Hong Kong General Chamber of Commerce
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19 March 2024

Mr Stephen Lo
Principal Assistant Secretary for Financial Services and
the Treasury (Treasury)(R2)
Financial Services and the Treasury Bureau
24/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

Dear Mr Lo,

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

The Hong Kong General Chamber of Commerce welcomes the opportunity to respond to the captioned consultation.

In an increasingly complex business landscape, the Chamber strongly advocates for greater collaboration with the international community in enhancing tax transparency and combating tax evasion amid the growing digitalisation of the economy. We welcome and support the Government's initiatives to safeguard Hong Kong's competitive edge as an international financial centre by maintaining a simple, certain, and low tax regime.

Moreover, with the imminent implementation of the GloBE rules and the complexity they entail, we respectfully urge the Government to provide comprehensive guidance on all facets of the new rules to assist businesses in their compliance efforts.

We hope you will find our comments useful.

Yours sincerely,

Patrick Yeung
CEO

Encl.

Consultation Paper by Financial Services and the Treasury Bureau and Inland Revenue Department "Implementation of Global Minimum Tax and Hong Kong Minimum Top-Up Tax" (December 2023)

Submission by The Hong Kong General Chamber of Commerce ("HKGCC")

Introduction

HKGCC welcomes this opportunity to respond to the above consultation paper ("CP"). We set out first our general comments on the proposals contained in the CP, then our answers to the specific consultation questions.

General Comments

We support the Government's stated guiding principles in implementing the global minimum tax and Hong Kong minimum top-up tax. In particular, we agree that this should include "upholding Hong Kong's simple, certain and low tax regime" and "minimising the compliance burden of in-scope MNE groups".[1]

With these guiding principles in mind, and given that the new rules are highly complex, we respectfully request that the Government (including the Inland Revenue Department ("IRD") in particular):

- gives full practical written guidance (in easy-to-understand terms) on all aspects of the new rules to assist businesses in their compliance efforts;
- continues its outreach efforts to businesses, in face-to-face and/or remote sessions, to explain the new rules;
- publishes user-friendly FAQs on the new rules;
- establishes a dedicated hotline to answer questions on the new rules;
- shows leniency in the legislative drafting, and in the initial years of the new rules being in effect, when it comes to the issue of penalties for non-filing, or late or incorrect filing. We address this important issue in more detail in our answer to Consultation Question 19 below.

Answers to Consultation Questions

<u>Charging Provisions (Chapter Three)</u>

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)*

   This approach seems to be broadly in line with that generally taken in other jurisdictions.

[1] CP Introduction para 7.

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

   The CP proposes that Hong Kong charge the UTPR top-up tax as an additional tax rather than denial of expenses regardless of the low-taxed constituent entity's local tax position. While most top-up tax would have already been collected under the QDMTT or IIR, and the UTPR rules would only apply in limited circumstances, it would be prudent for Hong Kong to adopt a wait-and-see attitude to observe how other jurisdictions implement the UTPR before making any further decisions.

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)*

   We agree that, in determining whether an entity is located in Hong Kong for the purpose of collecting top-up tax, incorporation in Hong Kong should not be the sole criterion. As the CP notes, some entities are created outside Hong Kong, but carry on business or are managed or controlled in Hong Kong. We therefore agree with the proposed alternative criterion of "normally managed or controlled in Hong Kong". However, we suggest that guidance be given on what this concept means, such as through a list of indicative factors as to what constitutes normal management or control, either in the legislation itself or in IRD guidance. In addition, we recommend that the IRD seek confirmation from the OECD that the definition of "tax resident" for GloBE rules purposes should encompass not only entities *prima facie* fully "liable to tax" on their worldwide income or "subject to tax" in a jurisdiction, but should also extend to entities that meet the "tax resident" criteria as defined and interpreted by the domestic tax authority, a definition which should be acknowledged by other jurisdictions.

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)?*

   Retrospective legislation can raise issues of legal, and in this case tax certainty. However, provided that the retrospective application of the meaning of a Hong Kong resident entity does not result in businesses incurring a tax liability that they were not in a position to foresee, we have no objection to this proposal.

