

Application of Tax and Accounting Depreciation Based On IAS / IFRS and Legislation in Slovakia

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Introduction

Regulations in the European Union in the field of accounting are defined under international accounting standards. Individual EU Member States prefer to implement international accounting standards into national legislation in order to ensure competitive business environment of national enterprises in global business environment. Among international accounting standards we can see standard IAS 16 - Property, Plant and Equipment. This standard defines of long run fixed assets and is elaborating various methods of depreciations. The initial objective of our article is to compare various depreciation methods under IAS with depreciations methods applicable by law in the Slovak Republic. Depreciation is in book keeping cost item which represents cost related to the consumption of investments in to the transformation process.

Keywords

depreciation, accounting depreciation, tax depreciation, IAS 16 characteristics - Property, plant and equipment, depreciation methods,

1. International accounting standards

By the beginning of 70-ties in 20th century, IFRS (International Financial Reporting Standards) were introduced by IASC (International Accounting Standards (International Accounting Standards Committee). This institution was created based on accountancy bodies of various

countries over the world, like Australia, Canada, Great Britain, Holland, Mexico, Japan, Germany, etc. Later on this committee was changed in to International Accounting Standards Board (IABS) with the headquarter in London, UK. Over the period, IASC introduced over 41 standards marked as International Accounting Standard (IAS). Some of them in a mean time were dismissed, some of them were replaced by new ones, and some of them were merged with some others. This is a sign that process of standardization is "alive" procedure, and most possible never ending story, as far as real live is changing as well. Since 2001 are International Financial Statements Standards introduced. (Epstein, Jermakowicz, p. 35). Up to now there are 9 of them. Behind above mentioned activities we can find International Federation of Accountants, established by the end of 90ties, last century, with following objectives:

- Introduction of international standards for global harmonization of accounting
- Support of branch offices over the world, and members assistance
- Quality control development for audit companies providing audit of international and global companies.
- Cooperation with local regulatory bodies, local standard creators and financial institutions.

Particular governments have an option to implement international standards in to their national standards.

2. Implementation of International Accounting Standards in To the Slovak Legal System.

IFRS/IAS standards were introduced in to the Slovak legal system already before joining of EU, especially in accounting of investments. After 1998 Slovak governments realized that without international integration there is no guarantee for economical growth. Therefore quanta of new laws were introduced in various areas, to make Slovakia as a country more friendly and interesting for international and global cooperation. After Slovak republic joined EU, the requirements for implementation off IFRS/IAS gown rapidly, because EU had implement them a far before.

3. International Accounting Standard IAS 16 - Property, Plant and Equipment

The objective of IAS 16 is to offer a standard for accounting treatment for real estates, machinery and equipment, so that users can distinguish information above particular investments and eventual changes. The key issues are the recognition of these assets, the determination of their carrying out amounts (accounting values), determination of depreciations, and determination of impairment losses, which are in connection with them.(Štangová, N,Víghová, A, Hajduchová, E., p. 56)

IAS 16 excludes tangible assets not covered by IAS 16:

- tangible fixed assets classified as assets held for sale
- biological assets (like forests and renewable natural resources) related to agricultural activities
- the recognition and valuation of exploration and evaluation of mineral raw materials
- the right to minerals and mineral resources;

Rules for fixed assets accounting have to meet following four requirements:

- determination of the amount by which the property is supposed to be valuated at its initial acquisition,
- monitoring of the initial acquisition price changes and their presentation on relevant accounts
- setting of the rate by which property value is allocated in to the costs of future periods
- Booking of the definitive disposal of assets.

Under IAS 16 the purchase price of an item of real estate, machines and technology equipment includes:

- the purchase price including import duties and non-refunded taxes, after deducting trade discounts and rebates
- all directly attributable costs of transportation of property on the destination and installation costs
- Initial estimate of dismantling and removing costs, including costs for reorganizing the place to its origin state.

Costs that are not part of the purchase price are as follows (example):

- the cost of setting up of a new business activity
- new product introduction and marketing costs
- market penetration costs
- costs of the acquisition to the new customer target group, including the cost of training and staff
- Administrative and other overhead costs of a general nature.

Entity begins to depreciate an asset at a time when the asset is in his working destination, ready for its exploitation. Depreciated is as an asset that has a bounded lifetime. Land in general, with certain exceptions, is not depreciated. The exceptions are as quarries, areas used as a waste dumps.

