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Initial Assessment and Analysis of the Implementation of Global Minimum Corporate Tax

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On 5 June, the Group of Seven (G7) Finance Ministers' Meeting reached a historic agreement on the implementation of global minimum corporate tax. On 1 July, the Organization for Economic Co-operation and Development (OECD) announced that 130 countries and regions around the world have agreed to this global tax reform and to levy at least 15% corporate tax rate, on a national or regional basis, on multinational corporations to prevent them from transferring their profits to other lower tax regimes. On 10 July, the Group of Twenty (G20) Finance Ministers' meeting also agreed to the reform and invited the OECD to formulate detailed implementation plan for their consideration at the October meeting, i.e. the first major global corporate tax reform for decades. If the new minimum corporate tax is to be implemented on a global scale, the next step will be formulating detailed implementation plan, obtaining legislative approval from all these countries and regions, as well as seeking supports from those not yet agreed to the reforms, etc. This article will discuss the background and content of the global minimum corporate tax reform, and assess its impact on the simple and low tax system of Hong Kong.

1. The background and content of the global minimum corporate tax reform

In the past couple of years, the global economy was seriously hit by the pandemic. Many countries and regions around the world implemented highly simulative economic policy to boost their economy, which resulted in a sharp increase in fiscal deficit and debt burdens of their governments. It is thus necessary to raise new revenue from corporations, high income and wealthy individuals in order to seek a fiscal balance. This eventually paves the way for 130 countries and regions to reach an agreement to the global minimum corporate tax reform. Take the US as an example, the US government has implemented several rounds of economic stimulus programs to provide the lost income for the corporations, individuals and households during the pandemic. It also hopes to increase spending on infrastructure facilities and technological innovations to maintain its economic competitiveness. As such, the fiscal deficit to GDP ratio will rise to 14.9%, 16.7% and 7.8% between 2020 and 2022 respectively, and the debt to GDP ratio will rise to about 130%. The Biden administration hopes to raise tax and revenue from high-income individuals and corporations, with the global minimum corporate tax be one of its measures.

Many large corporations, especially those income coming from intangible assets, such as drug patents, software and intellectual property rights, etc., have normally used tax havens or other tax regimes to lower their tax burdens. This leads to the case of unfair tax burden, which the large corporations might not have to pay tax in a region, even though they make profits there. Against this background, the Trump administration implemented a 10.5% Global Intangible Low-Taxed Income, i.e. half of the US corporate tax rate, to make up for the tax revenue lost due to the tax havens. Many European countries also introduced digital service tax as an extension of corporate tax, mainly targeting at large US technology companies. Regardless of the country in which those technology corporations are located, they will be liable to the digital service tax locally if they provide internet and technology services, including the use of local user data for advertising, online stores, social media platforms, and video streaming services, etc., in that region. As such, both the US and European countries would like to implement a more widely recognized global minimum corporate tax in order to alleviate the issue of tax base erosion, not to put their corporations at a disadvantage position, and facilitate fair competition in technological innovation, infrastructure, and other areas.

Furthermore, the US has promoted liberalism reform and substantially reduced taxes to stimulate economic growth since the 1980s. This triggered a rush to reduce corporate tax rates around the world. In 2017, the US once again reduced the corporate tax rate significantly, resulting in a reduction of the average global statutory corporate tax rate from 40.11% in 1980 to 23.85% in 2020. However, a couple of issues arose after the aggressive reduction of corporate tax rates. First, the government might need to raise sales tax or personal income tax to make up for the lost revenue due to the reduction of corporate tax rate, resulting in unfair tax burden. Second, many non-tax havens or countries and regions with normal tax rates faced the problem of tax base erosion after many countries successively lowered the corporate tax rates. Therefore, there are calls for reforms, like global minimum corporate tax, to put an end to the unhealthy competition on lowering corporate tax rates.

The statement of OECD stated that an agreement on fair distribution of taxing right has been reached, meaning that a country or region in which the market is located can levy taxes on 20% to 30% of the operating profits of those largest and most profitable multinational corporations, which have an annual global revenue of 20 billion euros and more than 10% profit margin, except extractive industries and regulated financial services. They also agreed to coordinate the implementation of new global minimum corporate tax rules and abolition of digital service tax and other similar measures, and pledged to levy at least 15% of the global minimum corporate tax based on countries or regions. Moreover, they agreed to a two-pillar agreement, i.e. ensuring the fair distribution of taxing right between countries and the large global corporations to pay at least the global minimum corporate tax, though they still have to further discuss on the implementation details and arrangements, and strive for seeking support from those countries and regions which have yet agreed to join. It is expected that the new global minimum corporate tax could be implemented in 2023 at the earliest.

