



Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 5 (REVISED)

PROFITS TAX

DEDUCTIONS FOR EXPENDITURE ON –

TECHNICAL EDUCATION

BUILDING REFURBISHMENT

PRESCRIBED FIXED ASSETS

ENVIRONMENTAL PROTECTION FACILITIES

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

These notes replace those issued in July 2012.

WONG Kuen-fai
Commissioner of Inland Revenue

April 2019

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

No. 5 (REVISED)

CONTENT

	Paragraph
Introduction	1
Section 16C – Payments for Technical Education	
Deduction of payments for technical education	2
Deductible payments	4
Section 16F – Expenditure on Building Refurbishment	
Deduction of expenditure on building refurbishment	8
Timing of deduction	10
Qualifying expenditure	11
Non-qualifying expenditure	15
Section 16G – Capital Expenditure on the Provision of a Prescribed Fixed Asset	
Deduction of capital expenditure on prescribed fixed asset	17
Specified capital expenditure	18
Prescribed fixed asset	19
Excluded fixed asset	20
Manufacturing process	23
Computer hardware	25
Computer software and computer system	26
Prescribed fixed asset used partly in the production of profits	27
Sale of prescribed fixed asset	28
Destruction of prescribed fixed asset	33
Capital expenditure incurred prior to commencement of business	34

**Sections 16H to 16L – Capital Expenditure in relation to
Environmental Protection Facilities**

Deduction of expenditure on environmental protection facilities	35
Types of environmental protection facility	36
Specified capital expenditure	37
Environmental protection machinery	39
Environment-friendly vehicle	41
Environmental protection installation	42
Energy efficient building installations	43
The Hong Kong Energy Efficiency Registration Scheme for Buildings	44
Timing of deduction	45
Facilities used partly in the production of profits	49
Capital expenditure incurred prior to commencement of business	50
Sale and destruction	
Environmental protection machinery or installation	51
Environment-friendly vehicle	57
Time of sale	60
Controlled sale	61
Environmental protection installations owned before 1 April 2018	62

INTRODUCTION

It is a canon of taxation that capital expenditure is not normally an allowable deduction in ascertaining the assessable profit of any trade, profession or business. The following sections were added, inter alia, to the Inland Revenue Ordinance (the Ordinance) over the years which gave important exceptions to the normal principle of allowing tax deductions:

<u>Section</u>	<u>Relating to</u>
16C	Payments for technical education
16F	Expenditure on building refurbishment
16G	Capital expenditure on the provision of a prescribed fixed asset
16H to 16L	Capital expenditure in relation to environmental protection facilities

SECTION 16C – PAYMENTS FOR TECHNICAL EDUCATION

Deduction of payments for technical education

2. Section 16C was introduced to allow payments made by a person carrying on a trade or business for technical education. Effective from the year of assessment 1998/99, the section was extended to a person carrying on a profession.

3. Under section 16C(1), a person carrying on a trade, profession or business in Hong Kong is allowed a tax deduction for any payment to be used for the purposes of technical education related to that trade, profession or business at:

- (a) any university, university college or technical college; or
- (b) any other similar institution which is approved by the Commissioner.

The recognition of the institution for this purpose shall start from whatever date is specified in the approval. This may be before or after the date of approval. Prior to 1 April 1996, the approval was given by the Director of Education. The approval given can be withdrawn at any time.

Deductible payments

4. For the purposes of section 16C, technical education is deemed to be related to a trade, profession or business if and only if it is of a kind specially requisite for persons employed in that class of trade, profession or business as per section 16C(2).

5. The deduction applies to any payment to an approved institution to be used for the purposes of technical education related to a particular trade, profession or business. It does not have to be directly for the education of any person or persons actually employed in the particular business at the time of payment. The deduction extends to a payment to establish a unit or for the general maintenance of a unit at an approved institution so as to provide technical education of a kind specially suited or requisite to a particular class of trade, profession or business. However, contributions in response to appeals made for funds to be used on purchase of capital equipment would not be allowable.

6. Where payments are made for the technical education of particular persons, the payment may be made to either such persons or the approved institution.

