the fiscal year and reduced by any QDMTT in order to arrive at the jurisdictional top-up tax.

5.14. Certain provisions of the GloBE rules require the ETR and top-up tax in a previous fiscal year or fiscal years to be re-calculated. To avoid complexity and administrative burden, any additional top-up tax computed in respect of the previous fiscal years are charged to the fiscal year in which the recalculation is performed.

5.15. Any tax payable pursuant to a QDMTT is taken into account at such point of calculation. Tax payable pursuant to a QDMTT can offset the top-up tax that would have been computed. In many cases, the top-up tax will be reduced to nil.

Allocate jurisdictional top-up tax among constituent entities

5.16. Jurisdictional top-up tax computed for a low-tax jurisdiction is allocated among the constituent entities in the jurisdiction. It is allocated only to constituent entities that have GloBE income for the fiscal year. The allocation is based on the constituent entities' proportion of the GloBE income over that of all constituent entities located in the jurisdiction.

5.17. Such allocation of top-up tax facilitates the application of the IIR by parent entities other than the UPE. For example, if the UPE is not subject to a qualified IIR, the top-up tax will be collected through a combination of the IIR applied by POPEs and some intermediate parent entities. The allocation will therefore be necessary to ensure that the appropriate top-up tax for the jurisdiction is collected.

Views sought:

6. Are there any uncertainties that could be clarified in IRD's administrative guidance regarding the process for calculating top-up tax, in particular the de minimis exclusion and SBIE?

CHAPTER SIX – TRANSITION RULES

6.1. The GloBE rules provide certain transition rules which apply for a period of time when an MNE group first enters the scope of the GloBE rules.

6.2. An MNE group's transition year is determined on a jurisdiction basis. For a jurisdiction, transition year means the first fiscal year in which an MNE group comes within the scope of the GloBE rules in respect of that jurisdiction.

GloBE Rules Explained

Losses and timing differences

6.3. When an MNE group becomes subject to the GloBE rules, it will be required to calculate its ETR in each jurisdiction it operates. Losses and other timing differences occurred before an MNE group's transition year will affect its ETR calculation in the transition year and subsequent years. The failure to address these transition-related issues may distort the group's tax position and result in an inappropriately low ETR in a year when the group is subject to the GloBE rules for the first time.

6.4. Under the transition rules, an MNE group would be treated as though it were already subject to the GloBE rules at the time the losses or timing differences occurred. Existing deferred tax accounting attributes will be taken into account. Losses and timing differences must be recast to the lower of statutory rate of the jurisdiction and the minimum rate of 15%.

6.5. Deferred tax assets generated after 30 November 2021 from items that are excluded from the GloBE income or loss must be disregarded for GloBE purposes.

6.6. With respect to assets acquired in an intra-group transaction carried out after 30 November 2021 and before the commencement of transition year of an MNE group, the basis in

the acquired assets shall be based on historical carrying values of the disposing entity. This is to limit the ability to step-up the basis in such assets without including the resulting gain in the computation of the GloBE income or loss. As there is no change in the asset basis, deferred tax assets and liabilities must therefore similarly be determined based on historical carrying value.

Higher substance-based income exclusion

6.7. The percentages used in the SBIE are higher during a transition period. The carve-out percentages start at 10% for payroll and 8% for tangible assets, tapering down to the normal rates of 5% over the 10-year transition period. The transition period applies regardless of when an MNE group comes within the scope of GloBE rules. For a fiscal year beginning in 2033, the percentages for both are at 5%.

Filing deadline in transition year

6.8. The normal filing deadline for GloBE Information Return and notifications is no later than 15 months after the end of the reporting fiscal year. In order to provide an MNE group with additional time to set up the necessary compliance processes and systems when they come within the scope, the filing deadline for the first year will be extended to 18 months after the end of its reporting fiscal year.

MNE groups in their initial phase of international activity

6.9. As a temporary relief, the UTPR will not apply to MNE groups which are in their initial phase of international activity. The exclusion from the UTPR is effected by reducing to zero any amount of top-up tax that would otherwise be taken into account for determining the UTPR top-up tax amount.

6.10. This relief applies on an annual basis and expires after an MNE group has been in scope of the GloBE rules for five years. For an MNE group that is in scope for the GloBE rules, the period of

five years will start at the time the UTPR comes into effect. The five-year period is not suspended if the MNE group's revenue declines so that it falls outside the scope of the rules during those five years.

6.11. An MNE group is in its initial phase of its international activity if it has constituent entities in no more than six jurisdictions and the sum of the net book values of tangible assets of all constituent entities located in all jurisdictions other than the reference jurisdiction does not exceed EUR 50 million. Reference jurisdiction of an MNE group is the jurisdiction where the MNE group has the highest total value of tangible assets for the fiscal year in which the MNE group originally comes within the scope the GloBE rules.

6.12. The GloBE rules provide an optional provision (i.e. Article 9.3.5) that the relief for initial phase of international activity will not apply if the implementing jurisdiction is the reference jurisdiction of an in-scope MNE group (i.e. the jurisdiction where the group has the highest total value of tangible assets for the fiscal year in which the group originally comes within the scope of the GloBE rules).

Implementation in Hong Kong

6.13. It is for each jurisdiction to decide whether to apply the optional provision under Article 9.3.5 of the GloBE rules. To provide a level playing field between a Hong Kong-headquartered MNE group and a foreign-headquartered MNE group, and to prevent a Hong Kong-headquartered MNE group from abusing the relief for initial phase of international activity by group inversion, the Government proposes to adopt the optional provision.

