

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**
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16 October 2003

Clerk to the Panel
LegCo Panel on Financial Affairs
Legislative Council
3/F, Citibank Tower
3 Garden Road
Central, Hong Kong
(Attn: Ms Connie Szeto)
[Fax: 2869 6794]

Dear Ms Szeto,

Panel on Financial Affairs
Submission on Hong Kong Tax Lease Transactions

Further to AA to SFST's letter of 17 September 2003 to you on the captioned subject, I provide below our response to the submission for your reference.

Acquisitions of plant and machinery for the use in the production of goods by the manufacturing sector, or of aircraft, etc. by the transport sector, through leasing rather than outright purchase, are not uncommon in Hong Kong. Leasing arrangements enable an owner of plant or machinery to pass on the depreciation allowances (which cannot be enjoyed by it in full in the initial years due to little profits or losses made) as lessee to a lessor partnership (with a financial institution as a partner). Such transactions, being a form of financing, will result in cheaper financial cost for the original owner (the lessee). Such transactions will also result in deferral of taxes.

In order to guard against leaseings undertaken solely or predominantly for tax purposes, there is a specific anti-avoidance provision (section 39E) in the Inland Revenue Ordinance.

The Inland Revenue Department has also issued a Departmental Interpretation & Practice Note [“DIPN”] to set out the Department’s views on the minimum standards required for leveraged lease transactions, if they are to be accepted as transactions under section 39E of the Inland Revenue Ordinance. The type of Hong Kong lease transactions mentioned in the letter dated 1 February 2003 are leveraged lease transactions which are particularly covered by the DIPN.

Approvals for favourable rulings concerning leveraged lease transactions are invariably sought from the Inland Revenue Department. The Department has always applied the guidelines as set out in the DIPN. Favourable rulings will only be given where leveraged lease transactions comply with all of the requirements. In particular, the applicants are required to show to the Department that the transaction will result in assessable profits to the lessor after the first three years’ operation of the lease; and that the aggregate taxable profits of the lessor over the term of the lease are not less than 1% of the cost of the plant or machinery. In this way, the Department will ensure that the tax previously deferred can be recouped together with the 1% extra profits to offset the deferment benefit. There is thus no loss of revenue.

It is relevant to note that leveraged lease transactions are indeed commonly accepted in other tax jurisdictions, subject to conditions imposed by the respective tax authorities.

Yours sincerely,

(Miss Erica Ng)
for Secretary for Financial Services and the Treasury