

Taxation of Environment-Friendly Vehicles

(Relevant to AAT Examination Paper 5: Principles of Taxation)

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Introduction

The Inland Revenue (Amendment) (No. 3) 2010 was gazetted on 18 June 2010 to give effect to, *inter alia*, the proposal in the 2010/11 Budget to provide an accelerated profits tax deduction for environment-friendly vehicles (EFVs) as from 18 June 2010.

This article describes the taxation for EFVs together with related examples. All references to statutory provisions in this article, unless otherwise specified, refer to sections in the Inland Revenue Ordinance (IRO).

What is an environment-friendly vehicle?

An EFV is defined in Part 3 of Schedule 17 of the IRO as:

1. 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:
 - (a) the Tax Incentives Scheme for Environment-friendly Commercial Vehicles;
 - (b) the Tax Incentives Scheme for Environment-friendly Petrol Private Cars.
2. 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:
 - (a) Consumable fuel;
 - (b) Battery, capacitor, flywheel, generator or other electrical energy or power storage device.
3. 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 does not emit any exhaust gas.

In short, EFVs cover the following vehicles:

- (a) eligible vehicles under the “Tax Incentives Scheme for Environment-friendly Commercial Vehicles” and the “Tax Incentives Scheme for Environment-friendly Petrol Private Cars” administered by the Environmental Protection Department (EPD);
- (b) hybrid electric vehicles; and
- (c) electric vehicles.

Related information about EFVs can be found on the website of Environment Protection Department, viz.,

[http://www.epd.gov.hk/epd/english/environmentinhk/air/prob_solutions/Profits Tax Deduction_EFV_Models.html](http://www.epd.gov.hk/epd/english/environmentinhk/air/prob_solutions/Profits_Tax_Deduction_EFV_Models.html).

Tax Treatment for specified capital expenditure (SCE) on EFVs acquired on / after 18 June 2010

Any capital expenditure incurred on the provision of any EFV, excluding expenditure:

- that can be deducted under another section of the IRO, or
- incurred under a hire-purchase agreement, by a person on or after 18 June 2010

can be fully deducted, subject to apportionment if the EFV is not 100% used in the production of chargeable profits (section 16I(1)).

Example 1

On 2 July 2010, A Ltd purchased two electric cars (Vehicle I and Vehicle II, annual allowance = 30%) for \$180,000 and \$220,000 respectively and used them for the production of chargeable profits. A Ltd prepares its accounts to 31 December each year.

As the expenditure was incurred on EFVs on or after 18 June 2010 during the basis period from 1 January 2010 to 31 December 2010, A Ltd can claim a total deduction of \$400,000 (i.e. \$180,000 + \$220,000) in respect of Vehicle I and Vehicle II for the year of assessment of 2010/11.

Example 2

On 2 August 2010, A Ltd acquired, for \$200,000, a hybrid electric car (Vehicle III, annual allowance = 30%) by means of hire purchase. The terms of hire purchase were as follows:

Down payment on 2 August 2010 \$80,000
12 equal monthly instalments: \$10,500 each commencing from 2 September 2010

Even though the expenditure was incurred on the provision of an EFV, A Ltd cannot claim a full deduction for Vehicle III as it was acquired by means of hire purchase. A Ltd can only claim depreciation allowances in respect of Vehicle III for the year of assessment 2010/11 as follows:

Vehicle III

	<u>Under hire purchase</u>	<u>Allowance</u>
Cash price	200,000	
Initial allowance (IA) 60% x (\$80,000 + 4 x \$10,000)	<u>(72,000)</u>	72,000
	128,000	
Annual allowance (AA) 30%	<u>(38,400)</u>	<u>38,400</u>
Written down value (WDV) c/f	<u>89,600</u>	<u>110,400</u>

Tax treatment on disposal of EFVs

If any EFV in respect of which a deduction has been allowed under section 16I in ascertaining the profits from a trade, profession or business is subsequently sold, the relevant proceeds of sale, to the extent that they are not otherwise chargeable to profits tax and do not exceed the amount of the deduction, are to be treated as a trading receipt of the trade, profession or business, arising in or derived from Hong Kong and accruing:

- at the time of the sale (section 16J(2A)); or
- if the sale occurs on or after the date on which the trade, profession or business is permanently discontinued, immediately before the date of discontinuance (section 16J(3)).

Example 3

On 2 January 2011, A Ltd in Example 1 sold Vehicle I to an unrelated company for \$60,000.

As A Ltd has claimed a deduction of \$180,000 for Vehicle I for the year of assessment 2010/11, the total proceeds of \$60,000 will be:

- treated as a trading receipt, and
 - chargeable to profits tax
- in the year of assessment 2011/12.

Sale of EFVs between connected persons

If, in relation to a sale of an EFV,

- (a) the buyer is a person over whom the seller has control;
 - (b) the seller is a person over whom the buyer has control;
 - (c) both the seller and the buyer are persons over both of whom some other person has control;
- or
- (d) the sale is between a husband and his wife, not being a wife living apart from her husband,

the Commissioner of Inland Revenue (CIR) shall, if he is of the opinion that the sale price of the facility does not represent its true market value at the time of the sale, determine such true market value, and the amount so determined shall be treated as the proceeds of that sale (section 16J(4)).

