

Financial Services Tax News

Financial Services Tax Group

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Tax Reform in Basic Circular for Corporate Tax Law on Capital Expenditure

The Basic Circular for Corporate Tax Law ("Circular") was amended on June 22, 2007 by the National Tax Agency in accordance with the 2007 tax reform on depreciation.

This Newsletter summarizes on the treatment of capital expenditure as outlined in the Circular.

1. The applicability of Special Rules on the Acquisition Cost of Capital Expenditure

(1) General rule

In general, capital expenditure made on or after April 1, 2007, is depreciated individually as a newly acquired depreciable asset, using the same asset type and useful life as the original depreciable asset on which the capital expenditure is made.

(2) Special Rules on the Acquisition Cost of Capital Expenditure

However, certain special treatments apply (as set out below excluding the special treatment for lease assets). If one of the special treatments applies to the capital expenditure, in general the capital expenditure can not be depreciated individually.

- ① For capital expenditure on depreciable assets acquired on or before March 31, 2007, the capital expenditure can be added to the acquisition cost of the depreciable assets on which the capital expenditure is made in the fiscal year the capital expenditure is made.
- ② For capital expenditure made on depreciable assets acquired on or after April 1, 2007, provided that the declining balance method applies to the original depreciable assets and the capital expenditure, at the beginning of the fiscal year following the fiscal year in which the capital expenditure is made, the new asset is regarded as being acquired at the price calculated below:

The book value of the capital expenditure at the beginning of the following fiscal year + the book value of the original depreciable asset at the beginning of the following fiscal year on which the capital expenditure is made.

- ③ Where ① and ② is not applied, at the beginning of the fiscal year following the fiscal year in which the capital expenditure is made, the new assets can be regarded as having been acquired at the price calculated below, provided the declining balance method applies to the capital expenditure:

The sum of the book value of the capital expenditures at the beginning of the following fiscal year, which are made in the same fiscal year end, which are categorized in the same asset type to which the same useful life applies.

2. Useful life for Capital Expenditure

Where the general rule described in 1(1) or the special rules described in 1(2)② or ③ apply, the capital expenditure is depreciated using the same useful life which applies to the original depreciable assets.

3. Special Rules on Accumulated Depreciation for the Capital Expenditure

Depreciable assets acquired on or before March 31, 2007 can be depreciated up to their residual value (i.e., up to 5% of their acquisition cost). If the assets are depreciated up to their residual value, such asset is allowed to be depreciated over five years after the fiscal year in which the depreciable asset reached the residual value until it reaches the nominal value of JPY 1 (“**Special Rules on the Depreciation Limitation Amount**”).

This Special Rules on the Depreciation Limitation Amount is not applicable to depreciable assets whose total book value of original assets and capital expenditure is more than 5% of the total acquisition cost of the original depreciable asset and capital expenditure after 1(2)① above is applied. Where the Special Rules on the Depreciation Limitation Amount is not applicable, the depreciable assets should be depreciated under the standard method of depreciation. Whether the Special Rules on the Depreciation Limitation Amount become applicable will be determined on 5% of the original depreciable asset and capital expenditure.

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