

Japan Tax Update

Monthly tax update

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Depreciation – the amended declining balance method

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1. Overview of the amended declining balance method

- (1) Under the amended rules for depreciation, depreciable property which is acquired on or after April 1, 2007 can be depreciated up to the residual value of JPY 1 for each asset. For these assets, the rate that will be applied under the accelerated balance method will be 250% of the rates under the straight line method.
- (2) Under the new declining balance method, the statutory depreciation amount is calculated as the beginning net book value of the property multiplied by the applicable depreciation rate of 250% (i.e. 250% declining balance method). When the depreciation expense under this accelerated method falls below the depreciation expense as calculated using the depreciation rate provided in the table of the Enforcement Order (the guaranteed rate), the remaining balance is depreciated on a straight line basis over the remaining useful life of the asset with a residual value of 1 yen.

2. Capital expenditure

- (1) General rule:

Capital expenditures that are incurred for existing depreciable property which was acquired before April 1, 2007 are deemed to be the acquisition of new property with the same property class and useful life as the existing property. The existing property continues to be depreciated under the method currently in use.

- (2) Exception:

If the declining balance method is applied to both the existing property and the capital expenditure, on the first day of the year following the year that the capital expenditure was incurred, the existing property and the capital expenditure are combined into a new single property, whose acquisition cost is the sum of the net book values of both at that point.

The first day of the year following the year when the capital expenditure was incurred is deemed to be the acquisition date of such property and the property class and useful life of the existing property is carried to such property.

3. Reporting requirements

(1) Election of depreciation method:

The depreciation method elected by the taxpayer for each class of depreciable property which is acquired on or after April 1, 2007 must be reported by filing an Application for Election of Depreciation Method with the applicable tax office by the due date of the final corporate tax return.

However, when the old straight line, old declining balance, or old activity-based method was elected for a certain class of property which was acquired before April 1, 2007 and the election application was not filed for property which is acquired on or after April 1, 2007 and such property would have been treated as the same class if it was acquired before April 1, 2007, a new straight-line, new declining balance, or new activity-based method is deemed to be elected for such class of property. In other words, the election application is not required if the same type of depreciation method will be applied to the same class of property.

(2) Change of depreciation method:

Generally, an Application for Change of Depreciation Method must be filed with the applicable tax office before the beginning date of the tax year to which the changes are applied and approval must be obtained in order to change the depreciation method. However, when the taxpayer intends to change the depreciation method in the first tax year ending on or after April 1, 2007, the application may be filed by the due date of the corporate tax return for such year.

For example, in the following situation, the taxpayer needs only to file an Application for Change of Depreciation Method by the due date of the corporate tax return and does not have to file an Application for Election of Depreciation Method for property acquired on or after April 1, 2007.

- The taxpayer uses the old straight-line method for a certain class of property;
- The taxpayer would like to apply the new declining balance method to the class of property, which was acquired on or after April 1, 2007; and
- The taxpayer would like to change the depreciation method from the old straight line method to the old declining balance for such class of property, which was acquired before April 1, 2007.

4. Additional notes

(1) Property placed in service in the middle of the tax year:

When property is placed in service in the middle of the tax year, the statutory depreciation amount for such property is prorated for the months that the property was placed in service. However, when the amount calculated under the declining balance method is compared to the depreciation rate provided in the tables (the guaranteed amount) to see if the conversion to the straight-line method should occur, the non-prorated amount should be used.

(2) Property with useful life of 2 years:

When the declining balance method is used for property with a useful life of 2 years and such property is placed in service for 12 months in the first year, such property can be fully depreciated (up to the residual value of JPY1) in the first year since the rate of depreciation is 1.000.

(3) Capital expenditure made in later years of useful life of property with declining balance method:

When a capital expenditure is incurred for property after the declining balance method is converted to the straight-line method and such expenditure is aggregated with the existing property into a new single property at the beginning of the following year of the capital expenditure, the depreciation method is converted back to the declining balance method since the beginning date of the following year of the capital expenditure is deemed to be the new acquisition date. Then, the depreciation method will be converted to the straight-line method in the year when the amount calculated using the declining balance method is less than the rate prescribed in the depreciation tables.

(4) Special provision for reporting requirement:

The special provision which extends the due date for reporting the change in the depreciation method to the due date of the corporate tax return is applied only to the transition period (the first year ending on or after April 1, 2007). After the transition period, an Application for Change of Depreciation Method must be filed before the beginning date of the tax year to which the change is applied and approval must be obtained.

You have a vision. PricewaterhouseCoopers helps bring that vision to reality. We hope you enjoy the current issue of Japan Tax Update and appreciate your comments or ideas for what you'd like to see covered in future issues.

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