<u>Calculation of Effective Tax Rate (Chapter Four)</u>

5. *Are there any uncertainties that could be clarified in Inland Revenue Department's ("IRD") administrative guidance regarding the following:*

   - *adjustments made to the financial accounting net income or loss;*
   - *the rules relating to covered taxes;*
   - *the mechanism to address temporary timing differences;*
   - *post-filing adjustments?*

As noted in our General Comments above, the proposed new rules set out in the CP are extremely complex, and will present a compliance challenge even for large MNEs. We therefore recommend that IRD gives the fullest possible guidance on the above matters, and the new rules generally. We also recommend that IRD includes a standardised calculation template of Effective Tax Rate in the draft legislation or guidelines to ensure consistent understanding among taxpayers as well as to reduce the compliance burden they face.

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")?*

   See answer to Question 5 above.

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?*

   See Answer to Question 5 above.

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)*

   We have no views on this issue at this stage.

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)*

   In the interests of legal and tax certainty, it is important for the Hong Kong rules to follow the GloBE rules as closely as possible, as the CP proposes. It is also important (as also proposed) to secure the availability of the QDMTT safe harbour.

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

    We support the CP's proposal to allow the group to designate one or more constituent entities to pay the HKMTT. This would provide welcome flexibility. This flexibility should also be extended to top-up tax liabilities under IIR and UTPR.

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

    We agree with and support the adoption of local financial accounting standard for the purposes of the HKMTT. This will ease the compliance burden of Hong Kong entities in a Group that prepare and file their profits tax return based on the local financial accounting standard, as well as making it easier for the IRD to verify the HKMTT return. Furthermore, for entities that are not required to produce audited financial statements in Hong Kong, we appreciate the Government's / IRD's confirmation that it is sufficient for such entities' financial accounts to be consistent with or the same as that would have been prepared under the local financial accounting standard in Hong Kong.

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)*

    We support these proposals. To maintain Hong Kong's international tax competitiveness, it is crucial that its tax rate does not exceed 15%, and that the proposed exclusions are adopted.

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)*

    We have no views on this issue at this stage.

<u>Simplification (Chapter Eight)</u>

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)*

    This is an important and necessary simplification, and follows the practice in other jurisdictions: we support the proposal.

    The transitional country-by-country reporting safe harbour is intended to simplify reporting until the detailed GloBE rules are fully implemented. Preparing and filing a GloBE Information Return ("GIR") may counteract this intention for entities not obligated to perform comprehensive GloBE computations. Therefore, if the transitional country-by-country reporting safe harbour tests have been satisfied and applied, it would be preferable if an MNE only needs to file a simplified notification to the IRD.

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)*

    Yes - see answer to Question 14 above.

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)*

    We have no views on this issue at this stage, but would make the general point that, in the interests of legal and tax certainty, it would be appropriate to follow the GloBE rules as closely as possible. In addition, we would appreciate if the tax authorities provide specific examples illustrating the application of the four conditions as mentioned in para 8.10 regarding the switch-off mechanism.

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)*

    We would welcome further guidance on, and clarification of, what is meant by "data points required in the GIR" (para 9.9).

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)*

    It is a positive step in principle to allow a period of time after the notice of assessment is issued for paying the top-up tax (as proposed in para 9.15), as opposed to other jurisdictions, including the UK, Canada and Ireland, which require the top-up tax to be paid on or before the filing deadline of the GIR. However, we recommend that a period of two months rather than the proposed two weeks would be more reasonable, as we understand is the case in the Netherlands.

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)*

    Yes, we have strong views on this issue. The CP notes the OECD's recommendation that jurisdictions 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. We strongly support this recommendation. It will take a significant amount of time and resources for both companies and tax authorities to fully understand the new rules and their application, and to establish robust compliance and reporting systems, especially during the initial years of the new regime. There should be no question of a company being subject to a penalty during this period (we would suggest at least three years) if it has taken reasonable measures to comply with the rules.

    However, we do not believe that IRD's proposal (para 9.22) to adopt the existing mechanism in section 82A, whereby the taxpayer can make representations before a penalty is imposed, provides sufficient comfort to companies in this respect. In particular, it is not clear what IRD would regard as "reasonable excuse" under para 9.20 (a) and (b). (We agree that no relief is appropriate where a taxpayer makes an incorrect filing wilfully with intent to

evade tax under para 9.20(c)). Typically, a mistake in understanding the law would not normally be regarded currently as a reasonable excuse. However, given the complexity of the new rules, a good faith misunderstanding of them might be precisely the reason for the non-filing, or late or incorrect filing. No penalty should be imposed in this situation, and this needs to be made clear, to give companies sufficient comfort.