7. The intention of section 16C is to broaden and not to restrict what would ordinarily be allowable deductions. So expenditure by an employer on the technical training or education of any of his employees may be allowed under section 16(1) even if the institution is not an approved institution.

SECTION 16F – EXPENDITURE ON BUILDING REFURBISHMENT

Deduction of expenditure on building refurbishment

8. Section 16F was introduced as from the year of assessment 1996/97. For the years of assessment 1996/97 and 1997/98, a deduction is allowed for capital expenditure incurred on the renovation or refurbishment of a hotel by a person who carries on business as an owner or operator of a hotel to produce chargeable profits. With effect from the year of assessment 1998/99, the deduction was extended to cover capital expenditure incurred on the renovation or refurbishment of a building other than a domestic building by a person (who

may be an owner or tenant of a building) in the production of chargeable profits. Any expenditure allowed under this section will not qualify for depreciation allowances under Part 6 of the Ordinance.

9. The term “domestic building or structure” is defined in section 16F. It means any building or structure used for habitation, but does not include any building or structure used as a hotel or guesthouse. It is the actual use or intended use of the building, not the type of the building, that counts. The terms “hotel” and “guesthouse” have the same meaning as in the Hotel and Guesthouse Accommodation Ordinance (Cap. 349). Thus, the deduction does not apply to buildings used for letting for residential purposes or as directors’ or staff quarters.

Timing of deduction

10. Capital expenditure meeting the requirements under section 16F(1) is allowed as a deduction by five equal instalments, the first of which is allowed in the basis period during which the expenditure was incurred and the remaining four instalments in the basis periods for the next succeeding four years of assessment as per section 16F(2). If the relevant property is sold before the instalments are fully granted, the person entitled to the instalments is still granted the instalments as if the property has not yet been sold.

Qualifying expenditure

11. To qualify for deduction, the expenditure incurred must be a renovation or refurbishment in nature. The words “renovation” and “refurbishment” are not defined in the Ordinance. According to the Shorter Oxford English Dictionary, “renovation” means renewal or restoration, and “refurbishment” is renovation.

12. Renovation or refurbishment expenditure can be either capital or revenue in nature, depending on whether the expenditure results in improving or repairing the building or structure concerned. Renovation expenditure of a capital nature is deductible in the manner specified under section 16F while renovation expenditure of a revenue nature is deductible under section 16(1)(e).

13. The Shorter Oxford English Dictionary defines “repair” as “the action or process of restoring something to unimpaired condition by replacing or fixing worn or damaged parts”. In the Privy Council case of *Auckland Gas Co. Ltd. v CIR* [2000] STC 527, Lord Nicholls of Birkenhead said at pages 532 and 533 that the solution to the question of whether work constituted repair or replacement was not to be found by any rigid test or description. The answer depends on a consideration of all the circumstances. An important consideration is whether the work is of such a nature and scale as to change the character of the relevant asset. Where the work changed the character of the asset so that a significant portion of the asset has been upgraded, the work is of capital nature.

14. Thus, the question of improvement or repair to a building or structure is one of fact and degree and close examination of the facts of the particular case is required. The commonly used test for this purpose is the “entirety” test. If the entirety of a building or structure is replaced, it is improvement; and if part of the entirety is replaced, it is repair. In *Lurcott v Wakely & Wheeler* [1911] 1 KB 905, Buckley LJ said at page 924 that repair is restoration by renewal or replacement of subsidiary parts of a whole. Renewal, as distinguished from repair, is reconstruction of the entirety, meaning by the entirety not necessarily the whole but substantially the whole subject-matter under discussion.

Non-qualifying expenditure

15. Section 16F(4) provides that the deduction does not apply to capital expenditure incurred:

- (a) for a building which is used or intended to be used as a domestic building;
- (b) to enable a building to be first used substantially by the person for the production of chargeable profits;
- (c) to enable a building to be used for a purpose different from that for which it was used immediately before the capital expenditure was incurred.

16. Capital expenditure incurred on the initial construction, decoration or fitting out of a commercial building or structure, and expenditure on alteration of a building to enable a different usage do not qualify for the deduction under section 16F(1) but they may qualify for commercial building allowance under section 33A.

