PKF
Hong Kong

Hong Kong Tax Update: The New Pillar Two Tax Regime

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Introduction

Subsequent to Hong Kong's commitment to the Organisation for Economic Co-operation and Development's ("OECD") Base Erosion and Profit Shifting (BEPS) 2.0 framework, the Inland Revenue (Amendment) (Minimum Tax for Multinational Enterprise Groups) Ordinance 2025 was enacted on 6 June 2025. Starting from 1 January 2025 (the Year of Assessment 2025/26), this legislation introduces a global minimum tax and a Hong Kong Minimum Top-up Tax ("HKMTT"). The primary objective is to ensure that large multinational enterprise ("MNE") groups operating in multiple jurisdictions pay a minimum level of tax on income arising in each jurisdiction where they operate, thereby curbing artificial profit shifting and establishing a global minimum tax floor.

Covered Taxpayers and the Definition of an MNE

The new regime applies to constituent entities of an MNE group operating in Hong Kong. For the purposes of Pillar Two, an MNE group is generally defined as a multinational enterprise that operates as a consolidated group for financial accounting purposes and includes at least one entity or permanent establishment located in a jurisdiction different from that of its ultimate parent entity.

To fall within the scope of these new rules, the MNE group must also meet a specific financial threshold: it must have an annual consolidated group revenue of EUR 750 million or more in at least two of the four fiscal years immediately preceding the tested financial year. Entities that meet both the structural and financial criteria are considered "in-scope" and are subject to the new global minimum tax requirements.

Covered Tax Mechanisms: The GloBE Rules & HKMTT

The Pillar Two framework primarily consists of the Global Anti-Base Erosion ("GloBE") Rules, which include the Income Inclusion Rule ("IIR") and the Undertaxed Profits Rule ("UTPR"), and domestic mechanisms like the HKMTT. They interact as a highly coordinated system to ensure an MNE group pays at least a 15% effective tax rate ("ETR") on its income globally.

- **Hong Kong Minimum Top-up Tax (HKMTT)**: This is Hong Kong's implementation of a Qualified Domestic Minimum Top-up Tax ("QDMTT"). It is designed to take priority over the IIR and UTPR. If the aggregate jurisdictional ETR for all in-scope constituent entities in Hong Kong falls below 15%, the HKMTT ensures that Hong Kong exercises its primary right to collect the top-up tax locally, rather than allowing another jurisdiction to collect it under the GloBE Rules.

- **Income Inclusion Rule (IIR)**: Serving as the primary GloBE Rule, the IIR requires a Hong Kong parent entity to pay top-up tax on the profits of its low-taxed foreign subsidiaries (entities with an ETR below 15% in their respective jurisdictions), provided those foreign jurisdictions have not applied their own QDMTT.

- **Undertaxed Profits Rule (UTPR)**: This rule serves as a secondary backstop to the IIR. It ensures that any remaining top-up tax is collected in cases where the low-taxed profits are not captured by a QDMTT or an IIR (for instance, if the ultimate parent entity is located in a jurisdiction that has not implemented the GloBE Rules).

Both the HKMTT and the IIR apply from 1 January 2025, whereas the effective date for the UTPR will be announced later by the government.

Rule Hierarchy and the Prevention of Double Top-up Taxation

The GloBE Rules follow a strict hierarchy to prevent double top-up taxation while ensuring the 15% floor is met. First, the local jurisdiction has the primary right to tax its own under-taxed income (e.g. Hong Kong collects tax via the HKMTT, or a foreign country collects via its local QDMTT). Second, if a local jurisdiction does not have a QDMTT, the IIR allows the parent entity's jurisdiction to collect the top-up tax. Finally, if the parent's jurisdiction does not enforce the IIR, the UTPR kicks in as the ultimate safety net, allowing other jurisdictions where the MNE operates to collect the remaining tax shortfall.

Impact on Offshore Claims

It is critical to note how this framework impacts local tax strategies. If the aggregate jurisdictional ETR for all in-scope constituent entities in Hong Kong falls below the 15% threshold—for example, due to successfully making an offshore claim on trading or service profits under Hong Kong's territorial tax regime—Hong Kong will exercise its primary right under the HKMTT to collect a top-up tax to bridge the gap to 15%.

Filing Requirements and Deadlines

To streamline compliance, the Inland Revenue Department ("IRD") is launching a dedicated electronic Pillar Two Portal in phases starting from January 2026. If Pillar Two is triggered, each Hong Kong constituent entity must fulfill two key reporting obligations.

First, a **Top-up Tax Notification** must be filed within 6 months after the end of the relevant fiscal year to notify the IRD of the group's Pillar Two status and identify the entity responsible for filing the GloBE Information Return ("GIR"). Second, a **Top-up Tax Return** must be filed within 15 months after the end of the relevant fiscal year (extended to 18 months for the first transitional year). The necessary GIR information will be incorporated directly into this return.

The obligation to file the GIR information will be relieved if such information is filed in a jurisdiction that will be able to exchange GIR information with Hong Kong under a qualifying competent authority agreement.

To alleviate administrative burdens, MNE groups are permitted to designate a single local constituent entity to file these documents on behalf of all other Hong Kong entities within the group. Failure to file constitutes an offence, subject to a fine of HK$10,000 plus a further penalty of treble the amount of the top-up tax undercharged, alongside potential court orders.

Safe Harbours

To further reduce the compliance and calculation burdens for in-scope MNE groups, the OECD has developed several safe harbours which Hong Kong has adopted. These include the Transitional Country-by-Country Reporting ("CbCR") Safe Harbour, the Transitional UTPR Safe Harbour, the QDMTT Safe Harbour, and the Simplified Calculations Safe Harbour for non-material constituent entities.

When applicable, the top-up tax for the qualifying jurisdiction is deemed to be zero. However, please note that even if a safe harbour applies, the relevant Hong Kong constituent entities are still strictly required to file the mandatory Top-up Tax Notifications and Top-up Tax Returns.

How PKF Can Help

Our tax professionals have deep knowledge of the tax and accounting advisory aspects of Pillar Two. We are well-positioned to deliver the highest standard of services to help your organization cope with the new regime:

Consultation: We provide detailed advice on the Pillar Two framework, including the operation of the HKMTT, IIR, and UTPR, and how these rules interact with your existing offshore claims and overall tax profile.

Risk evaluation & impact assessment: Our team will review the current holding and operating structure of your MNE to identify at-risk jurisdictions. We can model your top-up tax liabilities and evaluate the potential application of CbCR and QDMTT safe harbours to minimize your exposure.

Operational readiness: We assess your data readiness, identify reporting gaps, and assist in sourcing the estimated 100+ required data points from outside your standard Enterprise Resource Planning (ERP) systems. We also help you establish a feasible compliance model and designate key responsibilities among internal group functions.

Compliance & reporting: Our professionals prepare the complex ETR calculations for each jurisdiction, draft and review your annual Top-up Tax Notifications and Returns, manage your registration on the IRD's Pillar Two Portal, and act as your liaison in the event of tax disputes or IRD inquiries.

Contact Us

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PKF Tax and Business Advisory provides a wide range of comprehensive tax advisory services in respect of international, Hong Kong and China matters. If you require assistance in any compliance or advisory matters, please feel free to contact our teams.

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