Views sought:

7. Are there any uncertainties in relation to the operation of the transition rules that may need to be clarified in law or IRD's administrative guidance?

8. Do you have views on the proposed adoption of the optional provision relating to the relief for initial phase of international activity under Article 9.3.5 of the GloBE rules? (para 6.13)

CHAPTER SEVEN – DESIGN OF HONG KONG MINIMUM TOP-UP TAX

7.1. The GloBE rules contemplate that jurisdictions may introduce a DMTT, which would use the same tax base as the GloBE rules but take priority over the rules.

7.2. A DMTT introduced by a jurisdiction will be assessed by the OECD as to whether it is functionally equivalent to the GloBE rules so that it can be treated as a QDMTT[6]. Tax arising under a QDMTT directly reduces the amount of top-up tax arising under the GloBE rules. This crediting of a QDMTT against a top-up tax liability computed under the GloBE rules (i.e. the top-up tax before the application of the holding percentage) preserves and reinforces the primary taxing rights for the jurisdiction where the income arises. Where a DMTT does not qualify as a QDMTT because it is not closely based on GloBE rules, it would be treated as a covered tax instead and be included in the ETR calculation for the jurisdiction.

Implementation of HKMTT

7.3. The HKMTT will be so designed that enables itself to qualify as a QDMTT. To this end, the HKMTT will mirror all the requirements of the GloBE rules subject to the permitted and optional variations within the OECD's framework. In addition, the HKMTT will be designed to produce a liability for top-up tax that is equivalent to the top-up tax liability that would have arisen under the GloBE rules.

7.4. Given the creditability of QDMTT against the total top-up tax computed under the GloBE rules, the HKMTT will be imposed on the whole amount of the total top-up tax computed in respect

[6] There are two guiding principles in determining whether a DMTT is functionally equivalent to the GloBE rules and therefore qualifies as a QDMTT. Firstly, the DMTT must be consistent with the design of the GloBE rules. Secondly, the DMTT must provide for outcomes that are consistent with the GloBE rules, including that the jurisdiction does not provide any benefits that are related to such rules.

of all Hong Kong constituent entities of an in-scope MNE group under Article 5.2.3 of the GloBE rules, irrespective of the ownership interest held in the constituent entities by any parent entity of the group.

(a) Scope

7.5. Consistent with the scope of the GloBE rules, the Government proposes that the HKMTT will only apply to MNE groups with annual consolidated revenue of or above EUR 750 million. Small MNE groups and purely local groups are excluded from the scope of the HKMTT.

7.6. In-scope MNE groups, whether headquartered in or outside Hong Kong, will be covered by the HKMTT. All Hong Kong constituent entities of the groups, as well as JVs and JV subsidiaries held by the groups, will be subject to the HKMTT regardless of the ownership interest of the UPE or POPE in the entities concerned. This is to ensure that Hong Kong can collect top-up tax of low-taxed constituent entities in Hong Kong, which would otherwise be collected by other jurisdictions under the IIR or UTPR. This will also provide a level playing field for all in-scope MNE groups operating in Hong Kong and relieve them from paying top-up tax in other jurisdictions.

7.7. Following the GloBE rules, JVs held by an in-scope MNE group will be subject to ETR and top-up tax computations separate from those for other Hong Kong constituent entities of the group under the HKMTT. To secure the availability of QDMTT safe harbour, as permitted under the Administrative Guidance, the HKMTT attributable to such JVs and their JV subsidiaries will be directly imposed on the JVs and JV subsidiaries concerned instead of being allocated to other Hong Kong constituent entities of the group.

(b) Hong Kong resident entities

7.8. The meaning of Hong Kong resident entity referred to in paragraph 3.22 will also apply under the HKMTT.

(c) Allocation of HKMTT liability

7.9. The Administrative Guidance does not require a jurisdiction that implements QDMTT to allocate the QDMTT top-up tax among constituent entities in any particular manner, so long as the tax liability is allocated to one or more than one constituent entity that is subject to tax in that jurisdiction. The Government proposes that the HKMTT payable will, by default, be allocated among Hong Kong constituent entities of an in-scope MNE group pursuant to the formula adopted in Article 5.2.4 of the GloBE rules, i.e. based on the ratio of the GloBE income of the Hong Kong constituent entity to the aggregate GloBE income of all Hong Kong constituent entities of the group. However, this default allocation mechanism will be disapplied if the group designates one or more than one Hong Kong constituent entity to pay the HKMTT as described in paragraph 9.16.

(d) Financial accounting standard

7.10. For the purposes of QDMTT, a jurisdiction may require the excess profit (i.e. net GloBE income after deduction of SBIE) of an in-scope MNE group in the jurisdiction to be computed based on the local financial accounting standard (i.e. an acceptable financial accounting standard or authorised financial accounting standard but is adjusted as necessary to prevent material competitive distortions) rather than the one used by the group's UPE in preparing the consolidated financial statements.

7.11. The Government proposes to allow the use of local financial accounting standard for the HKMTT computation since it should provide additional flexibility and simplification. However, to secure the eligibility for the QDMTT safe harbour, the HKMTT must meet, among others, the QDMTT accounting standard (see

paragraph 8.9(a) of Chapter 8). Where the local financial accounting standard is adopted, the QDMTT accounting standard requires that the QDMTT jurisdiction must require the use of the local financial accounting standard where the conditions are met. MNE groups must not be given an option to choose which standard to use. It follows that all constituent entities of an in-scope MNE group must have financial accounts based on the local financial accounting standard.

