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Hong Kong, December 9th, 2009

The Honourable Chan Kam-lam
Chairman of the Legco's Panel on Financial Affairs
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Sir,

We are writing this letter to you because we learned that a special meeting of the Panel on Financial Affairs of the Legislative Council will be held on December 14th 2009, to discuss the concerns of taxpayers, as regards the denial of tax depreciation allowances, under section 39E, for plant and machinery used wholly or principally outside Hong Kong.

As we are currently discussing such a case with Inland Revenue Department (IRD), we thought it could be useful to alert you on the current position of IRD that we do not understand.

SEB Asia Ltd is a company incorporated in Hong Kong and is principally engaged in the distribution of cookware products and small electrical household appliances. SEB Asia Ltd ultimate holding company is SEB S.A., which is incorporated in France, where the central management of Groupe SEB sits.

1. Mode of operation

Prior to 2005, SEB Asia Ltd was mainly engaged in purchasing products from industrial fellow subsidiaries and unrelated suppliers and selling the same to unrelated Hong Kong and Taiwan customers. SEB Asia Ltd was acting :

- as a distributor of the Groupe SEB's products sold in Hong Kong and Taiwan,
- as a sourcing agent of finished products and components in the PRC (i.e. no sales and purchases recorded in the books of SEB Asia Ltd regarding the sourcing activity).

Since January 1st 2005, SEB Asia has been acting as the central purchasing office of Groupe SEB, in addition to the activities mentioned above. This means that SEB Asia Ltd has been interposed between the unrelated PRC suppliers and all fellow subsidiaries engaged in the sales of finished goods in their local markets (Overseas Commercial Fellow Subsidiaries), so that it could be in control of the global sourcing functions of Groupe SEB.

SEB Asia Ltd consolidates the orders and purchase forecasts from all Overseas Commercial Fellow Subsidiaries and places orders to the unrelated PRC suppliers accordingly. Upon completion of the production, the PRC suppliers deliver finished products to the Overseas Commercial Fellow Subsidiaries directly. Subsequent to the delivery of finished products, the PRC suppliers issue invoices to SEB Asia Ltd and SEB Asia Ltd issue sales invoices to the Overseas Commercial Fellow Subsidiaries. It is worth noting that we are not working under any contract processing arrangement or any import processing arrangement, since we neither control nor sell raw materials used by the PRC suppliers.

The main reasons for implementing this new business model were threefold :

- Simplify communication between PRC suppliers and Groupe SEB's various overseas Commercial Fellow Subsidiaries (PRC suppliers would receive only purchase orders from SEB Asia Ltd),
- Have a better control on inventory level and production planning (by consolidating through SEB Asia Ltd all purchase orders and forecasts from overseas commercial Fellow Subsidiaries) and, as a consequence, bargain cheaper purchasing prices,
- Take ownership and control of the toolings and moulds (prior owned by Overseas Industrial Fellow Subsidiaries) located at PRC suppliers' factories. On January 1st 2005, SEB Asia acquired the legal titles of toolings and moulds for both management and accounting purposes. As SEB Asia Ltd engaged the unrelated PRC suppliers to manufacture the products bearing our Group's brand names, such as Tefal, Rowenta, Moulinex, KRUPS, etc., there is a genuine business need for SEB Asia Ltd to retain the ownership and control over the moulds in order to protect our group's intellectual properties.

2. Ways of acquisition of toolings and moulds

Since January 1, 2005, in order to perform this central purchasing function, SEB Asia Ltd has acquired and supplied toolings and moulds to the unrelated PRC suppliers, to enable them to produce finished goods in accordance with the specifications given by SEB Asia Ltd.

These toolings and moulds are bought and paid by SEB Asia through specific invoices. They are recognized as fixed assets in SEB Asia Ltd accounting. It is important to highlight that they are located at the PRC suppliers' factories (and have never been located out of the PRC, since they were originally manufactured in the PRC).

Toolings and moulds are of special design, catered for the manufacturing of particular finished goods to be sold by SEB Asia Ltd. As a part of the agreement with the PRC suppliers, toolings and moulds are solely and exclusively made for manufacturing finished goods for SEB Asia Ltd and could not be used for any other purposes. Neither verbal nor written agreement was entered into between SEB Asia Ltd and the PRC suppliers on any lease of the toolings and moulds to the PRC suppliers. Consequently, SEB Asia Ltd does not grant the PRC suppliers a "right to use" the toolings and moulds and no person held any right as a lessee, under a lease.

3. Consequences of this change on assessable profits of SEB Asia Ltd

Prior to 2005, SEB Asia was acting as a sourcing agent and consequently was not recording any purchases and sales in its accounting books. Costs of toolings and moulds were recorded and recognized as fixed assets in Overseas Industrial Fellow Subsidiaries accounting books.

Since 2005, acting as central purchasing office of Groupe SEB, SEB Asia has directly bought finished goods from the PRC suppliers and re-invoiced them to Overseas Commercial Fellow Subsidiaries, with a margin applied on the cost of production (moulds and toolings being part of the cost of production). This margin, earned through the central purchasing function, have led to a dramatic surge of assessable profits derived from the trading activity, as detailed below :

	Before change	After change (% represent Year Over Year increase)			
	2004 MHK\$	2005 MHK\$	2006 MHK\$	2007 MHK\$	2008 MHK\$
Revenue (% increase)	428	2,551 (+496%)	3,896 (+53%)	5,157 (+32%)	6,827 (+32%)
Profits before tax per audited accounts	29	62	182	296	430
Assessable profits reported (% increase)	25	56 (+120%)	186 (+232%)	289 (+55%)	404 (+40%)

Despite the fact that we have already provided plenty of documentary evidence to substantiate that the moulds were owned by SEB Asia Ltd and that the unrelated PRC suppliers only used the moulds to produce goods for SEB Asia Ltd, IRD has informed us recently that it is denying depreciation allowances on our moulds held in the PRC, while referring to section 39E and section 2 of the Inland Revenue Ordinance. It considers there is a lease arrangement between SEB Asia Ltd and PRC suppliers and refers to the fact that moulds are outside Hong Kong.

4. Our opinion on IRD's position

The change of operational mode has been done for commercial purposes without any tax avoidance as the moulds are used to produce chargeable profits (which have been offered for assessment) in the beneficial and commercial senses. Consequently, we consider our claim for depreciation allowance as fair and reasonable, especially considering that expanding its business as central purchasing function in recent years, SEB Asia Ltd had contributed more to Hong Kong economy and has paid more tax in Hong Kong.

SEB Asia Ltd has played a key role in the global supply chain and intellectual properties management of Groupe SEB, after the change of operational mode. We notice from the Chief Executive's Policy Address for 2009-10 that it is the Government's goal to maintain Hong Kong's leading position in the global supply chain. Nevertheless, the IRD's attitude on this issue nowadays would definitely discourage foreign investors like SEB S.A. to set up business in Hong Kong to perform the global supply chain management functions. We would respectfully like to draw your attention on this case. If IRD maintains its view, we shall have no other choice but to reconsider our way of working in the future. Such a change would certainly not be beneficial for Hong Kong economy, which we would highly regret.

We would be glad to supply further details if needed.

Yours faithfully,



 Gilles-Henri Leroy
 Managing Director - SEB Asia Ltd