According to the global minimum corporate tax framework, overseas income of multinational corporations is required to pay certain level of tax, but there are huge difference in corporate tax rates among different countries and regions for a long time. Among 223 countries and regions, 15 do not levy any corporate tax, 138 have corporate tax rates of 20% or below, and 26 have corporate tax rates of 30% or above. Thus, it is not easy to agree to a uniform global minimum corporate tax rate across the world. Before the Biden administration, the OECD advocated the use of 12.5% as the global minimum corporate tax rate. However, the US government has only actively participated in promoting the G20 to reach an agreement on the global minimum corporate tax, with a tax rate of 21% since Biden became the US President, and the US has to pay for the large-scale economic stimulus and investment programs. In May 2021, the US lowered the advocated global minimum corporate tax rate to 15% to reduce negotiation difficulty, facilitating the G7 Finance Ministers to reach a consensus in June, and further promoting the agreement among 130 countries and regions under OECD. Even though the global minimum corporate tax rate is agreed to be 15%, it might negatively affect the interest of developed countries and regions with higher tax rates. Nevertheless, the multinational corporations can no longer avoid taxes completely and is expected to bring financial benefits to the governments under the global minimum corporate tax regime.

After countries and regions around the world agree on a minimum corporate tax rate, they can still set their own corporate tax rates. If the tax rate paid by a multinational corporation or its subsidiary is lower than the global minimum corporate tax rate, its parent corporation will have to pay additional taxes to make up for the difference, depending on where it is located. The OECD estimated that the global minimum corporate tax could raise US$ 50 to 80 billion annually to the governments globally.

Even though 130 countries and regions around the world have reached agreement on global minimum corporate tax, there are still issues to be resolved. For example, the specific scope of global minimum corporate tax, whether exemption only applies to extractive industries and regulated financial services, what other industries are exempted and how to define which corporations belong to these two industries, whether it includes REITs and other investment funds, when will the new tax be applied, and how to deal with the multinational corporations from countries and regions which have yet agreed to the global minimum corporate tax reform, etc. Currently, the goal of OECD is to implement the new tax system as soon as 2023, but it is expected to take some time to formulate detailed implementation plan, obtain legislative approval from all these countries and regions, and seek supports from those not yet agreed to the reforms, etc. If countries and regions around the world could eventually implement the global minimum corporate tax in the future, it is expected to alleviate the issues related to uncoordinated and disruptive tax measures, and trade disputes, etc. This could help raise tax revenue, maintain investment stability, as well as lower the compliance and administrative costs of multinational corporations.

2. Initial impact assessment of the global minimum corporate tax on Hong Kong

Given Hong Kong long has an advantage of a simple and low tax system, there are opinions that the global minimum corporate tax could hurt Hong Kong. However, the current agreement does not include extractive industries and regulated financial services. Large US and European technology and innovation corporations rarely use Hong Kong as a base to reduce their tax burden. Moreover, Hong Kong has many advantages in its tax system and business environment, in particular the strong connection with the Mainland, further integration into the Bay Area, and interconnection between Mainland and Hong Kong's capital markets, etc. The global minimum corporate tax reform is not expected to have a significant impact on Hong Kong.

The global minimum corporate tax mainly targets at the large multinational technology corporations, but they rarely use Hong Kong as a base to reduce their tax burden. For a long time, Hong Kong does not provide any tax incentives for specific industries, such as high-technology or manufacturing industries, until more recently it provides tax incentives to promote the development of specific sectors, such as corporate treasury centers, aircraft leasing, offshore funds, and private equity funds, etc., with these specific sectors could be affected by the global minimum corporate tax reform. However, the OECD's statement mentioned that the extractive industries and regulated financial services are not included in the scope of the global minimum corporate tax agreement, and whether there will be further exemptions are still to be discussed, but its impact on Hong Kong's financial center is likely to be notably reduced. Furthermore, the global minimum corporate tax reform mainly targets at large multinational technology corporations as well as those that are the largest and most profitable. Most of them did not use Hong Kong to reduce their tax burden on income from intangible assets such as drug patents, software and intellectual property rights. Thus, Hong Kong's economy and fiscal position are not expected to face significant impact from the reform, while the actual situation will still depend on the implementation details.

