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Japan Tax Bulletin

Valuation loss on assets

April 2017

1. Valuation loss

A valuation loss on an asset is generally disallowed in calculating taxable income (Article 33①of Corporation Tax Law ("CTL")). However, a loss can be deductible in limited circumstances where the assets are devalued due to legal procedures, such as company rehabilitation procedures, or the assets are physically devalued.

2. Valuation loss on inventory

A deduction for a valuation loss on inventory is allowed where the loss arises due to the following facts (Article 68①(1) of the Corporation Tax Law Enforcement Ordinance ("CTLEO")):

- Inventories are significantly damaged by natural disasters;
- Inventories are significantly obsolete. Obsolescence means a significant decrease in the value of inventories due to economic environment changes, from which a recovery is not expected. Examples of obsolescence are as follows (Corporation Tax Law Basic Circular ("CTLBC") 9-1-4):
  - Unsold seasonal goods which cannot be sold at their normal price, with reference to the past sales records or other situations; or
  - Products that cannot be sold at their normal price due to the release of new products that are used in the same way as the products, but of different type, quality or performance to the products.
- Facts similar to the above.

3. Valuation loss on securities

A deduction for a valuation loss on securities is allowed where the loss arises due to the following facts (Article 68①(2) of CTLEO):

- A significant decrease in the value of publicly traded securities. A significant decrease in value is a decrease in market price of approximately 50% of book value, which is unrecoverable in the near future (CTLBC 9-1-7);
- A significant decrease in the value of securities other than the above (non-publicly traded securities) due to a significant deterioration in the financial position of the issuing corporation. A significant deterioration in financial position is evidenced by the following facts occurring within a reasonable period of time after the acquisition (CTLBC 9-1-9):
  - An order for commencement of a special liquidation;
  - A notice of commencement of bankruptcy proceedings;
  - A notice of commencement of corporate reorganization;
  - A notice of commencement of corporate rehabilitation; or
  - A decrease in net equity per share to less than 50% of the acquisition date value.

  The value of non-publicly traded securities is determined as follows (CTLBC 9-1-13):
  - Where there are actual trading records in the 6 months prior to the end of the business year when the valuation loss is recorded, a reasonable traded price;
  - Where the issuing company is in the process of an IPO, the price in ordinary trades with reference to the IPO price, determined after a competitive bidding process conducted in accordance with the internal regulations of a financial instrument exchange;
  - Where there are no actual trading records, but the value of a company comparable in terms of type of business, business scale, profitability is known, the estimated value with reference to the comparable company's value; or
  - Where none of the above are applicable, the price in ordinary trades with reference to the net equity value per share of the issuing company at the end of the business year closest to the end of the business year when the valuation loss is recorded.
- Facts similar to the above.

4. Valuation loss on fixed assets

A deduction for a valuation loss on fixed assets is allowed where the loss arises due to the following facts (Article 68① (3) of CTLEO):

- The fixed assets are significantly damaged by natural disasters;
- The fixed assets have been idle/unutilized for 1 year or more;
- The fixed assets are not used for their original purposes;
- Conditions on the site where the fixed assets are located have significantly changed; or
- Facts similar to the above. For example, fixed assets which have not been put into business use for 1 year or more from the date of acquisition (CTLBC 9-1-16).

A deduction for valuation loss is not allowed in the following circumstances (CTLBC 9-1-17):

- Fixed assets have been significantly damaged due to excessive use or insufficient repair and maintenance;
- Fixed assets which have not been depreciated sufficiently;
- Fixed assets whose acquisition cost was excessive compared to the price of other assets of the same kind; or
- Machinery and equipment that has become out-dated due to the rapid improvement of production methods.

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