SECTION 16G – CAPITAL EXPENDITURE ON THE PROVISION OF A PRESCRIBED FIXED ASSET

Deduction of capital expenditure on prescribed fixed asset

17. Section 16G was effective from the year of assessment 1998/99 and onwards to allow a deduction for specified capital expenditure incurred by a person on the provision of a prescribed fixed asset, by providing for a 100% immediate write-off in respect of the expenditure.

Specified capital expenditure

18. The term “specified capital expenditure” is defined in section 16G(6) to mean any capital expenditure incurred by a person on the provision of a “prescribed fixed asset”, but does not include:

- (a) capital expenditure that may be deducted under any other section of Part 4 of the Ordinance;
- (b) capital expenditure incurred under a hire-purchase agreement.

Prescribed fixed asset

19. “Prescribed fixed asset” is defined in section 16G(6) to mean:

- (a) the following items of machinery or plant specified in the First Part of the Table annexed to Rule 2 of the Inland Revenue Rules as is used specifically and directly for any manufacturing process –

<u>Item</u>	<u>Nature of the assets</u>
16	Type and blocks
20	Bleaching and finishing machinery and plant
24	Electronics manufacturing machinery and plant
26	Plastic manufacturing machinery and plant including moulds
28	Silk manufacturing machinery and plant
29	Sulphuric and nitric acid plant
31	Textile and clothing manufacturing machinery and plant
33	Weaving, spinning, knitting and sewing machinery
35	Any other machinery or plant, not specified in items 1 to 34

(b) computer hardware, other than that which is an integral part of any machinery or plant;

(c) computer software and computer systems;

but does not include an “excluded fixed asset”.

Excluded fixed asset

20. The term “excluded fixed asset” is defined in section 16G(6) to mean a fixed asset in which any person holds rights as a lessee under a lease. Section 2(1) defines “lease”, in relation to any machinery or plant, to include any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person.

21. In *Braitrim (Far East) Limited v CIR* [2013] 4 HKLRD 329, the Court of Appeal held that the word “lease” in section 16G(6) was to be understood in accordance with the definition in section 2(1) instead of its commonly understood legal meaning. Delivering the unanimous decision of the Court, Barma JA said at page 339 that the legislative intention was to limit the scope of the section 16G deduction so that it was not available in cases where the fixed asset in question was the subject of an arrangement by which a person other than its owner was granted a right to use it.

22. Machinery or plant may be provided by a person carrying on business in Hong Kong to a Mainland Chinese enterprise for manufacturing products sold to the person. On the authority of *Braitrim*, this arrangement constituted the granting of rights to use the machinery or plant to the Mainland Chinese enterprise, which falls within the extended definition of “lease” in section 2(1). In such case, the Mainland Chinese enterprise is holding rights in the machinery or plant as a lessee under the lease. The machinery or plant should be regarded as “excluded fixed asset” and thus the expenditure incurred by the person on the machinery or plant cannot be deducted under section 16G.

Manufacturing process

23. To qualify for a deduction under section 16G, the machinery or plant must be used specifically and directly for any manufacturing process. As the term “manufacturing process” is not defined in the Ordinance, we have to refer to its ordinary meaning. In general, it means a series of activities or operations, usually carried out inside a factory or any other similar premises, for the creation of any new product.

24. Though the term “manufacturing process” is capable of a wide interpretation, it does not include construction. In fact, bulldozers and graders commonly used in construction works are not included in the definition of prescribed fixed asset in section 16G(6).

Computer hardware

25. Prescribed fixed asset includes computer hardware which is not an integral part of any machinery or plant. In other words, stand-alone computer hardware qualifies for deduction but computer hardware forming an integral part of an item of machinery or plant will not be granted the section 16G deduction unless the machinery or plant containing the computer hardware happens to be a prescribed fixed asset.

Computer software and computer system

26. Capital expenditure incurred on computer software and a computer system used in the production of chargeable profits is deductible under section 16G. This includes the relevant consultancy fees and associated costs.

Prescribed fixed asset used partly in the production of profits

27. Where a prescribed fixed asset is used partly in the production of chargeable profits and partly for other purposes, the deduction shall be such part of the specified capital expenditure as is proportionate to the extent of the use of the asset in the production of the chargeable profits.

