

**Press release**

**LCQ16: Inland Revenue Ordinance section 39E**

Wednesday, January 26, 2011

Following is a question by Dr Hon Lam Tai-fai and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (January 26):

Question:

Regarding section 39E of the Inland Revenue Ordinance (IRO) (Cap. 112), will the Government inform this Council:

(a) given that in reply to my question on January 12, 2011, the Secretary for Financial Services and the Treasury (SFST) has not provided a direct response to the issue relating to the "relevant authorities of the Guangdong Province" which was mentioned in his reply to the questions raised on November 24 and December 8, 2010, whether SFST can now provide a direct response to which mainland authorities are actually referred to as "relevant authorities of the Guangdong Province", when SFST asked them for information (together with copies of the relevant correspondences and information papers), and whether SFST has assessed if the views of the "relevant authorities of the Guangdong Province" are correct;

(b) given that SFST indicated in his reply to a Legislative Council Member's supplementary question on November 24, 2010 that he had conducted a lot of communication in great detail with the sectors through different opportunities, and he had conducted face-to-face communication with the sectors numerous times, of the names of the associations and individuals from the industry whom SFST had met with in the past three years regarding the issue of section 39E, as well as the dates and venues of the relevant meetings (list in table form); if such information cannot be provided, of the reasons for that;

(c) whether the Joint Liaison Committee on Taxation (JLCT) has responded to the letter dated November 24, 2010 from SFST, indicating his refusal to accept JLCT's recommendation; if it has, whether SFST can provide the relevant papers and correspondences; and whether the authorities have any further communication and contact with JLCT thereafter; if they have, of the details; if not, the reasons for that;

(d) given that SFST indicated in his reply to my question on November 24, 2010 that JLCT has not proposed effective measures to plug possible tax avoidance loopholes, whether the authorities, in inviting JLCT to look into the issue of section 39E, have also clearly requested JLCT to explore effective measures to plug possible tax avoidance loopholes; if they have, of the details and whether JLCT has clearly acknowledged the Government's request; if not, the reasons for that;

(e) whether the Government will again request JLCT or other experts to explore effective measures to plug the tax avoidance loopholes which may exist as claimed by the Government; if it will, of the details; if not, the reasons for that;

(f) given that SFST indicated in his reply to my question on October 20, 2010 that if there is a need to consult other government departments in the course of review, including the Department of Justice (DoJ) and the Commerce and Economic Development Bureau (CEDB), the authorities will invite their participation, whether the authorities have consulted other government departments, such as DoJ and CEDB on the issue of section 39E; if they have, of the details; if not, the reasons for that;

(g) how CEDB assesses the impact of the problem of section 39E on enterprises' investment on machinery and plant to enhance their productivity and competitiveness;

(h) in each of the past 10 years, of the respective numbers of Hong Kong enterprises that had declared to have upgraded and restructured from originally engaging in "contract processing" to engaging in "import processing", and the number of enterprises engaging in "import processing" that had winded up their businesses;

(i) given that the Chief Executive indicated at the Question and Answer Session of this Council on July 13, 2010 that he expected me to follow up the issue of section 39E with SFST, and if there were still problems, they could be handled by the Financial Secretary, and then by him, whether SFST has reported to the Chief Executive on the issue and sought his advice; if he has, of the details; if not, the reasons for that;

(j) given that in reply to my question on January 12, 2011, SFST has not explained why he refused to accept the recommendation made by JLCT in its review report to amend the definition related to "lease" in section 2 of IRO, and whether it is too loose an interpretation for the Inland Revenue Department to indicate that the definition covers the situation of Hong Kong enterprises making available their machinery and plant for use by mainland enterprises free of charge under "import processing", whether SFST can now provide a direct response to these questions; if not, of the reasons for that;

(k) given that in reply to my question on January 12, 2011, SFST has not responded to the claim that when section 39E was amended in 1992, the situation in which Hong Kong enterprises made available their machinery and plant for use by mainland enterprises free of charge under "import processing" was not prevalent, and therefore the amendments to section 39E at that time were not aimed at handling this situation, whether SFST can now respond directly if this claim is true; if he again refuses to respond directly, of the reasons for that; and

(l) given that in reply to my question on January 12, 2011, SFST has not replied to my question as to whether the comments made by the Board of Review in its written decision on the case with reference no. D61/08, that section 39E had not stipulated that there should be "an intention to avoid tax" for the application of the provision, is inconsistent with section 19 of the Interpretation and General Clauses Ordinance (Cap. 1) and the principle adopted by the court in the construction of legislation, of the reasons for that; whether SFST will, after consulting DoJ, submit DoJ's legal advice to this Council; if he will not, of the reasons for that?

Reply:

President,

(a) to (f), (i) to (l) In response to the questions raised repeatedly by Members of the Legislative Council (LegCo) in the past two months, we have indicated clearly that we have already completed the review on whether the restriction in section 39E of the Inland Revenue Ordinance (IRO) should be relaxed. We have also explained in detail to the LegCo the outcome of our review and the relevant justifications. In short, given the established fundamental principles such as "territorial source principle" and "tax symmetry principle" of Hong Kong's tax system, as well as the transfer pricing issue, we consider that there are no justifiable grounds to relax the existing restriction in section 39E. During the course of deliberations, we have already taken into consideration the views of the industrial and commercial sector, the accounting sector and tax experts (including the Joint Liaison Committee on Taxation (JLCT)). We have also communicated with the relevant Mainland authorities with a view to understanding the operation and related taxation matters of the processing trade in the Mainland.

On December 7, 2010, we provided the JLCT's report and the Administration's response to the report to the LegCo Panel on Financial Affairs for information. After considering the response from the Administration, the JLCT is of the view that since the JLCT has made its recommendation and the Administration has considered and rejected it, this is a matter for the Administration, and there is nothing else for the JLCT to do at this stage.

In our reply to the written question raised by Dr Hon Lam Tai-fai on January 12, 2011, we have already indicated that we respect the decision of the Board of Review on the case with reference number D61/08.

(g) The Commerce and Economic Development Bureau (CEDB) is aware of the trade's concerns in relation to section 39E of the IRO, and that the Financial Services and the Treasury Bureau has taken duly into consideration the trade's views in conducting the review. The policy objective of the CEDB is to provide support to the operation of Hong Kong enterprises in the Mainland, including maintaining liaison with the trade and the Mainland authorities at various levels on the issue of restructuring and upgrading, and reflecting the trade's views to the relevant authorities. The Mainland authorities have also responded positively to the trade's views and introduced various measures to support the restructuring and upgrading of enterprises in recent years.

(h) We do not have the relevant data.

Ends