(e) Substance-based income exclusion

7.12. It is not mandatory for a jurisdiction to provide a SBIE. However, if such exclusion is in place, it must not be broader than that permitted under the GloBE rules. To maintain consistency with the GloBE rules and reduce the tax burden of in-scope MNE groups, the Government proposes to include a SBIE as permitted by the GloBE rules under the HKMTT.

(f) Tax rate

7.13. Whilst the tax rate applicable under a QDMTT must not be less than the minimum rate, jurisdictions are allowed to adopt a rate higher than the minimum rate. To maintain consistency with the GloBE rules, the Government proposes the minimum tax rate under the HKMTT be set at 15%.

(g) Application of de minimis exclusion

7.14. A QDMTT is not required to have a de minimis exclusion provided under Article 5.5 of the GloBE rules. However, for the same reasons stated in paragraph 7.12, the Government proposes the inclusion of the same de minimis exclusion in the HKMTT.

(h) Initial phase of international activity

7.15. A jurisdiction can choose whether to put in place the exclusion for initial phase of international activity under its QDMTT. With a view to providing further relief to in-scope MNE groups and

having regard to the Administrative Guidance and practices adopted by other jurisdictions, the Government proposes to allow such exclusion under the HKMTT but limit its application to in-scope MNE groups where no parent entity is required to apply qualified IIR with respect to Hong Kong constituent entities of the group.

Views sought:

9. Do you have views on the scope of the HKMTT? (paras 7.5 to 7.7)

10. Do you have views on the allocation rules of HKMTT liability? (para 7.9)

11. Do you agree with the adoption of the local financial accounting standard for the purposes of the HKMTT? (para 7.11)

12. Do you have views on the proposed optional variations in the design of HKMTT, namely the inclusion of a SBIE, the tax rate of 15%, and the inclusion of the same de minimis exclusion? (paras 7.12 to 7.14)

13. Do you agree to allow the exclusion of initial phase of international activity under the HKMTT but limit its application to in-scope MNE groups where no parent entity is required to apply qualified IIR with respect to Hong Kong constituent entities of the group? (para 7.15)

CHAPTER EIGHT – SIMPLIFICATION

8.1. Given the concerns about the complexity of the calculations and adjustments for GloBE purposes, the IF has agreed to develop jurisdictional safe harbours to relieve compliance burden for MNE groups from performing full GloBE calculations when certain conditions are met.

8.2. The permanent safe harbours allow in-scope MNE groups to assume that the top-up tax for a jurisdiction is zero under certain conditions so as to reduce the burden in complying with the detailed computational requirements of the GloBE rules. The transitional safe harbours allow the MNE groups to determine whether they are liable to any top-up tax by a simple calculation or yardstick in the initial years in which the GloBE rules are being introduced.

Safe Harbours Developed by IF

Transitional – CbCR safe harbour

8.3. The transitional CbCR safe harbour operates through the use of simplified jurisdictional revenue and income information contained in the MNE's qualified CbC report and jurisdictional tax information contained in its qualified financial statements. It only applies to a transition period covering all of the fiscal years beginning on or before 31 December 2026 but not including a fiscal year that ends after 30 June 2028. For a fiscal year that falls within the transition period, top-up tax of an in-scope MNE groups in a jurisdiction will be deemed to be zero if the group can satisfy one of the following tests:

(a) De minimis test: The group reports total revenue of less than EUR 10 million and profit (loss) before income tax of less than EUR 1 million in such jurisdiction on its qualified CbC report for the fiscal year; or

(b) Simplified ETR test: The group has a simplified ETR that is equal to or greater than the transition rate in such jurisdiction for the fiscal year. The transition rate is 15% for fiscal years beginning in 2023 and 2024, 16% for fiscal year beginning in 2025, and 17% for fiscal years beginning in 2026; or

(c) Routine profit test: The group's profit (loss) before income tax in such jurisdiction is equal to or less than the SBIE amount, for constituent entities resident in that jurisdiction under the CbCR, as calculated under the GloBE rules.

8.4. If an in-scope MNE group has not applied the transitional CbCR safe harbour in respect of a jurisdiction for a fiscal year in which the group is subject to the GloBE rules, the group cannot qualify for the safe harbour in respect of that jurisdiction for a subsequent fiscal year. In other words, this safe harbour adopts a "once out, always out" approach.

Transitional – UTPR safe harbour

8.5. The transitional UTPR safe harbour is designed to provide a transitional relief from the application of UTPR to the UPE jurisdiction during the transition period. The transition period means fiscal years which run no longer than 12 months that begin on or before 31 December 2025 and end before 31 December 2026. At the election by an in-scope MNE group, the UTPR top-up tax amount calculated for the UPE jurisdiction will be deemed to be zero for each fiscal year that falls within the transition period if the UPE jurisdiction has a corporate income tax at a rate of at least 20%.

Permanent – QDMTT safe harbour

8.6. The possibility of variations between QDMTT and the GloBE rules means that there may be particular fact patterns where the top-up tax imposed under the QDMTT is less than the amount that would have been due under the GloBE rules. However, this

may not give rise to any integrity risk because the credit mechanism under the GloBE rules ensures that any shortfall in QDMTT will result in an additional top-up tax payable under the GloBE rules.

8.7. The application of the above credit mechanism requires at least two separate top-up tax calculations in respect of the same jurisdiction. The first calculation is based on the QDMTT legislation and the further calculation is based on the GloBE rules. This will result in increased compliance cost for MNE groups and administration burdens for tax authorities.

