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財 經 事 務 及 庫 務 局
(庫 務 科)
香 港 下 亞 厘 畢 道
中 區 政 府 合 署



FINANCIAL SERVICES AND THE
TREASURY BUREAU
(The Treasury Branch)
Central Government Offices,
Lower Albert Road,
Hong Kong

傳真號碼 Fax No. : 2530 5921
電話號碼 Tel. No. : 2810 2370
本函檔號 Our Ref. :
來函檔號 Your Ref. : CB1/PL/FA

10 March 2010

Ms Anita Sit
Clerk to Panel on Financial Affairs
Legislative Council Secretariat
Legislative Council Building
8 Jackson Road
Central
Hong Kong
(Fax : 2121 0420)

Dear Ms Sit,

Panel on Financial Affairs
Motion on “Depreciation allowances in respect of
machinery or plants under import processing arrangements”
passed by the Panel at its special meeting
held on 14 December 2009

Thank you for your letters of 14 and 16 December 2009. The Administration’s response to the motion is provided below.

Item 1

Section 39E of the Inland Revenue Ordinance (“IRO”) is a specific anti-avoidance provision. It is applicable to any commercial arrangement falling within the specific scope of the provision, irrespective of whether there is “an intention to avoid tax”. The Inland Revenue Department (“IRD”) cannot enforce this provision selectively. Applying different criteria for tax assessment to different taxpayers would be in violation of the principles of fairness and neutrality under our tax system.

Item 2

The IRD has all along been implementing section 39E of the IRO in accordance with the legislation. The IRD's interpretation and practice of the provision have been accepted by the Board of Review. In the decision of a relevant case, the Board pointed out that section 39E did not stipulate that there should be "an intention to avoid tax" for the application of the provision.

Item 3

Noting the restructuring of Hong Kong enterprises in the Pearl River Delta region in recent years, we understand that the industry would like to continue to enjoy the deduction of depreciation allowances in Hong Kong under import processing arrangements. However, if the restriction under section 39E is relaxed, the completeness of the anti-avoidance provisions in the IRO would be affected. There are also practical difficulties in the implementation and the provision could easily be abused, resulting in substantial tax loss.

In view of the above, we have no plan to amend section 39E at this stage. Nonetheless, in response to the request of the industry, we have invited the Joint Liaison Committee on Taxation to study the issue of section 39E. After completion of the study, we would be pleased to consider any practical and feasible recommendations by the Committee to address the concerns of the industry and the Administration.

Yours sincerely,



(Ms Shirley Kwan)
for Secretary for Financial Services
and the Treasury

c.c. CIR (Attn: Mr Wong Kuen-fai) Fax : 2511 7414