February 2014

TAX NEWS

L E R I K A , D o m a ž l i c k á 1 , 1 3 0 0 0 , P r a h a 3 , w w w . l e r i k a . e u

Dear Clients and Business Partners,

In the February issue of our Tax News, we will introduce several new concepts in accounting that were brought to us by 2014. We believe it will be interesting and valuable for you. Should you have any questions, please do not hesitate to contact us whenever you like.

With best regards,

LERIKA Team

In this issue

CHANGES IN ACCOUNTING AS OF 1 JANUARY 2014

TECHNICAL IMPROVEMENTS

The first change relates to the change in Directive No. 500/2002 Coll., which provides for practical application of provisions of Act No. 563/1991 Coll., on accounting. Starting 1 January 2014, important changes relating to **technical improvements of fixed assets** have been introduced. As of this year, the Act on Accounting newly contains its own definition of technical improvement. Until now, the concept had been defined in the Income Taxes Act from where it was adopted for accounting purposes. As a result, there was complete symmetry between accounting and tax recognition of technical improvements. Newly, a definition of technical improvement is introduced in accounting regulations which define technical improvement as a modification of an existing, utilized asset the result of which is a change of their purpose or technical parameters or extension of level of equipment or utility value of the asset, including construction works resulting in extension or change of structures.

Tax I Accounting I Payroll

Should you not wish to receive our Tax News,
please contact Lucie Kalová
via e-mail:
lucie.kalova@lerika.eu
or phone: +420 222 362 678.

For further information please contact the respective LERIKA's specialist.

Costs of technical improvements include the sum of all costs incurred on all completed fixed asset modifications in a given accounting period. In substance, this definition does not differ from the one in the Income Taxes Act. However, substantial differences exist in terms of thresholds that cause a specific modification to qualify as technical improvement.

If costs incurred by the accounting unit fully correspond to the above definition, they are considered as technical improvement at the point when they exceed the general threshold stipulated by the accounting unit for recognition of fixed assets. Should the sum of costs not exceed the stated threshold, it is considered a one-off operating expense. The threshold is thus no longer the same for everyone but corresponds to the individual threshold set for recognition of fixed assets on the balance sheet. The above applies to intangible assets, fixed assets and sets of fixed assets. In contrast, different treatment applies to real estate i.e. the sum of costs constitute a technical improvement only under the assumption that materiality threshold defined in relation to the acquisition price or replacement cost of each individual building is reached. The threshold for technical improvement of buildings is thus stipulated individually by each accounting unit based on the materiality criterion.

If the accounting unit stipulates a limit for recognition of intangible assets of e.g. CZK 50,000, improvement costs of up to CZK 50,000 in a given accounting period are to be considered a one-off operating expense. Over this threshold, the costs will qualify as technical improvement increasing the acquisition price. However, given that the threshold for technical improvements in the Income Taxes Act remains at CZK 40,000 level, a situation can arise where the costs represent technical improvement from the tax point of view but one-off operating expense from the accounting point of view. In our example, this would arise in case if the sum of costs were between CZK 40,000 and CZK 50,000. This would cause a difference between accounting and tax treatment not only in as regards depreciation but also in terms of the acquisition price.

ABOLITION OF THE RESERVE FUND

Another piece of news for 2014 relating to the adoption of the Act on Corporations is the abolition of an obligation to create mandatory reserve fund from profit. The accounting unit can decide on its own whether to continue in creation of the reserve fund or whether to dissolve it. If the accounting unit decides for the latter alternative i.e. dissolution, it has to comply with a number of conditions. One of them is a change in statute or in Articles of Association in case the latter provide for the reserve fund creation. In most cases, the obligation to create reserve fund is stipulated in such documents by virtue of their copying of the relevant Commercial Code provisions. However, nowadays, such obligation can be simply dropped from the text of the documents. In case the accounting unit leaves the Articles of Association as they are, it is obliged to continue in fund creation. From the accounting perspective, dissolution of the reserve fund can be resolved through its transfer to retained earnings. Decision on a change of Articles of Association and on the dissolution of the reserve fund is subject to an approval by General Meeting.

ACCOUNTING FOR INTERIM DIVIDENDS

The last piece of accounting news that we shall summarize is relating to equity distribution, specifically payment of interim dividends which is governed by the Act on Corporations. Until the end of 2013, payment of interim dividends was disallowed by the Commercial Code. Newly, payment of interim dividends can be made based on interim financial statements that are not older than 6 months and which show that the company has sufficient funds to enable profit distribution.

Interim financial statements are such that are prepared during the course of an accounting period at a point different from the regular closing of books. Interim financial statements shall contain all the relevant accounting entries such as depreciation, creation of reserves, tax liability estimates etc.

The amount of interim dividends shall not exceed the sum of current year profit, retained earnings and other funds created from profits reduced by non-compensated losses and mandatory reserve fund contribution. It is also required to make sure that the accounting unit shall not become insolvent as a result of the distribution. Insolvency within the meaning of Article 3 of Act on Insolvency is understood as an inability to pay liabilities or the state of over indebtedness.

Therefore, insolvency test has to be performed. From the accounting point of view, the issue is dealt with by an amendment of Accounting Standard No. 018. Payment of interim dividends shall be recognized in the liability section of the balance sheet with a minus sign whereas a new entry titled “Interim dividends scheduled for distribution” shall be recorded under account group 43 – Current Year Profit. The interim dividend is subject to 15% final withholding tax.

In case of any questions to the above, please do not hesitate to contact us for assistance.

petr.hajek@lerika.eu

Contacts:

Corporate taxation	VAT and customs	Personal taxation	Accounting
Ivana Ottová	Alena Kučerová	Martin Pecka	Monika Borkovcová
+420 277 277 085	+420 277 277 084	+420 277 277 087	+420 222 363 073
ivana.ottova@lerika.eu	alena.kucerova@lerika.eu	martin.pecka@lerika.eu	monika.borkovcova@lerika.eu