Sale of prescribed fixed asset

28. Where the prescribed fixed asset in respect of which a deduction has been allowed is sold, the sale proceeds, not otherwise chargeable to profits tax and not exceeding the amount of deduction previously allowed, shall be treated as a trading receipt.

29. On sale of a prescribed fixed asset used partly in the production of chargeable profits, such part of the sale proceeds as is proportionate to the extent to which the deduction has been allowed, not otherwise chargeable to profits tax and not exceeding the amount of deduction previously allowed, shall be treated as a trading receipt.

30. The deemed trading receipt shall accrue and be assessable at the time of sale. If the sale occurs on or after the date on which the business is permanently discontinued, the deemed trading receipt shall accrue on the date immediately before the discontinuance.

31. The time of sale of a prescribed fixed asset is either the time of completion of the sale of the asset, or the time when possession of the asset is given, whichever is the earlier.

32. Where a prescribed fixed asset is sold and the seller has control over the buyer, or vice versa, or both are under the common control of some other person, or the buyer and seller are husband and wife, the Commissioner may determine the true market value of the asset if he is of the opinion that the sale price does not represent its true market value.

Destruction of prescribed fixed asset

33. Where a prescribed fixed asset is destroyed, the asset shall be treated as if it had been sold immediately before the destruction. Any insurance money or other compensation received and any money received in respect of the remains of the asset are to be treated as the sale proceeds.

Capital expenditure incurred prior to commencement of business

34. Where a taxpayer incurs specified capital expenditure on the provision of a prescribed fixed asset for the purposes of a trade, profession or business which is about to commence, the expenditure shall be treated as if it has been incurred on the first day on which the taxpayer carries on the trade, profession or business.

SECTIONS 16H to 16L – CAPITAL EXPENDITURE IN RELATION TO ENVIRONMENTAL PROTECTION FACILITIES

Deduction of expenditure on environmental protection facilities

35. The Revenue Ordinance 2008 was enacted, inter alia, to accelerate profits tax deduction for capital expenditure on environmental protection machinery or installations from the year of assessment 2008/09. The Inland Revenue (Amendment) (No. 3) Ordinance 2010 allowed the acceleration of profits tax deduction for capital expenditure incurred on the provision of environment-friendly vehicles from the year of assessment 2010/11. The Inland Revenue (Amendment) (No. 9) Ordinance 2018 further allowed profits tax deduction of capital expenditure incurred for procuring environmental protection installations in full in one year of assessment instead of over five years of assessment from the year of assessment 2018/19. The relevant provisions are as follows:

<u>Section</u>	<u>Relating to</u>
16H	Definitions and general provisions
16I	Deductions
16J	Proceeds on sale
16L	Environmental protection installations owned before 1 April 2018

Types of environmental protection facility

36. The term “environmental protection facility” is defined to mean any environmental protection machinery, environmental protection installation or environment-friendly vehicle.

Specified capital expenditure

37. The term “specified capital expenditure” is defined to mean any capital expenditure incurred on:

- (a) the provision of any environmental protection machinery or environment-friendly vehicle; or
- (b) the construction of environmental protection installation;

but does not include –

- (a) any capital expenditure that may be deducted under any other section of Part 4 of the Ordinance; or
- (b) any capital expenditure incurred under a hire-purchase agreement.

38. Allowable specified capital expenditure hence does not include, for example, expenditure on research and development or expenditure on building refurbishment already deducted under section 16B or 16F. Also, specified capital expenditure deducted will not qualify for depreciation allowances under Part 6 of the Ordinance.

Environmental protection machinery

39. “Environmental protection machinery” is defined to mean any machinery or plant that is specified in Part 1 of Schedule 17 to the Ordinance, but does not include any machinery or plant in which a person holds rights as a lessee under a lease. Part 1 of Schedule 17 specifies the following machinery or plant:

- (a) Low noise construction machinery or plant registered under the Quality Powered Mechanical Equipment system administered by the Environmental Protection Department.
- (b) Air pollution control machinery or plant in compliance with the requirements under the Air Pollution Control Ordinance (Cap. 311).
- (c) Waste treatment machinery or plant in compliance with the requirements under the Waste Disposal Ordinance (Cap. 354).
- (d) Wastewater treatment machinery or plant in compliance with the requirements under the Water Pollution Control Ordinance (Cap. 358).