8.8. The QDMTT safe harbour intends to provide a practical solution to address the compliance issue. Where an in-scope MNE group is eligible for the QDMTT safe harbour in respect of a jurisdiction, the group will only need to undertake one QDMTT calculation and be relieved from applying the GloBE rules to that jurisdiction since the top-up tax payable in respect of that jurisdiction under the GloBE rules will be deemed to be zero. To prevent the risk that there would be potential shortfall between the QDMTT and top-up tax under the GloBE rules, the QDMTT must meet an additional set of standards to qualify for the safe harbour.

8.9. A jurisdiction that implements QDMTT ("QDMTT jurisdiction") must meet the following three standards for the purpose of benefitting from the QDMTT safe harbour:

(a) QDMTT accounting standard

(i) This requires the GloBE income or loss to be determined using certain accounting standards. The QDMTT legislation should adopt either the financial accounting standard used for preparing the consolidated financial statements of the UPE or the local financial accounting standard rule is met.

(ii) Under the local financial accounting standard rule, the QDMTT is required to be computed based on the local financial accounting standard of the QDMTT jurisdiction if all of the constituent entities of the group located in that jurisdiction have financial accounts prepared based on that standard and either are required to keep or use such accounts under a local corporate or tax law; or such financial accounts are subject to an external financial audit.

(iii) The local financial accounting standard means a financial accounting standard permitted or required in the QDMTT jurisdiction by the authorised accounting body or pursuant to the local legislation that is an acceptable accounting standard or authorised financial accounting standard adjusted to prevent material competitive distortion.

(iv) In case where the local financial accounting standard rule is not met or the fiscal year of such accounts is different to the fiscal year of the consolidated financial statements of the in-scope MNE group, the QDMTT will be computed based on the financial accounting standard of the UPE's consolidated financial accounts pursuant to Articles 3.1.2 and 3.1.3 of the GloBE rules.

(v) The QDMTT jurisdiction must not give an option to the group to choose which financial accounting standard is to be adopted. Hence, in order to meet the standard where a QDMTT jurisdiction adopts the local financial accounting standard rule, it shall require MNE groups to apply the standard consistently and use the local financial account standard where the conditions are met.

(b) Consistency standard

The computations under the QDMTT must be the same as those under the GloBE rules, except where the Administrative Guidance explicitly requires the QDMTT to depart from the GloBE rules. There are two mandatory variations and three optional variations. The mandatory variations require that a QDMTT: (i) should not take into account the allocation of cross-border taxes (such as CFC taxes or taxes incurred with respect to profits attributable to foreign permanent establishment), and (ii) should be computed using local currency in certain situations. The acceptable optional variations are those which produce equivalent or greater outcomes than those under the GloBE rules, including (A) no, or a more limited, SBIE: (B) no, or a more limited, de minimis exclusion; (C) and a minimum tax rate above 15% for the purpose of computing the top-up tax percentage for the jurisdiction.

(c) Administration standard

This requires that a QDMTT jurisdiction to be subject to the same ongoing monitoring process as the GloBE rules.

8.10. In some cases, the QDMTT meets the above standards, but an in-scope MNE group will not be able to apply the QDMTT safe harbour because the group will be subject to the switch-off rule. The switch-off rule applies where a QDMTT jurisdiction puts in place the following restrictions on imposing the QDMTT with respect to a particular constituent entity or corporate structure.

(a) The QDMTT jurisdiction decides not to impose the QDMTT on flow-through entities created in the jurisdiction.

(b) The QDMTT jurisdiction decides not to impose a QDMTT on investment entities subject to Articles 7.4, 7.5 and 7.6 of the GloBE rules.

(c) The QDMTT jurisdiction decides to adopt Article 9.3 of the GloBE rules with no limitation.

(d) The QDMTT jurisdiction includes JVs and JV subsidiaries within the scope of the QDMTT but imposes the liability on constituent entities of the main group instead of directly on the members of the JV Group.

8.11. The IF agreed that the above four restrictions will not affect the QDMTT from meeting the consistency standard, but an in-scope MNE group to which any of the restrictions applies will be subject to a switch-off rule, i.e. the group will not be able to benefit from the QDMTT safe harbour in relation to either all or a subset of its constituent entities in the QDMTT jurisdiction. Accordingly, the group will be switched to credit method for relieving double taxation under the GloBE rules in respect of a QDMTT. However, the QDMTT safe harbour would still be available for other in-scope MNE groups in the jurisdiction.

8.12. A distinction is to be made between QDMTT and QDMTT safe harbour. A DMTT that meets all the criteria of QDMTT will be regarded as a QDMTT. If a DMTT is a QDMTT and also meets the accounting standard, the consistency standard and the administration standard, an in-scope MNE group that is subject to the DMTT may be eligible for the QDMTT safe harbour.

Simplified calculation safe harbour for non-material constituent entities

8.13. The IF has also developed a simplified income and tax calculations which an MNE group could apply for its non-material constituent entities under the simplified calculation safe harbour.

8.14. A non-material constituent entity is a constituent entity of an MNE Group that is not consolidated in the UPE's audited financial statements solely for size or materiality grounds and includes any permanent establishment of such constituent entity.

8.15. Under the simplified calculation for non-material constituent entities, the top-up tax for a jurisdiction will be deemed to be zero for a fiscal year where the jurisdiction meets the requirements of the (a) routine profits test; (b) de minimis test; or (c) ETR test. A constituent entity may use a simplified income calculation, simplified revenue calculation, or a simplified tax calculation for the purpose of determining whether any of the above tests is met in the fiscal year.

8.16. The IF is now developing Administrative Guidance on this safe harbour. Upon the release of the guidance, the Government will study the guidance and consider adopting this safe harbour.

Implementation in Hong Kong

8.17. To provide tax certainty, the Government proposes to provide the transitional CbCR safe harbour for the purposes of the GloBE rules.

