

Paper for the Bills Committee

Inland Revenue (Amendment) Bill 2000

**Administration's Response to Concerns Raised at
the Meeting on 13 November 2003**

PURPOSE

This paper sets out the Administration's response to enquiries and concerns raised by the members in the meeting on 13 November 2003.

BACKGROUND

2. At the meeting on 13 November 2003, members enquired about the reasons and effects of clauses 9 to 13 of the Bill together with the relevant proposed CSAs in respect of initial and annual allowances for commercial and industrial buildings and structures. In particular members were concerned that the definitions of industrial and commercial buildings and structures under the Inland Revenue Ordinance, Cap. 112 (the Ordinance) were not consistent with those commonly adopted in other legislation.

3. Members were also concerned about the retrospective application arrangement for the proposed amendments in clauses 4 and 8 of the Bill, namely the six-year time limit for a taxpayer to request correction of an assessment under the existing law.

INDUSTRIAL AND COMMERCIAL BUILDINGS AND STRUCTURES

Purpose of the amendments proposed in clauses 9 to 13

4. Under the existing law, where a commercial building previously used as an industrial building is sold, only the allowances granted in respect of the building's use as a commercial building are taken into account in determining the balancing allowance or charge. The industrial building

allowances previously granted are ignored. The same position applies when an industrial building previously used as a commercial building is sold. This is not our policy intention. As it is now quite common for industrial buildings to be converted into commercial buildings, the existing provisions are vulnerable to abuse through deliberate tax planning.

5. Accordingly, the Bill proposes to amend the Ordinance to the effect that any initial, annual and balancing allowances granted, and balancing charges made, whether for industrial or commercial building, will be taken into account. The purposes and the intended effects of clauses 9 – 13 of the Bill are set out in paragraphs 19 – 24 of Legislative Council Brief (Paper reference: FIN CR 1/2306/00).

Definitions of Industrial and Commercial Buildings and Structures

6. Commercial buildings and structures and industrial buildings and structures are specifically defined in section 40 of the Ordinance. For the calculation of depreciation allowances for tax purposes, a “commercial building or structure” means any building or structure other than an industrial building or structure. Whereas, an “industrial building or structure” means any building or structure used for the purpose of what is commonly called a qualifying trade, which is set out in the definition. Manufacturing, processing and public utilities enterprises are examples of qualifying trades.

7. It is worth noting that under the Ordinance whether a building or structure is considered as an industrial building or structure or as a commercial building or structure is determined by the nature of the trade or business carried on by the person who uses the building or structure. The permitted use of the building or structure as provided for under the government lease and other covenants on the land or building, as well as other legislation are not relevant in this regard. Neither will the actual use to which a building or structure is put be a decisive factor. Thus a unit in a factory building is regarded as an industrial building or structure if it is owned and used by a manufacturer as a warehouse. However, if the property owner has changed the nature of his business from a manufacturing business to a trading concern, the unit will be changed from being an industrial building to a commercial building for tax purposes, even if it is still used as a warehouse and the permitted use of building under the government lease is still for industrial purposes.

Examples of changes in use of buildings

8. In the past few decades, many manufacturing concerns in Hong Kong have moved the manufacturing part of their business to the Mainland of China, leaving those parts dealing with product designs, accepting orders and promoting sales in Hong Kong. A common example is as follows. A manufacturing company, which used to operate a factory in Hong Kong in a factory building for 10 years, moved the manufacturing process of its factory to a subsidiary company set up in the Mainland of China. The company in Hong Kong has continued operations by way of soliciting and accepting orders and has turned the factory premises in Hong Kong into a warehouse and show room for displaying samples to potential buyers. Since the business has been changed from a manufacturing business to a trading business, the factory premises has, for tax purposes, been changed from an industrial building to a commercial building.

The Purposes and Effects of the CSAs on Clauses 9 and 13

Clause 9 of the Bill

9. Clause 9 of the Bill proposes amendments to section 33A of the main Ordinance so that the method of computation of annual allowance in respect of commercial buildings and structures as set out in subsection (2) of that section applies to a buyer of a building or structure regardless of whether the building or structure is a commercial building or structure at the time of the sale. It also proposes some tidying up amendments to the section. Section 33A was introduced in 1998 to replace the old scheme of granting rebuilding allowances on commercial buildings. There are references in the section to the commencement of that section (i.e. the commencement of the Inland Revenue (Amendment) (No. 2) Ordinance 1998) and the year of assessment in which the section commenced (i.e. 1998/99). After the section is amended by this Bill, these references may become ambiguous as to whether such references are referring to the commencement of the section amended by the current Bill or to the commencement of the old section before the amendment. To avoid doubts, a CSA is introduced to add paragraphs (b)(iii) and (c) to this clause to clarify that the references are not affected by this Bill.

Clause 13 of the Bill

10. The CSA proposes technical refinements to the amendments made to the definition of "residue of expenditure" in section 40(1) of the Ordinance so as to allow the balancing adjustments made under the existing section 33B (for commercial buildings), which will be repealed by this Bill, to be reflected in computing the residue of expenditure computation; and to build in the effect of the transitional arrangement of the 1998 legislative amendment to the depreciation allowance scheme for the commercial buildings (which provides for a deemed capital expenditure for a commercial building that was owned by a person immediately prior to the commencement of section 33A) in the computation.

RETROSPECTIVE APPLICATIONS TO THE AMENDMENTS ON PROVISIONS FOR DEDUCTIONS OF HOME LOAN INTEREST AND SELF-EDUCATION EXPENSES

11. The Administration will, as suggested by ALA, propose CSAs to make specific saving provisions for application of deduction of home loan interest under clause 8 in relation to the year of assessment 1998/99 and subsequent years and of deduction of self education expenses under clause 4 in relation to the year of assessment 2000/01 and subsequent years.

Financial Services and the Treasury Bureau

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