40. The list of registered low noise construction machinery or plant can be accessed at the web site of the Environmental Protection Department: www.epd.gov.hk. In ascertaining whether an item of machinery or plant complies with the requirements under the pollution control ordinances, the Assessor may make reference to the following documents:

- (a) A licence for the conduct of certain polluting industrial processes in any premises issued under section 15 of the Air Pollution Control Ordinance and an air pollution control plan required under section 14A of that Ordinance.
- (b) A waste collection licence or a waste disposal licence issued under section 21 of the Waste Disposal Ordinance.
- (c) A licence of discharges and deposits issued under section 20 of the Water Pollution Control Ordinance.

Environment-friendly vehicle

41. “Environment-friendly vehicle” is defined to mean any vehicle that is specified in Part 3 of Schedule 17, but does not include any vehicle in which a person holds rights as a lessee under a lease. Part 3 of Schedule 17 specifies the following environment-friendly vehicles:

- (a) Any vehicle qualified for remission of first registration tax (as defined by section 2(1) of the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330)) under the following schemes administered by the Environmental Protection Department –
 - (i) the Tax Incentives Scheme for Environment-friendly Commercial Vehicles;
 - (ii) the Tax Incentives Scheme for Environment-friendly Petrol Private Cars.

- (b) Any motor vehicle (as defined by section 2(1) of the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330)) that is capable of drawing energy from both of the following on-vehicle sources of stored energy or power for mechanical propulsion –
 - (i) consumable fuel;
 - (ii) battery, capacitor, flywheel, generator or other electrical energy or power storage device.

- (c) Any motor vehicle (as defined by section 2(1) of the Motor Vehicles (First Registration Tax) Ordinance (Cap. 330)) that is solely propelled by electric power and do not emit any exhaust gas.

Environmental protection installation

42. “Environmental protection installation” is defined to mean any installation, or part of any installation, that is specified in Part 2 of Schedule 17 and forms a building or structure. Part 2 of Schedule 17 specifies the following installations:

- (a) Any of the following installations –

- (i) solar water heating installations;
 - (ii) solar photovoltaic installations;
 - (iii) wind turbine installations;
 - (iv) offshore wind farm installations;
 - (v) landfill gas installations;
 - (vi) anaerobic digestion installations;
 - (vii) thermal waste treatment installations;
 - (viii) wave power installations;
 - (ix) hydroelectric installations;
 - (x) bio-fuel installations;
 - (xi) biomass combined-heat-and-power installations;
 - (xii) geothermal installations.
- (b) Energy efficient building installations (EEBIs) registered under the Hong Kong Energy Efficiency Registration Scheme for Buildings (HKEERSB) administered by the Electrical and Mechanical Services Department (EMSD).

Energy efficient building installations

43. EEBIs include four types of central building services installations (i.e. lighting installations, air-conditioning installations, electrical installations and lift and escalator installations). The building envelope itself is not a qualifying installation but commercial building allowance under section 33A or industrial building allowance under section 34 may be granted on the costs of construction as appropriate.

The Hong Kong Energy Efficiency Registration Scheme for Buildings

44. The HKEERSB is a voluntary scheme which aims to promote the enhancement of energy efficiency of buildings in Hong Kong by commending buildings/ premises achieving better energy efficient performance beyond the statutory requirements as prevailing at the time of submitting the application. In order to apply for registration of EEBIs under the HKEERSB, applicants are required to provide certification for the buildings/ premises equipped with EEBIs showing their compliance with the assessment standards under the building environmental assessment systems (BEAS) managed by the Hong Kong Green Building Council, i.e. the BEAM Plus Assessment System, or

other internationally recognised BEAS. Upon completion of each registration, EMSD will issue a compliance certificate for the building/ premises to certify that it complies with the standards under BEAS. The EMSD maintains a register of the buildings/ premises which have been registered under the HKEERSB. The register can be accessed at the web site of the EMSD: www.emsd.gov.hk.

Timing of deduction

45. Capital expenditure for the provision of any environmental protection machinery or environment-friendly vehicle is allowable in full in the basis period for the year of assessment in which it was incurred as per section 16I(2).