8.18. As regards the UTPR safe harbour, since the statutory corporate profits tax rate of Hong Kong is below 20%, this safe harbour is not applicable.

8.19. As for the QDMTT safe harbour, since the compliance burden of in-scope MNE groups can be reduced under the QDMTT safe harbour, the Government proposes to include this safe harbour in the legislation.

Views sought:

14. Do you have views on whether the transitional CbCR safe harbour should be adopted? If not, why not? (para 8.17)

15. Given additional standards need to be met, do you have views on whether the QDMTT safe harbour should be adopted? If not, why not? (para 8.19)

16. Do you have views on whether the switch-off mechanism under the consistency standard should be adopted for implementing the QDMTT safe harbour? If not, why not? (paras 8.10 to 8.11)

CHAPTER NINE – TAX COMPLIANCE AND ADMINISTRATION

GloBE Rules Explained

9.1. Under the GloBE rules, each constituent entity of an in-scope MNE group is required to file a standardised GloBE Information Return ("GIR") in the jurisdiction where the entity is located. Notwithstanding that the GloBE rules place the default filing obligation with respect to GIR on local filing, the rules also provide for the possibility to file a GIR in a single jurisdiction that will then exchange the information with other jurisdictions under a coordinated filing and exchange mechanism.

9.2. In July 2023, the OECD released a standard template of GIR and explanatory guidance. The GIR is a comprehensive return that contains the group's general information, corporate structure, safe harbours election, ETR computation on a jurisdictional basis, top-up tax calculations and attribution, etc. The information contained in a GIR is categorised in a way to facilitate the agreed dissemination approach.

9.3. An obligation to prepare and file a GIR is separate from the requirement to declare in a tax return. Hence, jurisdictions implementing the GloBE rules and QDMTT need to design their own tax return and determine the relevant return filing obligations.

9.4. To reduce compliance burden on in-scope MNE groups and facilitate coordination between jurisdictions, it is agreed that the same set of GIR data points should be used for computations under both the GloBE rules and QDMTT. Hence, the QDMTT jurisdiction could choose to use the GIR or rely on the information required in the GIR.

9.5. Under the GloBE rules, the GIR and notifications shall be filed with the tax administration no later than 15 months after the last

day of the reporting fiscal year. As a transitional measure, the filing deadline is no more than 18 months for the transition year.

Implementation in Hong Kong

9.6. IRD will put in place a dedicated tax administration framework to implement the GloBE rules and HKMTT. The framework will cover requirements in relation to the filing of notification and return, payment of top-up tax, record-keeping and penalty for non-compliance, etc. This chapter seeks views on the Government's proposed tax compliance and administrative framework.

Dedicated Electronic Platform

9.7. To facilitate filing of notifications and returns by constituent entities of in-scope MNE groups, an electronic platform will be developed by the IRD to allow registration of account, submission of notifications and returns, sending and receiving messages, etc. Modelled on the arrangements for CbCR and automatic exchange of financial account information in tax matters, which have already been put in place in Hong Kong by legislation, a filing entity will be allowed to engage a service provider to file a top-up tax return or top-up tax notification through this platform.

Filing of top-up tax return

9.8. Subject to the designation arrangement referred to in paragraph 9.10 below, each Hong Kong constituent entity of an in-scope MNE group will be required to furnish a single top-up tax return for the purposes of the GloBE rules and HKMTT ("top-up tax return") in a prescribed manner and form no later than 15 months after the last day of the reporting fiscal year. The filing deadline for the transition year is extended to 18 months.

9.9. A top-up tax return is a form specified by the Board of Inland Revenue. The return will require information necessary to

enable the IRD to determine the MNE group's top-up tax liabilities under IIR, UTPR or HKMTT as appropriate. For an in-scope MNE group which is headquartered in (a) Hong Kong; or (b) a non-Hong Kong jurisdiction that is unable to exchange GIRs with Hong Kong under a qualifying competent authority agreement, the top-up tax return will include the data points required in the GIR ("GIR information"). The GIR information reported in the top-up tax return of a Hong Kong-headquartered MNE group will be exchanged with other relevant jurisdictions which have a qualifying competent authority agreement in place with Hong Kong.

9.10. An in-scope MNE group, whether headquartered in or outside Hong Kong, will be allowed to designate one Hong Kong constituent entity ("designated local entity") to file the top-up tax return to the IRD such that all other Hong Kong constituent entities of the group will be relieved from their filing obligation. An appointment of designated local entity will need to be made annually and will remain valid in respect of the reporting fiscal year concerned. The IRD must be notified of the identity of the designated local entity through the top-up tax notification referred to in paragraph 9.12.

9.11. Given that the UPE should be in the best position to access all the relevant information of the group, the designated local entity, if appointed, should generally be the UPE if the group is headquartered in Hong Kong. However, if the group is (a) foreign-headquartered; or (b) Hong Kong-headquartered but prefers to appoint a designated local entity that is not the UPE, it must ensure that the designated local entity will be provided with all essential information for complying with the filing obligation. In respect of a reporting fiscal year, the designated local entity for the filing of top-up tax return and that for the filing of top-up notification must be the same Hong Kong constituent entity.

Filing of top-up tax notification

9.12. Subject to the designation arrangement referred to in paragraph 9.13, each Hong Kong constituent entity of an in-scope MNE group will be required to file an annual notification ("top-up tax notification") relating to its obligation of filing top-up tax return in a prescribed form and manner. Having regard to the deadline for filing CbCR notification (i.e. three months after the end of the reporting period) and the complexity of the GloBE rules and HKMTT, a top-up tax notification will be required to be filed within six months after the end of the fiscal year.

