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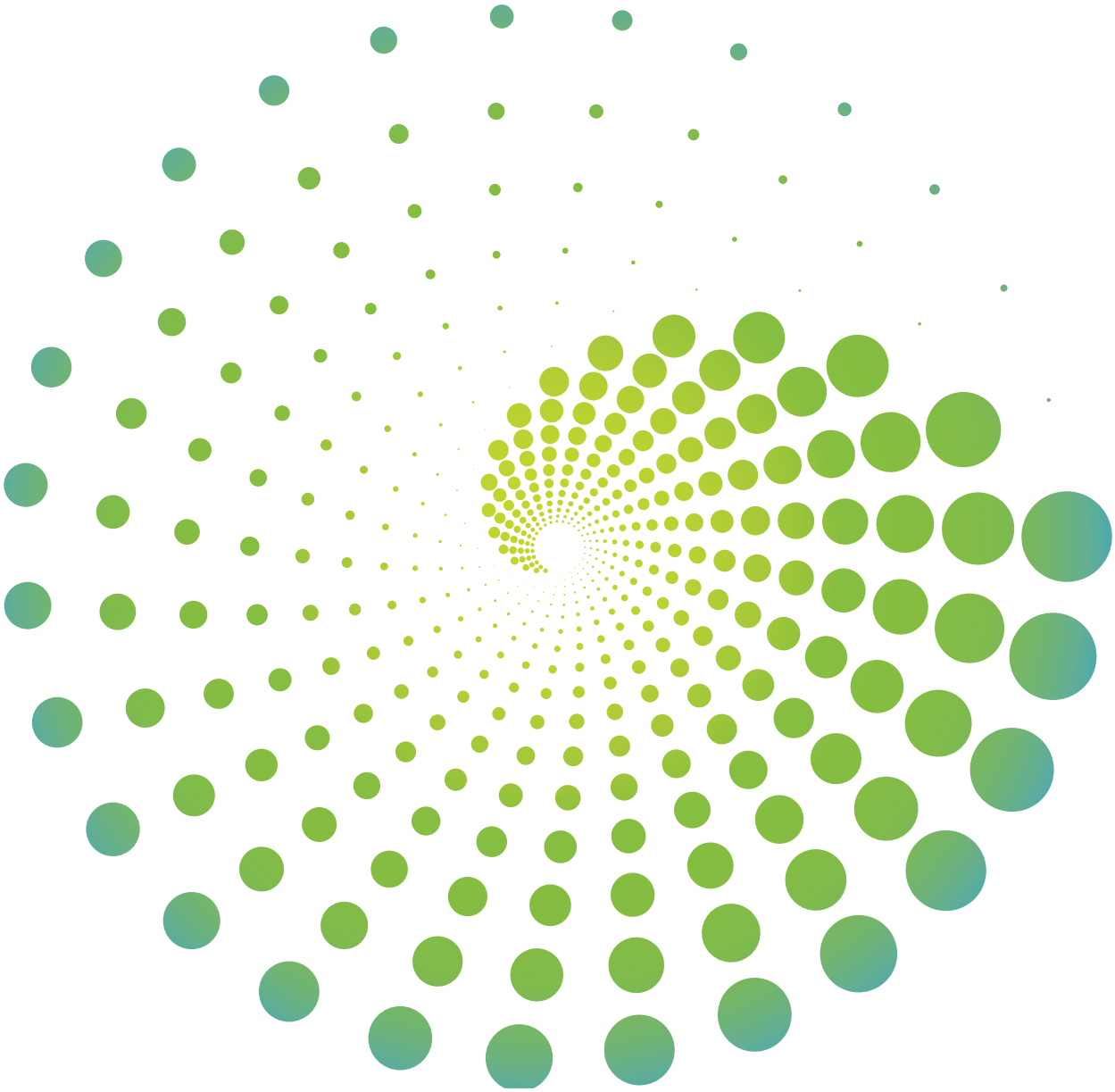

Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Topic 2

In this issue

This is the second of our series of Special Alerts summarising the major proposed changes under the Income Tax Act rewrite.

Fixed Assets and Depreciation Changes

The draft rewrite of the Income Tax Act contains many important implications to consider for taxpayers. In this article we summarise the implications for the calculation of depreciation on fixed assets.