46. Before the year of assessment 2018/19, capital expenditure incurred in relation to any environmental protection installation is allowed as a deduction by five equal instalments. Section 16I(3) provides that the first instalment is allowed in the basis period for the year of assessment in which the expenditure was incurred, and the remaining four instalments in the basis periods for the next succeeding four years of assessment. For the year of assessment 2018/19 and thereafter, section 16I(3B) provides that capital expenditure in relation to such installations is deducted in full in the basis period for the year of assessment in which it was incurred. Section 16I(3A) allows any part of expenditure that remains to be deducted for the year of assessment 2018/19 to be fully deducted in that year.

47. If capital expenditure in relation to an environmental protection facility is claimed for deduction in a tax return, the Assessor will allow the deduction, provided the required details are properly disclosed. Taking into account that it may take some time to obtain the BEAS certificate and complete the entire procedure for registration under the HKEERSB, the Commissioner will adopt a liberal approach in considering deduction for EEBIs. For those EEBIs the registration process of which has not been completed under the HKEERSB, deduction will be allowed in the year of assessment in which the relevant capital expenditure was incurred by a taxpayer on the conditions that the taxpayer provides the required details about the application status for registration of the EEBIs and undertakes to take all reasonable steps to complete the registration.

48. Enquiries will be raised regarding the application for registration of EEIBs under the HKEERSB upon a review of the deduction claim. In practice, the compliance certificate issued by the EMSD may be provided to show that the registration of the EEIBs under HKEERSB has been completed. If the application is ceased, withdrawn or refused such that the registration process cannot be completed, profits tax or additional profits tax assessment will be raised to withdraw the deduction previously granted within the six-year time limit under section 60(1).

Example 1

Under a building contract for the construction of EEIBs, Company-HK agreed to pay \$15,000,000, \$20,000,000 and \$30,000,000 in May 2016, May 2017 and May 2018 respectively. Company-HK applied for registration of the building equipped with the EEIBs under the HKEERSB and registration was completed in July 2019. Company-HK closed its accounts on 30 September each year and deductions were claimed under section 16I(3) for the payments made in May 2016 and May 2017 by five equal instalments.

Registration of the EEIBs under the HKEERSB had not been completed during the years of assessment 2016/17 to 2018/19. However, if Company-HK provided all the required details about the application status and undertook to take all reasonable steps to complete the registration, deductions would be computed as follows:

Year of assessment 2016/17

(Basis period: 1 October 2015 to 30 September 2016)

\$

Deduction allowed

- 1st payment (\$15,000,000 × 20%) 3,000,000

Total deduction allowed 3,000,000

Year of assessment 2017/18

(Basis period: 1 October 2016 to 30 September 2017)

\$

Deduction allowed

- 1st payment (\$15,000,000 × 20%) 3,000,000

- 2nd payment (\$20,000,000 × 20%) 4,000,000

Total deduction allowed 7,000,000

Year of assessment 2018/19

(Basis period: 1 October 2017 to 30 September 2018)

	\$
Deduction allowed	
- 1 st payment (\$15,000,000 × 20%)	3,000,000
- 2 nd payment (\$20,000,000 × 20%)	4,000,000
- 3 rd payment (\$30,000,000 × 100%)	<u>30,000,000</u>
Total deduction allowed	<u>37,000,000</u>

Example 2

Facts are the same as in Example 1, but in the year of assessment 2018/19 Company-HK claimed under section 16I(3A) full deduction for the remaining balances of the payments made in May 2016 and May 2017.

Deductions would be computed as follows:

Year of assessment 2018/19

(Basis period: 1 October 2017 to 30 September 2018)

	\$
Deduction allowed	
- 1 st payment (\$15,000,000 × 60%)	9,000,000
- 2 nd payment (\$20,000,000 × 80%)	16,000,000
- 3 rd payment (\$30,000,000 × 100%)	<u>30,000,000</u>
Total deduction allowed	<u>55,000,000</u>

Example 3

Facts are the same as in Example 1, but Company-HK subsequently failed to complete the registration of the building under the HKEERSB.

