

1 February, 2003

The Financial Secretary
Central Government Offices
West Wing
Lower Albert Road
Central
Hong Kong

Investigation for Hong Kong Tax Lease Transactions

I am a Hong Kong permanent resident and am working for a bank in Hong Kong. I'm very concern about the Hong Kong government's fiscal deficit situation and outlook. Among other policy measures under your considerations, I would like to propose to tighten up the preferential tax treatment for companies with significant capital expenditure.

Under the current Hong Kong tax laws, companies making eligible equipment investment are able to claim accelerated tax depreciation for such investment. This accelerated depreciation enables the companies to enjoy economic benefit of tax deferral (i.e. delaying tax payments), particularly for the first two years of such investment. As far as I understand, the objective of such accelerated depreciation was to encourage capital expenditure and thus to enhance the competitiveness of Hong Kong industries and the attractiveness of Hong Kong for overseas investors. However, over the years, companies with regular significant capital expenditure but without enough taxable profit to absorb the accelerated tax depreciation have "sold" such tax depreciation benefit to other companies, primarily financial institutions, through a structured financing arrangement known as Hong Kong Tax Lease. Such practice has breached the objective of accelerated depreciation and results in having the companies and financial institutions enjoying a tax deferral benefit at the expense of the Hong Kong government.

The companies active in these HKTLs are telecommunication and airlines in Hong Kong due to their regular significant capital expenditure. If such HKTLs are discontinued, the Hong Kong government will have immediate additional tax collections of hundreds of millions per year.

In order to better understand the current situation, you may contact the relevant division within Inland Revenue Department, which has been approving the HKTL transactions, or major banks in Hong Kong, which have been actively "purchasing" such tax benefit and/or "arranging" these transactions.

Yours sincerely,

Undisclosed

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Financial Committee of Legislative Council
Financial Services and Economic Bureau
Audit Commission