



香港工業總會
FHKI

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Federation of Hong Kong Industries

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Hon Chan Kam-lam, SBS, JP
Chairman
Panel on Financial Affairs
Legislative Council
Legislative Council Building
8 Jackson Road
Hong Kong

CB(1)662/09-10(01)

Dear Mr Chan,

**Depreciation Allowances for Profits Tax in respect of
Machinery or Plant under the Inland Revenue Ordinance**

Thank you for inviting us to attend the special meeting of the Panel on Financial Affairs held on 14 December 2009 and to give views on the above issue.

As a trade association representing the interests of Hong Kong manufacturers, the Federation of Hong Kong Industries is deeply concerned about the application of section 39E of the Inland Revenue Ordinance, which as is currently interpreted by the Inland Revenue Department covers any machinery or plant used wholly or principally outside Hong Kong by a person other than the taxpayer, despite that the machinery or plant is owned by the taxpayer. This implies that Hong Kong manufacturing companies engaged in import processing trade (進料加工), which is becoming the predominant form of foreign investment in the Mainland in the processing industry, would be denied any depreciation allowances for their plant or machinery (including moulds) used by their Mainland factories against their profits chargeable to Hong Kong tax.

Apparently, applying section 39E to such manufacturing companies does not quite accord with the general principle of Hong Kong's tax regime that taxpayers should be entitled to relief for costs incurred in generating taxable revenue. This is particularly so in the case of moulds used to generate profits that are chargeable to Hong Kong profits tax. Under normal circumstances, such moulds are used by their Mainland factories temporarily and returned to the Hong Kong taxpayers owning them upon completion of the manufacturing process of the relevant products.

To us, it also seems unreasonable that, where a Hong Kong manufacturing company which is able to claim 50:50 apportionment under a contract processing arrangement (來料加工) is permitted to also claim 50 per cent of the depreciation allowances for its plant or machinery used by its Mainland factory, whereas where one is deemed to be taxable in

Hong Kong on 100 per cent of its profits (under an import processing arrangement), it is not permitted to claim any depreciation allowance at all. In this connection, it is worth noting that the *modi operandi* of contract processing and import processing are essentially the same, where a Hong Kong manufacturing company supplies raw materials or parts and components to its Mainland factory for processing, on the condition that all of the manufactured goods are to be exported and not to be sold at the Mainland's domestic market.

We understand that when section 39E was first enacted in 1986, it was intended only as a safeguard against tax avoidance. Although the subsequent amendments to section 39E widened its application, its purpose has hitherto remained unchanged, as pointed out in the written reply by the Secretary for Financial Services and the Treasury to the question by a member of the Legislative Council on 25 November 2009 that "section 39E ... is a specific anti-avoidance provision." In light of this and considering that import processing arrangements are unrelated whatsoever to tax avoidance, we do not find it appropriate for the Inland Revenue Department to invoke section 39E to disallow manufacturing companies claiming the relevant depreciation allowances.

In view that more Hong Kong manufacturing companies with production facilities in the Mainland are shifting from contract processing to import processing in order to adapt to the new industrial policies introduced by the Mainland Government, we strongly urge the SAR Government to promptly address their concerns about the application of section 39E. If necessary, legislative amendments should be made to rectify the anomaly in the Inland Revenue Ordinance.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Cliff K. Sun', with a stylized flourish at the end.

Cliff K Sun, SBS, JP
Chairman