Example 4

If A Ltd in Example 3 sold Vehicle I to a connected person for \$20,000 while the market value was \$60,000, the CIR can treat \$60,000 as the sale proceeds of Vehicle I.

Destruction or theft of EFVs

If any EFV in respect of which a deduction has been allowed to a person is subsequently destroyed or stolen:

- (a) the EFV shall be treated as if it had been sold immediately before it was destroyed or stolen; and
- (b) any insurance money or other compensation of any description and any money derived from the remain of the EFV that is received by the person in respect of the destruction or theft are to be treated as the proceeds of that sale (section 16J(5A)).

Example 5

In February 2011, Vehicle II in Example 1 was stolen and A Ltd received compensation of \$30,000 from the insurance company. The compensation of \$30,000 is taxable.

Cessation of business

If any EFV in respect of which a deduction has been allowed to a person has not been sold, destroyed or stolen before the cessation of the trade, profession or business –

- (a) the EFV is deemed to have been sold immediately before the cessation; and
- (b) the person is deemed to have received immediately before the cessation the proceeds of that sale (s.16J(5B)).

The amount of proceeds of sale deemed to have been is such amount as the CIR may consider the EFV would have realized had it been sold in the open market at the time of cessation (s.16J(5C)).

If the EFV is sold, destroyed or stolen on, or within 12 months after, the cessation of the trade, profession or business, the person may claim an adjustment to the amount deemed to have been received (s.16J(5D)).

Example 6

B Ltd prepares its accounts to 31 July each year. On 19 June 2010, B Ltd purchased an electric car (Vehicle X) for \$250,000 and claimed a deduction of \$250,000 in respect of Vehicle X for the year of assessment 2010/11. On 2 April 2011, B Ltd ceased business without selling Vehicle X. The open market value of Vehicle X as at 2 April 2011 was \$100,000.

The CIR can treat Vehicle X as being sold for \$100,000 as at 2 April 2011 and assess that amount for the year of assessment 2011/12.

If B Ltd sells Vehicle X for \$80,000 within 12 months of 2 April 2011, B Ltd can lodge a claim with the Inland Revenue Department to have the taxable amount of \$100,000 adjusted to \$80,000 for the year of assessment 2011/12.

Time of sale of EFVs

The time of the sale, in relation to any EFV, shall be taken as:

- the time of completion of the sale of the EFV, or
 - the time when possession of the EFV is given,
- whichever is the earlier (section 16J(6)).

Tax Treatment of EFVs acquired before 18 June 2010

Subject to an election under section 16K(7), if, immediately before 18 June 2010, a person owned and had in use any EFV, that person shall, for the purposes of section 16I, be deemed to have incurred, on 18 June 2010, SCE in relation to that EFV (section 16K(1)). The SCE deemed to have been incurred shall be the capital expenditure incurred on the provision of that EFV reduced by the aggregate of :

- (a) the amount of initial allowances, if any; and
- (b) the amount of annual allowances, if any (section 16K(3)).

Example 7

On 1 May 2009, A Ltd in Example 1 purchased for \$300,000 a hybrid electric car (Vehicle IV, AA = 30%) for the production of chargeable profits. A Ltd claimed depreciation allowances in respect of Vehicle IV for the year of assessment 2009/10 as follows:

	<u>Vehicle IV</u>	<u>Allowance</u>
Cash price	300,000	
Initial allowance (IA) 60%	<u>(180,000)</u>	180,000
	120,000	
Annual allowance (AA) 30%	<u>(36,000)</u>	<u>36,000</u>
Written down value (WDV) c/f	<u>84,000</u>	<u>216,000</u>

If A Ltd makes a valid election under section 16K(7) for the year of assessment 2010/11, A Ltd will be deemed to have incurred SCE on 18 June 2010 of \$84,000 in relation to Vehicle IV and A Ltd can claim a deduction of \$84,000 in respect of Vehicle IV for the year of assessment 2010/11.

Election under section 16K(7) for accelerated deduction in respect of EFVs

Where a person is deemed to have incurred SCE under section 16K(1) in the basis period for any year of assessment, section 16K(1) applies to him only if he, at any time within one month after the date on which a notice of the assessment made in respect of that year of assessment under section 59 is given under section 62, elects in writing that the relevant provision shall so apply to him (section 16K(7)). An election under section 16K(7), once made, is irrevocable (section 16K(8)).

Example 8

If A Ltd wants to obtain an accelerated deduction in respect of Vehicle IV for the year of assessment 2010/11, it can make such an election within one month after the notice of assessment 2010/11. A Ltd may make such election in its profits tax return for the year of assessment 2010/11. On making a valid election, A Ltd can claim the deduction of \$84,000 (see Example 6) for the year of assessment 2010/11.

If A Ltd does not make such an election, the annual allowance in respect of Vehicle IV will continue to be calculated in the 30% pool for the year of assessment 2010/11.

Once A Ltd has made a valid election, it cannot subsequently revoke the election.

Conclusion

The statutory provisions in relation to EFVs became operative as from 18 June 2010. This article explains the deduction for capital expenditure incurred on EFVs on / before / after 18 June 2010 as well as the tax treatment for the sale proceeds of EFVs. Students preparing for the Accredited Accounting Technician Examination on Paper 5: Principles of taxation in 2011 and thereafter should know and understand the application of the above provisions as well as other examinable provisions.