9.13. An in-scope MNE group, whether headquartered in or outside Hong Kong, will be allowed to appoint one designated local entity to file a top-up tax notification so as to relieve other Hong Kong constituent entities from the filing obligation. The requirements concerning the designated local entity for the filing of top-up tax return (see paragraphs 9.10 and 9.11) will apply in relation to the designated local entity for the filing of top-up tax notification.

Assessment and payment of top-up tax

9.14. Since comprehensive information will be reported in the top-up tax return and filed electronically to the IRD, a notice of assessment demanding the top-up tax will be issued based on the information declared electronically upon the filing of the top-up tax return. No provisional top-up tax will be charged. Post-assessment audit and compliance check will be performed to ensure that in-scope MNE groups properly discharge their obligations under the GloBE and HKMTT regimes, and the groups are correctly charged the top-up tax.

9.15. While a number of jurisdictions such as the United Kingdom, Canada and Ireland require top-up tax to be paid on or before the filing deadline of the GIR, we consider it appropriate to allow additional time, say two weeks from the date of the notice of assessment, for paying the top-up tax.

Joint and several liability

9.16. The top-up tax under the IIR will be charged on the UPE. In respect of the UTPR or HKMTT regime, to accord flexibility for payment of top-up tax, an in-scope MNE group will be allowed to decide on how the tax payable is to be allocated among its Hong Kong constituent entities. The group can designate one or more than one paying entity, save that all Hong Kong constituent entities of the group will be jointly and severally liable for the whole amount of the top-up tax payable. This arrangement is provided in the Administrative Guidance promulgated by the OECD, and reflects the reality that the top-up tax is charged with respect to the low-taxed income of all Hong Kong constituent entities of the group on a jurisdictional basis.

9.17. Payments made by a paying entity on behalf of other Hong Kong constituent entities of the MNE group will not be allowed as deductions in calculating the income, profits or losses of the paying entity for profits tax purpose. Similarly, if the paying entity is reimbursed for making a payment towards the top-up tax, this will not be treated as a receipt for profits tax purpose.

Penalty

9.18. A Hong Kong constituent entity of an in-scope MNE group, or the group's designated local entity (if appointed), that is required to file a top-up tax return or top-up tax notification ("filing entity") will commit an offence where the entity fails to comply with the filing obligations without reasonable excuse. The filing entity will be liable on conviction to a fine at level 5, and the court may order the entity to file the top-up tax return or top-up tax notification within a specified period of time. In case of a continuing offence after conviction, a further fine of $500 will be imposed on the filing entity for each day of offence. The filing entity will also commit an offence for failing to comply with the court order and will be liable on conviction to a fine at level 6. These proposed penalties are in line with those imposed on similar

offences in respect of CbCR under section 80G(3), (4) and (5) of the IRO.

9.19. If a filing entity fails to file a top-up tax return or top-up tax notification without reasonable excuse, but no prosecution for an offence has been instituted in respect of the same facts, the entity will be liable to be assessed to additional tax of an amount not exceeding treble the amount of top-up tax that has been undercharged as a result of the failure, or would have been undercharged if the failure had not been detected. This proposed additional tax is in line with that proposed on a person for failing to file a profits tax return, or inform the person's chargeability to tax, under section 82A(1)(d) and (e) of the IRO.

9.20. As for wrongdoings relating to incorrect top-up tax return and incorrect top-up tax notification, the proposed penalties are modelled on sections 80, 82 and 82A as follows –

(a) A filing entity will commit an offence if it makes an incorrect top-up tax return and top-up tax notification without reasonable excuse. The entity will be liable on conviction to a fine at level 3 and a further fine of treble the amount of tax that has been undercharged as a result of the incorrect return or notification, or would have been so undercharged if the return or notification had been accepted as correct. These proposed penalties are in line with those imposed on a person for making or giving an incorrect return, statement or information under section 80(2)(a), (b) and (c) of the IRO.

(b) If a filing entity makes an incorrect top-up tax return or top-up tax notification without reasonable excuse, but no prosecution for an offence has been instituted for the same facts, the entity will be liable to be assessed to additional tax of an amount not exceeding treble the amount of tax that has been undercharged as a result of the incorrect return or notification, or would have been so undercharged if the return of notification had been accepted as correct. This proposed additional tax is in line with that imposed on a

person for making or giving an incorrect return, statement or information under section 82A(1)(a), (b) and (c) of the IRO.

(c) A filing entity will commit an offence if it makes an incorrect top-up tax return or top-up tax notification wilfully with intent to evade tax. The entity will be liable to a fine at level 3 and imprisonment for six months on summary conviction, and a fine at level 5 and imprisonment for three years on indictment, and a further fine of treble the amount of tax that has been undercharged as a result of the incorrect return of notification, or would have been so undercharged if the return of notification had been accepted as correct. These proposed penalties are in line with those imposed on a person making or giving a false return, statement of information under section 82(1)(a), (b) and (c) and (1A) of the IRO.

9.21. A service provider who is engaged to file a top-up tax return or top-up tax notification for a filing entity will be subject to penalties similar to those referred in paragraphs 9.18 to 9.20.

9.22. The OECD recommends jurisdictions to provide transitional penalty relief if an MNE group has taken reasonable measures to ensure the correct application of the GloBE rules in the initial years during which the GloBE rules come into effect. For the sake of simplicity, the IRD will adopt the existing mechanism under section 82A of the IRO that a taxpayer can make representations before imposition of administrative penalty. The factors mentioned in the OECD publication will be taken into account when considering whether there is any reasonable excuse for the wrongdoings.