Additional profits tax assessments for the years of assessment 2016/17 to 2018/19 would be raised on Company-HK to withdraw the total deduction of \$47,000,000 (\$3,000,000 + \$7,000,000 + \$37,000,000) previously allowed under section 60(1).

Facilities used partly in the production of profits

49. If an environmental protection facility is used partly in the production of chargeable profits and partly for other purposes, section 16I(4) provides that the deduction shall be such part of the specified capital expenditure that is proportionate to the extent of the use of the facility in the production of the chargeable profits.

Capital expenditure incurred prior to commencement of business

50. Where a taxpayer incurs specified capital expenditure in relation to an environmental protection facility for the purposes of a trade, profession or business which is about to commence, the expenditure shall be treated as if it has been incurred on the first day on which the taxpayer carries on the trade, profession or business.

Sale and destruction

Environmental protection machinery or installation

51. Where an environmental protection machinery or installation in respect of which a deduction has been allowed is sold, the relevant proceeds of sale, not otherwise chargeable to profits tax and not exceeding the amount of deduction previously allowed, shall be treated as a trading receipt as per sections 16J(2), (3A) and (3B).

52. Section 16J(3) provides that if an environmental protection installation in respect of which capital expenditure was incurred before the year of assessment 2018/19 and a deduction has been allowed by instalments is sold:

- (a) if the unallowed amount of the installation exceeds the relevant proceeds of sale, the excess shall be deducted for the year of assessment in the basis period during which the sale occurs; or
- (b) if the relevant proceeds of sale exceed the unallowed amount of the installation, or if there is not an unallowed amount, the excess or the relevant proceeds of sale, as the case may be, not otherwise chargeable to profits tax and not exceeding the

amount of deduction previously allowed, shall be treated as a trading receipt.

53. The deemed trading receipt in respect of the environmental protection machinery or installation sold shall accrue and be assessable at the time of the sale. If the sale occurs on or after the date on which the business is permanently discontinued, the deemed trading receipt shall accrue on the date immediately before the discontinuance.

54. The term “relevant proceeds of sale”, in relation to an environmental protection facility in respect of which a deduction has been allowed, means:

- (a) if the facility is used wholly in the production of chargeable profits, the proceeds of sale of the facility; or
- (b) if the facility is used partly in the production of chargeable profits, such part of the proceeds of sale of the facility as is proportionate to the extent to which the deduction has been allowed.

55. The term “unallowed amount”, in relation to an environmental protection installation in respect of which a deduction has been allowed and which is subsequently sold, means:

- (a) if the installation is used wholly in the production of chargeable profits, the amount of specified capital expenditure incurred in relation to the installation that is still unallowed as at the time of sale; or
- (b) if the installation is used partly in the production of chargeable profits, such part of the amount referred to in paragraph (a) above as is proportionate to the extent to which the deduction has been allowed.

56. Where an environmental protection machinery or installation is destroyed, the machinery or installation is deemed to have been sold immediately before the destruction. Any insurance money or other compensation received and any money derived from the remains of such machinery or installation are to be treated as the proceeds of that sale.

Example 4

Facts are the same as in Example 1 but in August 2019, Company-HK sold the EEIBs for \$20,000,000.

Deemed trading receipt would be computed as follows:

Year of Assessment 2019/20

(Basis period: 1 October 2018 to 30 September 2019)

	\$	\$
Specified capital expenditure		
- 1 st payment	15,000,000	
- 2 nd payment	<u>20,000,000</u>	35,000,000
<u>Less: Deduction allowed</u>		
- 1 st payment ($\$15,000,000 \times 60\%$)	9,000,000	
- 2 nd payment ($\$20,000,000 \times 40\%$)	<u>8,000,000</u>	<u>17,000,000</u>
<u>Less: Unallowed amount</u>		18,000,000
Relevant proceeds of sale		<u>20,000,000</u>
Deemed trading receipts for the year		<u><u>2,000,000</u></u> *

*Not exceeding the total deduction of \$17,000,000 previously allowed

Example 5

Facts are the same as in Example 1 but in August 2019 Company-HK sold the EEIBs for \$15,000,000.