Hong Kong has long been a bridge connecting the Mainland and the rest of the world. Many Mainland corporations going global might adopt offshore structures to leverage on Hong Kong's lower corporate tax rate. They normally set up regional sales centers, conduct overseas investment, go public or establish a global value chain, etc., in Hong Kong. Currently, the Mainland is one of 130 countries and regions that support OECD's global minimum corporate tax reform. After the implementation of global minimum corporate tax, intermediate entities located in lower tax regions might be required to make up for the additional taxes. This could reduce the multinational corporations' incentives to adopt offshore structures to reduce their tax burden. Nevertheless, the global minimum corporate tax rate agreed is 15%, which is 10 percentage points lower than the 25% corporate tax rate in the Mainland, but it does not differ much from 16.5% and 15% tax rates for corporations and sole proprietorships or partnerships in Hong Kong respectively. As such, those Mainland corporations using offshore structures may not have to make up huge tax difference to the Mainland authorities, and thus Hong Kong should remain attractive to them.

Furthermore, the global minimum corporate tax rate is a complicated subject, with many countries and regions also imposing taxes other than corporate tax. The difference in tax systems could not be ignored when comparing the corporate tax burden between different regions, for example, the Mainland has a standard value-added tax of 17%, and lower tax rates of 13% or below. Given taxes are levied in the production process, corporations have to pay taxes no matter they make profits or not, and thus the tax burden is particularly heavy during economic downturn. On the other hand, the US does not have value-added tax, but they levy sales tax on final customers, which brings great difference in corporate tax burden. Therefore, Hong Kong's advantage is not only its low tax rate, but also its simple tax system.

Hong Kong's advantage lies in its simple and low tax system, but not a tax haven. Hong Kong has a simple, low and transparent tax system, with the advantage of having only three direct taxes and a tax allowance system to reduce the overall tax burden. The three direct taxes are: 1) profits tax for the first HK$2 million of profits of corporations is 8.25%. Profits above that amount will be subject to the tax rate of 16.5%. For partnerships and sole proprietorships, the two-tiered tax rates will correspondingly be set at 7.5% percent and 15%, 2) salaries tax with standard rate of 15%, 3) property tax of 15%. Moreover, Hong Kong does not impose sales tax, consumption tax or VAT, withholding tax on dividends and interest, capital gains tax, dividend tax and inheritance tax, resulting in a lower tax burden for Hong Kong corporations than those in other regions.

Obviously, Hong Kong has the advantage of a simple and transparency tax system. It does not provide any special tax incentives to attract foreign investment, and has rigorous and effective anti-avoidance provisions. In addition, Hong Kong does not have a bank secrecy law, as well as complete information confidentiality, with the shareholders, directors, shareholding structure and other information of any Hong Kong-based company could be checked through the Companies Registry. Hong Kong also signed numerous information exchange agreements with multiple jurisdictions to improve tax transparency and combat tax evasion. On the other hand, tax haven generally refers to a place implementing a zero or symbolic tax rate, using complicated and opaque tax regulations or bank secrecy law to attract foreign investment which could evade taxes from other countries or regions. Therefore, the global minimum corporate tax will likely discourage those large multinational technology corporations to rely on the tax havens to reduce their tax burden, while the situation is different for Hong Kong, with its tax advantage not expected to be undermined.

The advantages of Hong Kong's business environment are not limited to low tax rates. The low tax rate is just one of the factors that corporations will consider whether to do business or invest in a place or not. Hong Kong has a number of advantages other than a simple and low tax system, including "One Country, Two Systems", free flow of capital, goods, information, and people, sound regulatory system, rule of law and judicial independence, well-functioning linked exchange rate system, and high-quality professional services, etc. Also, Hong Kong maintains a level playing field and there are no restrictions on foreign investment. Both Chinese and English are official languages, most business activities, such as contract signing and execution, are in English, and Hong Kong continues to participate in international conferences and organizations in its own name.

Leveraging on the above-mentioned institutional advantages and core competitiveness, the position of Hong Kong's international financial center remains solid. Hong Kong continues to be an international hub for financing, offshore RMB business, assets and risk management, a bridge between the Mainland and the rest of the world, and has strong commitment to promote the development of green and sustainable finance. Moreover, strong economic growth in the Mainland will be a bright spot for global economy in the future. The 14^{th} Five Year Plan calls for enhancing Hong Kong status as an international financial, shipping, trade center, and international aviation, innovation and technology hub, consolidating and enhancing Hong Kong's competitive advantages and better integrating into the nation's overall development plan. Hong Kong will enjoy the business opportunities brought by the Belt and Road initiative, the Guangdong-Hong Kong-Macau Greater Bay Area, and the increasing connection between the Mainland and Hong Kong's capital markets, offering international corporations and investors the opportunities in developing businesses in the Mainland, showing that the advantage of Hong Kong's business environment is not only limited to low tax rates.