Other administrative provisions

9.23. To provide simplicity, certainty and continuity, the Government proposes to ride on the existing administrative provisions of the IRO, with necessary modifications, for the purposes of the GloBE rules and HKMTT to deal with the record keeping requirements,

objection procedures, collection and recovery of tax, anti-avoidance issues, etc.

Views sought:

17. Do you have any views on the proposed arrangements for the filing of top-up tax return and top-up tax notification? (paras 9.8 to 9.13)

18. Do you have any views on the proposed arrangements for the assessment and payment of top-up tax? (paras 9.14 to 9.15)

19. Do you have views on the proposed penalties for wrongdoing and non-compliance in relation to the GloBE rules and HKMTT? (paras 9.18 to 9.22)

20. Do you have any views or comments on the proposed compliance and administration framework for the GloBE rules and HKMTT? (paras 9.7 to 9.22)

21. Do you have any views on the necessary modifications of the existing administrative provisions of the IRO to deal with the record keeping requirements, objection procedures, collection and recovery of tax, anti-avoidance issues, etc.?

CHAPTER TEN – MANDATORY ELECTRONIC FILING OF PROFITS TAX RETURNS

Need for implementing e-filing of profits tax returns

10.1. To keep pace with the global trend of digital transformation of tax administration, align with the Government's Smart City initiatives and implement the OECD's standard recommendation to Hong Kong regarding the exchange of information on request[7], the Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021 ("the 2021 Ordinance") was enacted to amend the IRO to, among others, enhance the statutory framework for electronic filing ("e-filing") of profits tax returns. One of the amendments was to add section 51AAB to the IRO to empower the Commissioner of Inland Revenue ("the Commissioner") to, through subsidiary legislation, specify the classes or descriptions of taxpayers who must furnish their profits tax returns by e-filing in a gazette notice.

10.2. When the amendment bill for the 2021 Ordinance was deliberated by the LegCo, the Government indicated that it would first allow business to voluntarily e-file profits tax returns including financial statements in 2023, and then to implement mandatory e-filing of the returns by phases. Large businesses with turnover above a certain threshold would likely be the first batch of taxpayers to be required to e-file their profits tax returns in the first phase of mandatory e-filing. In April 2023, the IRD launched the voluntary e-filing of profits tax returns where taxpayers can e-file the returns together with financial statements and tax computations in inline eXtensible Business Reporting Language ("iXBRL") format on a voluntary basis.

---

[7] As a member of the OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, Hong Kong is committed to implementing the international standards of exchange of information in different modes to enhance tax transparency and prevent tax evasion. In the peer reviews on Hong Kong with respect to exchange of information on request, the OECD recommended that Hong Kong should take measures to ensure that accounting records of all relevant businesses are available. To implement this recommendation would call for the issue of profits tax returns to all entities carrying on business in Hong Kong and processing of voluminous accounting and financial data which necessitate adoption of mandatory e-filing of profits tax returns and financial statements for businesses.

IRD's support to taxpayers

10.3. To enable taxpayers to familiarise themselves with the new iXBRL filing requirements, the IRD has implemented various support measures to assist taxpayers and their representatives in the transition to the iXBRL filing requirements. The support measures include:

(a) Provision of free conversion tools

The IRD provides conversion tools, namely the IRD iXBRL Data Preparation Tools (**"**the Tools**"**), which can be downloaded from the IRD's website free of charge. The Tools, comprising the Tagging Tool and the Template Tool, are user-friendly interfaces for users to generate the required iXBRL files which conform to the XBRL specifications and the IRD Taxonomy schema. The Tagging Tool, equipped with an auto-tagging feature, performs an automatic detection of figures and labels from financial statements and tax computations and matches them with the elements in the IRD Taxonomy Package based on certain built-in rules. The Template Tool, which is simple and easy to use, is specifically designed for small businesses (with gross income not exceeding $2,000,000) to input figures and text in pre-defined templates for generating iXBRL data files without the necessity of manually tagging the data with appropriate tags.

(b) Provision of online materials

Detailed guidance and training videos on the use of the Tools, online demonstration of the e-filing process and frequently asked questions on common issues have been uploaded onto the IRD's website for public users' reference.

(c) Helpdesk

To provide better customer service, the IRD has offered one-on-one direct assistance to taxpayers via an online booking

system, namely e-Appointment. Taxpayers can access e-Appointment which is hosted on the IRD's website (https://bkapp.ird.gov.hk/ixbrl/) to book in advance a specific timeslot for making general enquiries in relation to the use of the Tools via phone call. In addition, taxpayers may send their enquiries regarding the iXBRL filing requirements to the dedicated email account (ixbrl_reporting@ird.gov.hk).

(d) Outreaching Team

The IRD provides online webinars and outreaching training sessions in hybrid mode for different professional bodies, companies or businesses.

(e) Ongoing consultative stakeholder engagement sessions

The IRD has conducted rounds of consultation and briefings to solicit stakeholders' feedback on the proposals for taking forward the project on the e-filing of profits tax returns. The IRD has also attended a number of consultation sessions, webinars and meetings with more than 5,000 participants from various professional bodies, information technology and professional accounting firms. The IRD continues to organise and participate in focus discussion groups and engagement meetings during the current stage of voluntary e-filing and will take into account stakeholders' views, where appropriate, for strengthening the provision of e-services to the public.