We would suggest that, given the uncertainties as to what would constitute a "reasonable excuse", the IRD should not be entitled to impose a penalty as soon it takes the view (after giving the taxpayer the opportunity to make representations) that there is no such excuse, as currently proposed in para 9.20 (a) and (b). A better and fairer approach to these scenarios, in our view, would be to provide that IRD should (after giving the taxpayer the opportunity to make representations) first issue the taxpayer with a warning notice, specifying the (reasonable) steps that it requires the taxpayer to take to comply with the new rules. Only if the taxpayer fails to comply with a warning notice should IRD then be entitled to impose a penalty.

In this respect, reference could be drawn from the concept of a Warning Notice under the Competition Ordinance (Cap 619).[2] In that Ordinance, even if there is a failure to comply with a Warning Notice, the Competition Commission cannot impose a penalty directly: only the Competition Tribunal can do so, upon the application of the Commission. *A fortiori*, we submit that our above suggested approach is reasonable, given IRD's power to impose penalties directly.

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)*

In addition to the above comments contained in our answer to Question 19, we would appreciate clarifications on the roles and responsibilities of the designated local entity ("DLE") as set out para 9.10 of the CP such as whether the DLE is solely an administrative facilitator to file the top-up tax return to the IRD or, on the contrary, responsible for data accuracy, record keeping, handling potential queries/ audits, lodging objections and appeals, etc. of other group entities. To the extent that the DLE is merely a facilitator to ease the filing requirement, the DLE should not be held responsible for the tax obligations and any penalties for wrongdoings and non-compliance of the other constituent entities.

Where feasible under the OECD framework, it is recommended that the ultimate parent entity or the DLE should only be liable to the Allocable Share (as determined under article 2.2.1. of the OECD Model GloBE Rules) of the top-up tax attributable to partially owned constituent entities. Otherwise, the proposed "joint and several" top-up tax liability may prejudice the economic interest of the majority shareholders who should not be held liable to the full amount of top-up tax of the partially owned constituent entities.

[2] At section 82.

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.?*

    We have no views on this issue at this stage apart from those contained in our answer to Question 20 above.

Mandatory Electronic Filing of Profits Tax Return

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?*

    We have no objection in principle to mandatory e-filing. However, it is important that IRD gives businesses as much assistance as possible in making this transition. For example, IRD could consider introducing a test run for e-filing, and grant penalty reliefs for incorrect filing during an initial transitional period (particularly since it appears that no modification to a return is possible once it is submitted).

Other Comments

a. Review the Tax Incentives to Enhance Hong Kong's Competitiveness

    In implementing the GloBE rules and HKMTT which imposes a 15% minimum tax on certain MNEs, jurisdictions face fundamental changes to their tax systems. These changes limit the room for tax competition in jurisdictions like Hong Kong as the top-up taxes almost nullify various preferential tax treatment, such as non-taxable capital gains and R&D super deductions, available to entities in Hong Kong that fall within the scope of these rules.

    While the CP emphasizes the Government's commitment to adhere to the principle of upholding Hong Kong's simple, certain and low tax regime with regard to tax competitiveness, it has no mention of the need for a review of Hong Kong's approach to tax incentives to boost its competitiveness.

    Specifically, Qualified Refundable Tax Credits ("QRTCs"), which are refundable in cash or cash equivalents within four years, would benefit from more favorable treatment. Unlike other credits that reduce Covered Taxes, QRTCs are treated as additional income under the GloBE rules and therefore have a less significant impact on jurisdictional ETR. In a Pillar Two environment, it is crucial for Hong Kong to maximize the utilization of QRTCs to mitigate the negative impact of tax incentives on ETR and enhance their overall effectiveness.

b. Retrospective Application of GloBE Rules in Hong Kong

Many other jurisdictions have implemented the rules effectively from 1 January 2024. If taxpayers could elect to file the GIR (or similar) with the IRD from 2024 onwards voluntarily, it would allow in-scope MNEs, especially those headquartered in Hong Kong, to satisfy GloBE Rules compliance obligations solely in Hong Kong, without the need to file the GIR (or similar) with overseas tax authorities. This flexibility would be welcomed, considering a similar arrangement was made when the country-by-country reporting was first introduced in Hong Kong.

HKGCC Secretariat
March 2024