Depreciable assets are classified into 5 classes. The rate of depreciation on an individual asset is based on the straight-line method, calculated on a daily basis. However, in the case of assets in classes 1 to 3, the taxpayer can elect, with assets of the same class, to calculate depreciation on a pooling basis. Where the election is made, it is irrevocable, and all assets in that class must be calculated on a diminishing value basis at the rates set out in the table (on the right). In addition, the depreciation for the pool is calculated as follows:

(Written Down Value (WDV) at beginning of the tax year + 50% of cost of assets in the current year + 50% of cost of assets in prior year- consideration for disposal of assets in the pool during the current year) times the rate of depreciation (WDV method) for the pool.

Classes 4 and 5 cannot be pooled and must use the straight line method.

The classes and rates of depreciation are as follows:

Class	Depreciable Asset	Straight-line Rate	Diminishing Value Rate
1	Motor vehicles; buses and minibuses with a seating capacity of less than 30 passengers; goods vehicles with a load capacity of less than 7 tonnes; computers and data handling equipment; and construction and earthmoving equipment	25%	40%
2	Buses with a seating capacity of 30 or more passengers; goods vehicles designed to carry or pull loads of 7 or more tonnes; specialised trucks; tractors; trailers and trailer-mounted containers; and plant and machinery used in manufacturing, mining, forestry, or farming operations	20%	30%
3	Vessels, barges, tugs, and similar water transportation equipment; aircraft; office furniture, fixtures, and equipment; and any depreciable asset not included in another Category (other than a business intangible)	12.5%	20%
4	Structural improvement	5%	-
5	Business intangibles	Rate determined under clause (3)	-

- The rate of depreciation applicable to a depreciable asset that has a cost of less than K1,000 is 100%.
- The straight-line rates of depreciation applicable to business intangibles are -
  - For preliminary expenditure, 25%;
  - For a business intangible with a useful life of more than 10 years, other than a business intangible referred to in paragraph (a) or (c) of this clause, 10%;
  - For a long-term lease, is 100% divided by the term of the lease remaining at the date of acquisition; and
  - For any other business intangible, 100% divided by the useful life of the intangible.

Some further important features of the regime are as follows:

- Depreciable assets, under the definition, must be assets used in a business.
- There is now a small asset write-off, albeit limited to K1,000 (which larger businesses may feel is too low).
- Software appears to be in Class 3 and depreciable at either 12.5% SL or 20% WDV if included in a pool. These rates seems low for software which typically has a short life.
- If a depreciable asset, not in a pool, is sold any gain on sale is assessable. This is no longer limited to the depreciation previously claimed. Consequently, a capital gain on the sale of a depreciable asset is treated as an assessable gain. A loss on sale is deductible.
- If the consideration on sale of pooled assets exceeds the value of the pool, then the excess is assessable income.

- There are apportionment rules for assets used for private and business purposes. There are also special (fair value) rules for assets transferred from private to business purposes or vice versa.
- Business intangibles are depreciable in accordance with the table above. It is good to see the extension of the depreciation regime to previously "black hole" expenditure. Note goodwill remains non depreciable.
- Special rules apply to repairs and improvements. The deduction in the current year is limited to 20% of the value of the asset at the end of the tax year. The excess amount is added to the asset at the end of the year. In the case of pooled assets, the 20% is based on the WDV of the pool at the end of the year. The excess is added to the value of the pool at the end of the year. This is likely to increase compliance costs. In some cases, taxpayers will win, in other cases they will be losers. It is likely to make the use of pooled assets more attractive.
- In the case of Finance Leases, the lessee will be deemed to own the asset and entitled to claim depreciation (and interest implicit in the lease charges).
- Accelerated depreciation provisions are yet to be inserted into the draft Act, though an initial allowance of 20% for plant or machinery used in manufacturing is contained in the draft.

The abovementioned changes to the taxation of fixed assets are significant and taxpayers should take time to ensure they understand the implications for their business. There are a number of transitional issues to consider and respond on, such as the value of depreciable assets on the commencement of the new regime and the election to form pools of assets.

If you would like to discuss the draft changes, their impact or the making of a submission to Treasury, please let us know.

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