The Hong Kong SAR government also needs to assess its long-term fiscal stability. It is believed that Hong Kong will implement the relevant regulations in relation to global minimum corporate tax according to international agreement in the future, while striving to maintain the advantage of its simple, transparent and fair tax system and reduce the compliance costs of those affected companies. However, it is still unclear about how many companies will be affected and whether all the financial services sector will be exempted. The Hong Kong SAR government can also study early whether it can provide other non-tax incentives, such as improving the regulatory and business environment, and lowering the business costs to attract more financial, technology and innovation corporations to establish and develop in Hong Kong.

Based on the current assessment, the implementation of global minimum corporate tax will not have material impact on Hong Kong's business environment, corporate tax burden, and the competitiveness of its tax system. Hong Kong has a low tax rate, and its corporations have rarely reduced their tax burden through overseas tax havens. It is believed that the new fiscal revenue that the Hong Kong SAR government could raise through the implementation of global minimum corporate tax will be rather limited. With a narrow tax base and industry structure, the fiscal revenue of Hong Kong SAR government is rather volatile, moving in tandem with the performance of its real estate and financial sectors. Moreover, Hong Kong's population is ageing rapidly, which will further increase the fiscal pressure of Hong Kong SAR government in the future. Given Hong Kong is a small and open economy, as well as an important international financial center in the region, the fiscal stability of Hong Kong SAR government is also important to maintain international confidence on Hong Kong and its linked exchange rate system. As such, there is a need to explore what is the role of fiscal policy in its economy and broader society, so as to allocate resources properly, avoid structural deficits, and maintain the stability of Hong Kong economic environment and its government fiscal position.

主要經濟指標 (Key Economic Indicators)

	2019	2020	2020/Q4	2021/Q1
一. 本地生產總值 GDP				
總量(億元) GDP($100 Million)	27,997	26,277	7,138	6,975
升幅(%) Change(%)	-1.2	-6.1	-2.8	8.0
二. 對外貿易 External Trade			**2021/6**	**2021/1-6**
外貿總值(億元) Total trade($100 Million)				
總出口 Total exports	40,961	39,275	4,066	22,915
進　口 Total imports	45,714	42,698	4,471	24,371
貿易差額 Trade balance	-4,753	-3,422	-405	-1,656
年增長率(%) YOY Growth(%)				
總出口 Total exports	-5.6	-1.5	33.0	30.0
進　口 Imports	-8.1	-3.3	31.9	26.8
三. 消費物價 Consumer Price				
綜合消費物價升幅(%) Change in Composite CPI(%)	2.9	0.3	0.7	1.0
四. 樓宇買賣 Sale & Purchase of Building Units				
合約宗數(宗) No. of agreements	74,804	73,322	9,381	50,336
年升幅(%) Change(%)	-5.5	-2.0	13.7	53.7
五. 勞動就業 Employment			**2021/3-2021/5**	**2021/4-2021/6**
失業人數(萬人) Unemployed(ten thousands)	139	259.1	23.3	21.3
失業率(%) Unemployment rate(%)	2.9	5.5	6.0	5.5
就業不足率(%) Underemployment rate(%)	1.1	3.1	2.8	2.5
六. 零售市場 Retail Market			**2021/6**	**2021/1-6**
零售額升幅(%) Change in value of total sales(%)	-11.1	-24.3	5.8	8.4
零售量升幅(%) Change in volume of total sales(%)	-12.3	-25.5	2.8	7.1
七. 訪港遊客 Visitors				
總人數(萬人次) arrivals (ten thousands)	5,590	356.9	6.2	33.7
年升幅(%) Change(%)	-14.2	-93.6	-57.6	-99.0
八. 金融市場 Financial Market			**2021/5**	**2021/6**
港幣匯價(US$100=HK$) H.K. Dollar Exchange Rate (US$100 = HK$)	779.3	775.2	776.2	776.7
貨幣供應量升幅(%) change in Money Supply(%)				
M1	2.6	30.1	29.6	36.2
M2	2.8	5.8	7.1	7.5
M3	2.7	5.8	7.1	7.5
存款升幅(%) Change in deposits(%)				
總存款 Total deposits	2.9	5.4	7.3	7.9
港元存款 In HK$	2.5	6.2	8.9	11.5
外幣存款 In foreign currency	3.2	4.6	5.7	4.2
放款升幅(%) in loans & advances(%)				
總放款 Total loans & advances	6.7	1.2	0.9	5.2
當地放款 use in HK	7.1	1.7	2.1	8.6
海外放款 use outside HK	5.8	0.1	-1.9	-2.6
貿易有關放款 Trade financing	-0.7	-6.2	3.0	14.5
最優惠貸款利率(%) Best lending rate (%)	5.0000	5.0000	5.0000	5.0000
恒生指數 Hang Seng index	28,189	27,231	29,152	28,828