2024/25 Hong Kong Budget Commentary

Overview

On 28 February 2024, Mr. Paul M Chan, the Financial Secretary of Hong Kong, delivered his eighth budget speech to the Legislative Council.

Hong Kong's economy rebounded in 2023, with its GDP grew by 3.2 percent in real terms over 2022. Private consumption expenditure and inbound tourism are the key drivers of the revival of the Hong Kong economy, supported by rising household income and the government's various initiatives in the year 2023. After the removal of anti-epidemic measures, flights and other handling capacity continue to recover, coupled with the government's efforts to promote mega events, private consumption expenditure and inbound tourism are expected to continue to underpin economic growth for Hong Kong. Meanwhile, the overall inflation stayed moderate. The inflation rate for the year 2023 is 1.7%, which is the same as 2022. At the same time, the labour market continued to improve in 2023. The unemployment rate for the year 2023 stands in a low level at 2.9%, which is lower than 3.4% in 2022.

Looking ahead, the external environment at large remains unfavourable. Factors including the persisting geopolitical tensions, tight financial conditions and economic uncertainties would continue to weigh on exports of goods, and investment and consumption sentiment. However, different economic indicators of the Mainland have continued to improve. Together with different supporting measures launched by the Hong Kong Government to support different industries to recover to a level before COVID-19, it is expected that the Hong Kong economy would be optimistic in the near future.

The budget deficit of 2023/24 is HKD101.6 billion, which is HKD47.2 billion higher than the original deficit projection of HKD54.4 billion. At a time when the Hong Kong Government is striving to boost economic development and attract enterprises and talent, the actual circumstances and current development have been taken into account, when they consider measures to raise government revenue. As such, the budget has proposed the following relief measures:-

Highlights

	Proposed fiscal/ tax measures
1	Reduce profits tax, salaries tax and tax under personal assessment for 2023/24 by 100 percent, subject to a ceiling of HKD3,000
2	Waive rates for residential properties and non-residential properties for the first quarter of 2024/25, subject to a ceiling of HKD1,000
3	Cancelation of Special Stamp Duty, Buyers' Stamp Duty and New Residential Stamp Duty for any residential property transactions
4	Allow tax deduction for expenses incurred in reinstating the condition of the leased premises to their original condition starting from 2024/25
5	Implementing a two-tiered standard rates regime for salaries tax and tax under personal assessment which the portion of taxpayer net income exceeding HKD5 million under standard rate will be subject to 16% of tax rate starting from 2024/25
6	Increase annual business registration fees by HKD200 to HKD2,200 starting from 1 April 2024

	Policies for long-term development
1	Introduction of block trading from the Mainland, inclusion of RMB counters under the Southbound Stock Connect, and expansion of the mutual-market access regime to cover Real Estate Investment Trusts, bringing in more enterprises and capital to the Hong Kong market
2	Continue to build collaborative framework on cross-boundary credit referencing
3	To propell the development of digital economy in Hong Kong, Cyberport is expediting the establishment of an AI Supercomputing Centre to meet the demand of industry for computing power and to launch a three-year AI Subsidy Scheme to support industry and to encourage AI experts, enterprises and R&D projects to come to Hong Kong

<u>Hong Kong to Implement Global Minimum Tax and Hong Kong Minimum Top-up Tax</u>

On 21 December 2023, the Hong Kong Government published a consultation paper on the implementation of global minimum tax and qualified domestic minimum top-up tax ("QDMTT"), known in Hong Kong as Hong Kong Minimum Top-up Tax ("HKMTT"). The legislative framework for the consultation paper stem from Pillar Two of the international tax reform framework of a two-pillar solution to tackle the base erosion and profit shifting risks ("BEPS 2.0") that is promulgated by the Organisation for Economic Co-operation and Development ("OECD"). The consultation will last until 20 March 2024, while the legislative amendments target to be introduced into the Legislative Council in the second half of 2024 and will take effect for a fiscal year beginning on or after 1 January 2025.

Global anti-base erosion ("GloBE") rules and HKMTT

Pillar Two of BEPS 2.0 will apply to multinational enterprise ("MNE") groups with a global consolidated annual revenue of or above EUR750 million in at least two of the previous four fiscal years. It ensures that these MNEs pay a minimum tax of 15% in respect of the profits derived from every jurisdiction they operate in by imposing a top-up tax. Top-up tax is collected through the GloBE rules that consist of the following two interlocking rules:

1) the Income Inclusion Rule ("IIR") which imposes top-up tax on the parent entity of an in-scope MNE group in respect of its low-taxed constituent entities in proportion to its ownership interests in those entities. As a general rule, IIR is applied based on a top-down approach at the level of the ultimate parent entity ("UPE") and works its way down the ownership chain if the UPE is located in jurisdiction where it is not required to apply a qualified IIR. In cases where low-taxed constituent entities have a significant minority interest holder outside an in-scope MNE group, a partially-owned parent entity may has priority to apply the IIR.