In determining the life cycle of tangible assets is necessary to consider all following factors:

- Expected use of property – with the consideration of expected capacity or physical output from the asset
- The expected physical wear, which depends on operational factors, number of shifts over the day, plan for repairs and maintenance, level of the maintenance when is not in the use
- Technical and commercial obsolescence arising from changes or improvements in production or from changes in market demand for the product
- Legal or similar to legal limits on the use of asset, such as the date of completion of the related leases.

According to IAS depreciation method are as follows:

a) Straight-line method - this method of depreciation is depreciation for each accounting period during the lifetime equivalent, and provided that the cost does not change during the period of depreciation.

$$\text{The annual depreciation} = \frac{\text{Depreciable amount}}{\text{Lifetime}}$$

b) Accelerated depreciation method - this method is the characteristic by fact, that in the first years of higher amount of depreciation are booked, and then their booked level gradually decreases. IAS distinguishes three ways of accelerated depreciation:

1. Shrinking method on depreciation is calculated by multiplying a constant percentage of the current residual value.

$$s = 1 - \sqrt[n]{\frac{\text{Rez.H}}{\text{OC}}} \text{-----(1)}$$

$$\text{Annual depreciation} = \text{ZC} \times s$$

Where: a = annual depreciation rate
 Rez.H = residual (residual) value of the OC = CC = cost of carrying value

2. Method of DDB (Double Declining Balance Method) - this method is provided for depreciation percentage than twice the linear rate depreciation is calculated by multiplying the constant depreciation percentage to the current book value, there are various alternatives to this method, for example, 1.5 times the linear rate.

$$s = 2 \times \text{linear depreciation rate of annual depreciation} = \text{CC} = x \text{ s and, with an annual depreciation rate ZC} = \text{residual value}$$

3. SYD method (Sums of the Years Digits) - This method is based on the determination of the variable percent depreciation of the initial price set for depreciation.

$$\text{Annual depreciation in "i" - the year} = \frac{n + 1 - i}{n \times (n + 1)} \text{-----(2)}$$

Where "i" is "i"-th year depreciation

c) Performance depreciation method, which can be used by accounting entity for accounting of assets whose life cycle is determined by the certain amount of output. It is used mainly for accounting of transport equipment and depreciation of natural resources, since depreciation is gradual draining of the original amount of these resources.

$$\text{The annual depreciation} = \frac{\text{performance in a given year}}{\text{Over all performance}} \times (\text{OC} - \text{Rez. H})$$

Slovak Republic Legislation in the Area of Depreciations

By Slovak legislation there are two main groups of depreciations defined - accounting depreciation and tax depreciation.

Accounting depreciation is defined by the provisions of § 28 of Act no. 431/2002 Coll of Laws. Under that rule, an entity depreciates tangible assets other than inventory and intangible assets other than receivables, while articles of precious metal are excluded from depreciation. An entity is required to establish the plan of depreciations; under it will execute depreciations to the level of its initial price. Accounting depreciations are booked every month, and booking can not be interrupted.

Tax depreciation is governed by Act no. 595/2003 Collection of Laws, on income tax. The Annex no. 1 of the Income Tax determines the classification of fixed assets by depreciation groups. The article 26 defines the depreciation periods, depending on the depreciation group. Under current tax legislation in Slovakia there is the possibility of applying of balanced or accelerated depreciation methods. Depreciation method selected for particular asset can not be changed over the whole depreciation period. Law on Income Tax provides the option to interrupt booking of tax depreciation, without setting up the limit for how long the interruption can last. Tax depreciation is annual. Act through the provisions of § 23 defines that the property which is excluded from depreciation (for eg. land, levees, national movable cultural heritage).

