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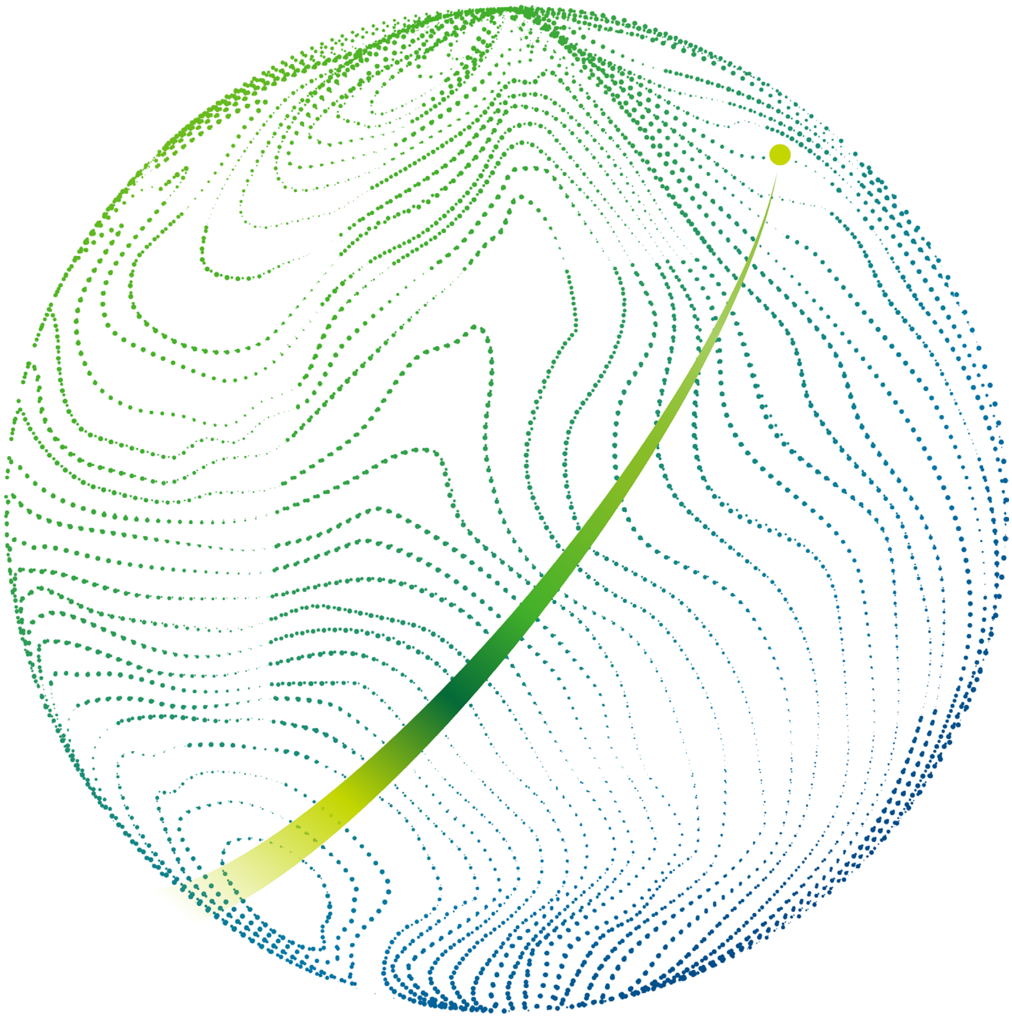

Papua New Guinea

Tax Alert

Income Tax Act Rewrite Series – Fixed Assets and Depreciation

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 implication for the calculation of depreciation on Fixed Assets. This Alert is updated to the 9th draft of the new Act. It is anticipated that the new Act will be included with the Budget announcements in late November 2022 with a commencement date of 1 January 2024.

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 above. 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.

Depreciation is not allowed for a building until the construction of the building is certified as complete even if the building is used partly constructed.

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; Software; 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)	-

1. The rate of depreciation applicable to a depreciable asset that has a cost of less than K1,000 is 100%. A depreciable asset must also have an ascertainable useful life of more than 1 year.
2. The straight-line rates of depreciation applicable to business intangibles are -
   A. for preliminary expenditure, 25%;
   B. 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%;
   C. for a long-term lease, is 100% divided by the term of the lease remaining at the date of acquisition; and
   D. 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, by definition, must be wholly or partly used to derive assessable income.
- In the 9th draft software has been moved to Class 1 and depreciation rate has now been increased to 25% SL or 40% WDV. This is more likely to be in line with the length of its life.
- Where a business places an item of eligible property into service for the first time it can claim an additional 20% depreciation in the first year. The remaining accelerated depreciation provisions available under the current Act have not been replicated. Eligible property is for plant and machinery used only in manufacturing.
- If a depreciable asset, not in a pool, is sold any gain on sale is assessable up to the level of depreciation previously claimed (a balancing charge). Consequently, a capital gain on the sale of a depreciable asset is not treated as a balancing charge . A loss on sale is deductible.
- Where a pooled asset is sold, the sale proceeds up to the level of the cost of the asset is deducted from the value of the pool. Any excess over the historic cost of the asset is currently treated as a tax-free capital gain.
- Roll-over relief (deferral of recognition of a gain or loss), may be available for assets, depreciated on a straight-line basis, in a variety of situations (death, divorce, compulsory acquisition, business asset replaced etc.).

- There is also group (95% or greater common ownership) provisions applying for the transfer of assets intra group. This essentially transfers the assets at tax book value with no gain or loss arising.
- If the consideration on sale of pooled assets (or cost, if less than the sale price) 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 for the repair of an asset 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 and therefore depreciable in the following 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 with depreciation being claimable in subsequent years. This 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). Where the deemed interest is paid to a non-resident withholding tax will need to be consider.
- There are transitional provisions now available for the assets that are subject to straight line depreciation under Sec 37 of the New Act.

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. The draft Act makes provision for regulations to deal with many of the transitional rules. We understand that draft regulations will be released during the course of the calendar year 2023.

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