# Talk Tax –Depreciation deduction for Tax purpose

**FT: How do you define depreciation allowance for tax purpose?**
**CEO:** Depreciation allowance is an amount of annual allowance to recover the cost of property that has declined due to wear and tear, deterioration or obsolescence. For tax purpose a deduction can be claimed for depreciation on most tangible property (except land) such as buildings, machinery, vehicles, etc.

**FT: What requirements must be fulfilled before a deduction is allowed for depreciation?**
**CEO:** For a depreciation deduction to be allowed, the asset must be used in the business or income-producing activity; the asset must have a determinable useful life; the asset must be used or expected to be used for more than one year.

**FT: There are various methods to account for depreciation. What methods are permissible by Fiji tax law?**
**CEO:** Effective from 1 January 2016 a taxpayer is required to use only one of two depreciation methods for all its assets that is either Straight Line (SL) or Diminishing Value (DV), however for building and structural improvements only straight line method can be used. Taxpayers can change their depreciation method upon approval by the CEO.

**FT: What are the allowable depreciation rates for various categories of asset?**
**CEO:** There are four (4) broad categories of assets and deprecation rates as follows:

| **Asset** | **Depreciation Rate** | |
|---|---|---|
| | **Diminishing value** | **Straight-line** |
| ▪ Motor vehicles; buses and minibuses with a seating capacity of less than 30 passengers;<br>▪ Goods vehicles with a load capacity of less than 7 tonnes;<br>▪ Computers and data handling equipment<br>▪ Construction equipment<br>▪ Earthmoving equipment | 40% | 25% |
| ▪ Buses with a seating capacity of 30 or more passengers<br>▪ Goods vehicles designed to carry or pull loads of more than 7 or more tonnes<br>▪ Specialised trucks; tractors; trailers and trailer-mounted containers<br>▪ Plant and machinery used in manufacturing, mining, or farming operations | 30% | 20% |
| ▪ Vessels, barges, tugs, and similar water transportation equipment<br>▪ Aircraft | | |

| | | |
|---|---|---|
| ▪ Specialised public utility plant, equipment, and machinery<br>▪ Office furniture, fixtures, and equipment<br>▪ Any depreciable asset not included in another category | 20% | 12.5% |
| Buildings<br><br>▪ Brick, stone or concrete<br>▪ Timber buildings<br>▪ Steel or steel prefabricated<br>▪ Steel or steel prefabricated on copra plantations<br>▪ Bures<br>▪ Other | | 2.5%<br>4%<br>4%<br>7%<br><br>15%<br>2.5% |

**FT: Can you please elaborate on how depreciation is calculated using the two methods discussed above?**
**CEO:** As earlier stated the two methods allowed are the Straight Line Method and the Diminishing Method.

**Straight Line Method**

The straight-line depreciation allows the taxpayers to claim depreciation deduction evenly over the useful life of the asset where the cost of a depreciable asset is deducted evenly over the useful life. In any case the total deductions allowed must not exceed the cost of the asset.

**Formula: Cost of Depreciable Asset x Depreciation Rate**

**Example 1 – Asset Fully Used for Business Purpose**

Mr J acquires a computer on January 1, 2017 wholly for use in his accounting business. The computer cost $4,000. The depreciation rate is 25%, which assumes a useful life of four years. Assuming Mr J holds the asset for four tax years, the depreciation deduction for each year is $1,000 ($4000 x 25%)

| **Year** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|
| Depreciation | $1000 | $1000 | $1000 | $1000 |

**Example 2 - Asset Partly Used for Business Purpose**

If Mr J uses the computer 75% of the time to derive gross income and 25% of the time for personal use. Assuming that Mr J holds the asset for four tax years, the depreciation deduction for each year is $750 ($4,000 x 25% x 75%).

| **Year** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|
| Depreciation | $750 | $750 | $750 | $750 |

**Example 3 – Asset Acquired During the Year**

Suppose instead that Mr J acquired the computer on July 1, 2017.

- The depreciation deduction for the 2017 tax year is $504 (4,000 x 25% x 184/365).

- Mr J is allowed a depreciation deduction of $1,000 in each of the next three tax years (2018, 2019 and 2020 tax years).
- At the end of the 2020 tax year, Mr J has been allowed total depreciation deductions of $3,504 in relation to the computer. If the computer is used for the whole of the 2021 tax year, the depreciation deduction for the year is limited to $496 ($4,000-$3504).

| **Year** | **2017** | **2018** | **2019** | **2020** | **2021** |
|---|---|---|---|---|---|
| Depreciation | $504 | $1000 | $1000 | $1000 | $496 |

**Diminishing Method**

The diminishing value depreciation method allows taxpayers to claim the depreciation deduction for a tax year in respect of a depreciable asset and is computed by applying the prescribed depreciation rate against the written down value of the asset at the beginning of the year. Because the written down value diminishes over time but the percentage does not change, the effect is to allow a larger deduction in the first year and decreasing deductions in subsequent years. This is based on the assumption that the decrease in value of depreciable assets caused by wear and tear is greater in the earlier years of use.

**Formula:**
**Year 1 = Cost of Depreciable Asset x Depreciation Rate**
**Year 2 onwards = Written Down Value x Depreciation Rate**

**Example 1**

On 1 January 2017, Mr D acquires drilling machinery worth $20,000 which is to be used solely in deriving mining income included in gross income. The diminishing value depreciation rate is 30%.

For the 2017 tax year, the depreciation deduction is $6,000 ($20,000 x 30%).

The written down value of the plant at the beginning of:

- 2018 tax year is $14,000 ($20,000 - $6,000) and the depreciation deduction allowed for that year is $4,200 ($14,000 x 30%).
- 2019 tax year is $9,800 ($14,000 - $4,200) and the depreciation deduction allowed for that year is $2940
- 2020 tax year is $6860 ($9800 -$2940) and the depreciation deduction allowed for that year is $2058

| **Year** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|
| Depreciation | $6000 | $4200 | $2940 | $2058 |

**Note the asset will be depreciated until the written down value will be $0.**

**Example 2**

Suppose instead that Mr D used the plant partly to derive business income included in gross income (50%) and partly to derive exempt income (50%).

- The depreciation deduction for the 2017 tax year is $3,000 (($20,000 x 30%) x 50%)

- The written down value of the plant at the beginning of the 2018 tax year is still $14,000 (i.e. computed on the assumption that the whole amount of the depreciation was allowed). The depreciation deduction for the 2018 tax year is $2,100 (($14,000 x 30%) x 50%).

- The written down value of the plant at the start of the 2019 year is still $9,800. The depreciation deduction for the 2019 tax year is $1,470 (($9,800 x 30%) x 50%).

- The written down value of the plant at the start of the 2020 year is still $6,860. The depreciation deduction for the 2020 tax year is $1,029 (($6,860 x 30%) x 50%).

| **Year** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|
| Depreciation | $3000 | $2100 | 1470 | 1029 |

**Note the asset will be depreciated until the written down value will be $0.**

**FT: Any other comments you want to make?**
**CEO:** Yes, I would like to stress on the importance of maintaining and proper records of assets and the respective depreciation method and allowance calculations. The following records must be kept and maintained by a taxpayer for a minimum of 7 years: list of assets in respect of which depreciation is claimed; date of purchase; cost; calculation of depreciation; date of disposal; consideration received; and records of profit and loss statement and amount claimed for income tax purposes.

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