First phase of mandatory e-filing

10.4. With all the above efforts in place, it is now considered appropriate to take forward the implementation of the first phase of mandatory e-filing of profits tax returns. Currently, in-scope MNE groups (i.e. MNE groups whose annual consolidated group revenue reaches at least EUR 750 million) are required to e-file their CbC reports. Following the implementation of the GloBE rules and HKMTT, such MNE groups will also need to e-file their

top-up tax returns and top-up tax notifications for a reporting fiscal year beginning on or after 1 January 2025. Having balanced the need to take forward the mandatory e-filing of profits tax returns and that to allow businesses, in particular small and medium enterprises, to have adequate time to understand the new e-filing mechanism, it is proposed that the first phase of mandatory e-filing will apply to in-scope MNE groups, which should be more familiar with e-filing of tax-related documents and more resource-sufficient to adapt to e-filing of profits tax returns. Indeed, from the perspective of such MNE groups, it may be more convenient for them to file all the required tax-related documents (i.e. profits tax returns, CbC reports and notification as well as top-up tax returns and notifications) electronically.

Effective year of assessment

10.5. The Commissioner plans to issue a gazette notice under section 51AAB of the IRO to require Hong Kong constituent entities of in-scope MNE groups to e-file their profits tax return for a year of assessment beginning on or after 1 April 2025 (i.e. year of assessment 2025/26). The gazette notice will form part of the subsidiary legislation subject to negative vetting by the LegCo. Pursuant to the gazette notice, all Hong Kong constituent entities of an in-scope MNE group will be required to e-file their profits tax returns through a designated computer system for the year of assessment 2025/26 and subsequent years. The earliest basis period for the year of assessment 2025/26 commences on 2 April 2024.

Views sought:

22. Do you have any views on the proposed application of mandatory e-filing of profits tax returns to in-scope MNE groups from the year of assessment 2025/26?

Annex

Consultation Questions

Charging Provisions (Chapter Three)

1. Do you have any views on the proposed equivalent adjustment approach to bring the undertaxed profits rule ("UTPR") top-up tax into charge? (para 3.20)

2. Do you have any views on the proposed allocation and payment mechanism for the UTPR top-up tax? (para 3.21)

3. Do you have any views on the proposed approach to deal with the issue relating to the location of an entity and the proposed meaning of Hong Kong resident entity for the purposes of the global anti-base erosion ("GloBE") rules and Hong Kong minimum top-up tax ("HKMTT")? (para 3.22)

4. Do you have any views on the retrospective application of the meaning of a Hong Kong resident entity from 1 January 2024 (para 3.23)?

Calculation of Effective Tax Rate (Chapter Four)

5. Are there any uncertainties that could be clarified in Inland Revenue Department's ("IRD") administrative guidance regarding the following –
   (a) adjustments made to the financial accounting net income or loss;
   (b) the rules relating to covered taxes;
   (c) the mechanism to address temporary timing differences;
   (d) post-filing adjustments?

Calculation of Top-up Tax (Chapter Five)

6. Are there any uncertainties that could be clarified in IRD's administrative guidance regarding the process for calculating top-up tax, in particular the de minimis exclusion and substance-based income exclusion ("SBIE")?

Transition Rules (Chapter Six)

7. Are there any uncertainties in relation to the operation of the transition rules that may need to be clarified in law or IRD's administrative guidance?

8. Do you have views on the proposed adoption of the optional provision relating to the relief for initial phase of international activity under Article 9.3.5 of the GloBE rules? (para 6.13)

Design of Hong Kong Minimum Top-up Tax (Chapter Seven)

9. Do you have views on the scope of the HKMTT? (paras 7.5 to 7.7)

10. Do you have views on the allocation rules of HKMTT liability? (para 7.9)

11. Do you agree with the adoption of the local financial accounting standard for the purposes of the HKMTT? (para 7.11)

12. Do you have views on the proposed optional variations in the design of HKMTT, namely the inclusion of a SBIE, the tax rate of 15%, and the inclusion of the same de minimis exclusion? (paras 7.12 to 7.14)

13. Do you agree to allow the exclusion of initial phase of international activity under the HKMTT but limit its application to in-scope multinational enterprise ("MNE") groups where no parent entity is required to apply qualified Income Inclusion Rule with respect to Hong Kong constituent entities of the group? (para 7.15)

Simplification (Chapter Eight)

14. Do you have views on whether the transitional country-by-country reporting safe harbour should be adopted? If not, why not? (para 8.17)

15. Given additional standards need to be met, do you have views on whether the Qualified Domestic Minimum Top-up Tax ("QDMTT") safe harbour should be adopted? If not, why not? (para 8.19)

16. Do you have views on whether the switch-off mechanism under the consistency standard should be adopted for implementing the QDMTT safe harbour? If not, why not? (paras 8.10 to 8.11)

Tax Compliance and Administration (Chapter Nine)

17. Do you have any views on the proposed arrangements for the filing of top-up tax return and top-up tax notification? (paras 9.8 to 9.13)

18. Do you have any views on the proposed arrangements for the assessment and payment of top-up tax? (paras 9.14 to 9.15)

19. Do you have views on the proposed penalties for wrongdoing and non-compliance in relation to the GloBE rules and HKMTT? (paras 9.18 to 9.22)

20. Do you have any views or comments on the proposed compliance and administration framework for the GloBE rules and HKMTT? (paras 9.7 to 9.22)

21. Do you have any views on the necessary modifications of the existing administrative provisions of the Inland Revenue Ordinance to deal with the record keeping requirements, objection procedures, collection and recovery of tax, anti-avoidance issues, etc.?

Mandatory Electronic Filing of Profits Tax Returns (Chapter Ten)

22. Do you have any views on the proposed application of mandatory e-filing of profits tax returns to in-scope MNE groups from the year of assessment 2025/26?