2) the Undertaxed Profits Rule ("UTPR") which produces an increase of tax equivalent to the amount of remaining top-up tax not brought into charge under the IIR. The top-up tax under UTPR will be reduced by the amount of top-up tax charged under IIR for ensuring that the IIR takes priority. The UTPR top-up tax is allocated among jurisdictions based on the proportion of the value of tangible assets and the number of employees in each UTPR jurisdiction.

To forestall the ceding of taxing right to other jurisdictions, Hong Kong plans to impose HKMTT based on the GloBE mechanics, which is an application of top-up tax to domestic low-taxed constituent entities. The HKMTT imposed will be directly creditable against liabilities otherwise arising under the IIR and the UTPR, thus will not increase the tax liability of the MNE group as a whole.

Computation of top-up tax

Top-up tax for a jurisdiction is determined by multiplying the excess profits by the top-up tax percentage. The top-up tax percentage is calculated by subtracting the jurisdictional effective tax rate ("ETR") from the 15% minimum rate. Whilst the excess profits represents the net GloBE income calculated on jurisdictional basis, which is the constituent entity's financial accounting net income or loss after making certain adjustments to align the accounting measures with the tax base, minus a formulaic carve-out based on payroll costs and tangible assets (i.e. Substance Based Income Exclusion "SBIE").

$$\text{Jurisdictional Effective Tax Rate ("ETR")} = \frac{\text{Adjusted covered taxes calculated on a jurisdictional basis}}{\text{Net GloBE Income calculated on jurisdictional basis}}$$

$$\text{Jurisdictional Top-up Tax} = (\text{Net GloBE Income} - \text{SBIE}) \times (\text{Minimum rate} - \text{ETR}) - \text{QDMTT}$$

De minimis exclusion

A de minimis exclusion applies where there is a relatively small amount of revenue and income. When the exclusion applies, the top-up tax for the constituent entities located in the jurisdiction shall be deemed to be zero, such that the MNE group would not need to compute the ETR of the constituent entities located in that jurisdiction. De minimis exclusion applies by election on an annual basis.

The two conditions for a jurisdiction to be eligible for the de minimis exclusion are as follows:-

1) the average GloBE revenue for the MNE group in that jurisdiction for the current and two preceding fiscal years is less than EUR 10 million; and
2) 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.

Transition rules and safe harbours

The GloBE rules provide certain transition rules and safe harbours to relieve compliance burden for MNE groups from performing full GloBE calculations when certain conditions are met. The Hong Kong Government proposes to provide the following transition rules and safe harbours.

<u>MNE groups in their initial phase of international activities</u>

As a transitional relief, UTPR will not apply to MNE groups which are in their initial phase of international activity. An MNE group is in its initial phase of international activities 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 (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 GloBE scope) does not exceed EUR 50 million. The relief applies on an annual basis and expires after an MNE group has been in scope of the GloBE rules for five years starting at the time the UTPR comes into effect. The Hong Kong government proposes to adopt the optional provision that the relief will not apply if Hong Kong is the reference jurisdiction of an in-scope MNE group.

<u>Transitional – Country-by-Country Reporting (“CbCR”) safe harbour</u>

The CbCR safe harbour operates through the use of simplified jurisdictional revenue and income information contained in the MNE’s qualified CbC report and jurisdiction tax information contained in its qualified financial statements. For a fiscal year falling within the transitional period (i.e. fiscal years beginning on or before 31 December 2026 but not including a fiscal year that ends after 30 June 2028), top-up tax in a jurisdiction will be deemed zero if the group can satisfy one of the following tests:-

1) 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

2) 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; or

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

<u>Permanent – QDMTT safe harbour</u>

The possibility of variations between QDMTT and the GloBE rules may give rise to two separate calculations of top-up tax in respect of the same jurisdiction. The QDMTT safe harbour, when applicable, will eliminate the need for a MNE group to undertake a second calculation under the GloBE Rules after completing the QDMTT calculation.

Tax compliance

An in-scope MNE group will be required to file an annual notification within 6 months after the end of the fiscal year and a top-up tax return for the purpose of the GloBE rules and HKMTT no later than 15 months after the last day of the reporting fiscal year. The filing deadline of the top-up tax return will be extended to 18 months for the transition year. The MNE Group may designate one Hong Kong constituent entity to furnish the top-up tax notification and return, otherwise each Hong Kong constituent entities of the MNE Group will be required by default to comply with the top-up tax filing requirement. To facilitate the filing compliance, the Inland Revenue Department will develop an electronic platform for submission of notification and returns, sending and receiving messages, etc.

Recommendation

As the GloBE rules and HKMTT are scheduled to implement in Hong Kong in 2025, in-scope MNE groups should consider whether their Hong Kong constituent entities could meet with the transitional rules and safe harbours available under the framework. If not, the in-scope MNE groups should analysis in advance the potential impact that would bring by the implementation of the GloBE rules and HKMTT, and allocate resources to support the implementation of the tax compliance.

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The Aoba & Hopkins Group consists of CPA firms and full service consulting firms located in Hong Kong, Guangzhou and Beijing that have been providing quality and efficient professional services to our valued clients aboard and at home since 1989.

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