



Financial Services Tax Group

News Letter

April 2004

Tax treatment on impairment loss

The National Tax Agency recently issued an amended *Corporation Tax Circular* primarily dealing with the FY 2003 Japanese tax reform applicable from the fiscal year ended March 31, 2004. The amendment includes Article 7-5-1¹ which concerns the definition of expenses charged to income as depreciation expense. In the amended Article 7-5-1, the tax treatment of impairment loss which is not allowed as a deduction from taxable income for corporate tax purposes is clarified.

In this Newsletter, we outline the corporate tax treatment on impairment loss charged to income under the *Accounting Standard for Impairment of Fixed Assets* (“Standard”).

I. Accounting guidelines

Further to the global harmonization of accounting standards, this Standard was published in 2002, and last year detailed guidelines were set out in “*Practical Guidelines for Application of Accounting for Impairment of Fixed Assets*”(“Guidelines”). In accordance with the Standard and Guidelines, the book value of an asset that is expected not to generate enough cash flows to recover its investment due to a deterioration of its profitability should be reduced under certain conditions. The mandatory application of the Standard starts for the business year commencing April 1, 2005, although early adoption for the year ended March 2004 is accepted for many companies.

Footnote¹ The <Citation: Amended Article 7-5-1 >

(5) The disposal loss or valuation loss recognized on the depreciable assets which is tax non-deductible.
(NOTE) The valuation loss includes the impairment loss.

II. Deductibility of impairment loss for corporate tax purposes

For corporate tax purposes, a valuation loss will be deductible from taxable income only under certain circumstances. These circumstances are quite limited, examples of which are: a) the fixed assets was considerably damaged; or b) the revaluation of the assets was necessary in accordance with the commencement of corporate reorganization proceedings under the *Corporate Reorganization Law* (Article 33 of the *Corporation Tax Law* and Article 68 of the *Cabinet Order of Corporation Tax Law*).

The method to compute the amount of impairment loss under the Standard and Guidelines differs from the method to compute the revaluation loss under the *Corporation Tax Law*. The impairment loss for accounting purposes is computed on a group of assets (or business) basis, whereas the *Corporation Tax Law* requires the revaluation loss per each individual asset. Therefore, even if the circumstances described above are met for an accounting impairment loss, it may not be treated as tax-deductible expense for Japanese corporate tax purposes.

III. Amendment of Article 7-5-1 (i.e., the definition of the expenses charged to income as depreciation expense)

The *Corporation Tax Law* prescribes that the amount to be deductible from taxable income as depreciation is, out of the amount charged to income as “depreciation”, limited to the statutory amount computed under the *Cabinet Order of the Corporation Tax Law* (Article 31 of the *Corporation Tax Law*). Even if the expenses are charged to income in an account other than “depreciation”, the expenses referred to the items described in the Article 7-5-1 can be deemed to be booked as a “depreciation account” for Japanese corporate tax purposes.

The impairment loss was not formerly treated as “expenses charged to income as a depreciation expense” when such loss was not tax-deductible for corporate tax purposes as described above. However, the amended Article 7-5-1 clearly describes that an impairment loss, which is not allowed as a deduction from taxable income under the *Corporation Tax Law*, is treated as “expenses charged to income as a depreciation expense”. Accordingly, such impairment loss can be treated as

depreciation and can be deducted in computing the taxable income for each fiscal year up to the statutory limit of depreciation for corporate tax purposes.

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