Deduction allowed would be computed as follows:

Year of Assessment 2019/20

(Basis period: 1 October 2018 to 30 September 2019)

	\$	\$
Specified capital expenditure		
- 1 st payment	15,000,000	
- 2 nd payment	<u>20,000,000</u>	35,000,000
<u>Less: Deduction allowed</u>		
- 1 st payment ($\$15,000,000 \times 60\%$)	9,000,000	
- 2 nd payment ($\$20,000,000 \times 40\%$)	<u>8,000,000</u>	<u>17,000,000</u>
Unallowed amount		18,000,000
<u>Less: Relevant proceeds of sale</u>		<u>15,000,000</u>
Allowable deduction for the year		<u><u>3,000,000</u></u>

Example 6

Facts are the same as in Example 2 but in August 2019 Company-HK sold the EEIBs for \$20,000,000.

Year of Assessment 2019/20

(Basis period: 1 October 2018 to 30 September 2019)

The relevant proceeds of sale of \$20,000,000 do not exceed the total deduction of \$65,000,000 (\$3,000,000 + \$7,000,000 + \$55,000,000) previously allowed and would be wholly treated as trading receipts.

Environment-friendly vehicle

57. Where an environment-friendly vehicle in respect of which a deduction has been allowed is sold before the cessation of business, the relevant proceeds of sale, not otherwise chargeable to profits tax and not exceeding the amount of deduction previously allowed, shall be treated as a trading receipt accruing and be assessable at the time of the sale as per section 16J(2A).

58. Where an environment-friendly vehicle is destroyed or stolen before the cessation of business, the vehicle is deemed to have been sold immediately before the destruction or theft. Any insurance money or other compensation received and any money derived from the remains of such vehicle are to be treated as the proceeds of that sale.

59. If an environment-friendly vehicle in respect of which a deduction has been allowed to a person has not been sold, destroyed or stolen before the cessation of business, the vehicle is deemed to have been sold and the person is deemed to have received the proceeds of that sale immediately before business cessation. The amount of proceeds is such amount the Commissioner may consider the vehicle would have realized had it been sold in the open market at the time of business cessation. If the vehicle is sold, destroyed or stolen on or within 12 months after the cessation of business, the person may claim an adjustment to the amount deemed to have been received by him.

Time of sale

60. The time of sale of an environmental protection facility is either the time of completion of the sale of the facility, or the time when possession of the facility is given, whichever is the earlier.

Controlled sale

61. Where an environmental protection facility is sold and the seller has control over the buyer, or vice versa, or both are under the common control of some other person, or the buyer and seller are husband and wife, the Commissioner may determine the true market value of the facility if he is of the opinion that the sale price does not reflect its true market value.

Environmental protection installations owned before 1 April 2018

62. Where, before 1 April 2018, a person:

- (a) incurred capital expenditure on the construction of a building or structure that is an environmental protection installation or is entitled to the relevant interest in relation to the capital expenditure incurred;
- (b) no deduction has previously been allowed under Part 4 of the Ordinance for the expenditure; and
- (c) he makes an election,

the person is taken to have incurred specified capital expenditure in relation to the building or structure on 1 April 2018 as per section 16L(1).

63. The specified capital expenditure in relation to the installation is to be the residue of expenditure under Part 6 of the Ordinance incurred in relation to the building or structure immediately before 1 April 2018.

64. A person who wishes to be taken to have incurred the specified capital expenditure on 1 April 2018 and claim a deduction in relation to the expenditure for the year of assessment 2018/19 may make an election in writing within one month after a notice of the assessment for that year of

assessment is given to him. The election, once made, is irrevocable.

Example 7

In October 2017, Company-HK incurred capital expenditure on the construction of EEIBs. The installation was registered under the HKEERSB in May 2018. Company-HK closed its accounts on 31 March each year.

Year of Assessment 2017/18

(Basis period: 1 April 2017 to 31 March 2018)

Company-HK claimed and was granted commercial building allowance in respect of the EEIBs.

Year of Assessment 2018/19

(Basis period: 1 April 2018 to 31 March 2019)

Company-HK would be allowed to make an election such that the specified capital expenditure could be taken as incurred on 1 April 2018. Full deduction would be allowed for the residue of expenditure incurred in relation to the installation immediately before 1 April 2018.