1. Tax depreciation methods

- a) **Straight-line method of depreciation** - the annual depreciation is determined by dividing the input price of tangible assets and the depreciation provided for depreciation for that group

Table no.1 Straight-line method of depreciation

Depreciation group	The annual depreciation
1	1/4
2	1/6
3	1/8
4	1/12
5	1/20
6	1/40

Thus, $OC / 4$ - if it is a property that belongs to the first depreciation of the group. OC = cost

- b) **accelerated depreciation method** – in this method of depreciation following coefficients are assigned to the following groups:

Table no. 2 Accelerated depreciation method

Depreciation group	The coefficient for accelerated depreciation		
	In the first year depreciation	In subsequent years depreciation	For increased residual price
2	6	7	6
3	8	9	8

While the accelerated method of depreciation write-offs determine:

- in the first year of depreciation as follows: $OC / \text{factor in the first year of depreciation}$
- depreciation in subsequent years as follows: $2 \times ZC / \text{coefficient of depreciation in future years - the number of years during which the property has depreciated}$ Taking $OC = CC = \text{cost residual value}$

It is interesting, that under the Law on Income Tax the tangible asset can be depreciated only by accounting depreciation, and they are tax deductible. In the case of tangible property tax costs are recognized as tax depreciation. If the accounting depreciation is greater than the tax, the difference is attributable to an item pre-tax profit.

In addition to these methods of depreciation Code of income tax defines annual depreciation for openings of pits (f.e. stone-pits, sand-pits or clay-pits). It defines annual depreciations of technical or spoil bank reclamation or recultivation of landscapes, unless they are not of the part of fixed asset to which input prices are included. Temporary structures and workings shells are determined as a percentage of the entry price for specified periods of time.

For moulds, forms, templates and models falling under the classification codes of products 25.73.6, 28.92.1 if it is the machine for forming foundry molds from the sand, and 28.96.1 and 25.73.5 codes the determination of annual depreciation is made as a percentage of the entry price for a particular live cycle or a specified number of produced castings or extrusions. (Víghová, A. p.65).

Fixed assets leased under finance lease, other than lands, can lessee to depreciate over the term of lease up to 100% of its value. In determining of the depreciation method the accounting entity can not apply neither balanced nor accelerated depreciation method. The amount of depreciation equals to the proportionally equal part for every month of lease, plus lease related expenses. (Štangová, N., Víghová, A. p.58)

2. Comparison of IAS 16 and the current legislation in Slovakia

Based on carried out analysis it is evident, that the depreciation methods and ways in Slovakia are clearly defined, whereas for the interruption of the tax depreciation booking there is not limit to the length of the interruption. It is not possible to determine, whether this is only a gap in the legislation or this was brought to the legislation intentionally.

Based on a comparison we can state, that there are following differences in depreciating between Slovak and International standards:

- in area of determination of the write off time
- in area of balanced method of depreciation
- in area of accelerated method of depreciation

a) Area of the determination of the depreciation period:

According to the IAS the criteria for write off time can be physical wear of or technical obsolescence of the fixed asset. According Slovak legislation Income Tax Code exactly prescribes the length of write off time.

b) Area of balanced method of depreciation

According to the IAS is balanced method defined as a difference between initial price and residual price of the asset, divided by amount of years in exploitation. According Slovak legislation Income Tax Code defines balanced method as a ratio between initial prices and write off time, and does not take the residual price in to the consideration.

Conclusions:

In terms of the revenue of the state budget clearly increase the rate of depreciation, reducing groups which are not depreciated causing revenue shortfalls and thus negative sign under the overall balance of the final account.

On the other hand, as already it pointed out, for businesses and write-off means the accounting of the costs, and therefore reflect both the consumption of production factors during the transformation process in the economic records but also the creation of resources for their subsequent use. Where an undertaking to implement its activities and with a view to maximizing the life cycle of the entity, the creation of depreciation carried out in order to be the best possible impact on its investment capabilities, technological growth and build a market position. The trader is thus increasing the possibility of depreciation incentive, and provide

better space for exploitation business sources, which should ideally results in increased production in profit and consequently of a higher tax liability and an increase in state budget revenues.

One of the negative attributes of fairness are depreciated in order to gain redemption. The company, which reported big losses and their development are also participating depreciation may redevelop part of its losses by selling. At a time when the income tax amounted to 50% of the price for the divestment of the loss was 20% of the volume loss. It is questionable whether such use depreciation is socially beneficial activities. If not, then it is worth considering whether what we are praised at the beginning - that the suspension of depreciation in case of loss - should not be optional instrument but would it not be the instrument mandatory.

Thus worth further consideration, or not consider the following measures:

1. Not allowing depreciation when the body is at a loss (obligatory)
2. Depreciation permit only if the write-off or at least a significant portion reflected in the investment, or from it a reserve fund for future
3. Review the method of depreciation in the rapidly evolving technology
4. Consider where the differentiation of the depreciation is a significant social interest.

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