

Corporate income tax reform (cont.) (1/34/17)

The first article in our corporate income tax (CIT) series mentioned the concept of deemed distribution of profit introduced by the new CIT Act. Deemed distributions will be considered to take place if a company incurs non-business expenses, lends to related parties, shares out surplus assets on winding-up, pays excessive interest, etc. This article explores the CIT treatment of one type of deemed distribution: non-business expenses.

Comparison of the existing and the new CIT model

Deemed distributions will mostly affect cash flows and the timing of tax payments, in particular for companies that have so far suffered tax losses with no CIT to pay. Under the new CIT model any company will be required to pay CIT on deemed distributions by including them in the taxable base for the month/year in which such costs are incurred.

It is important to note that non-business expenses and surplus assets on winding-up should be included in the taxable base each month. Other expenses to be recognised as deemed distributions should be included in the taxable base for the last tax period of the financial year.

The Act changes the classification of non-business expenses. These expenses will no longer attract an increasing coefficient of 1.5. The Act clearly states that when it comes to identifying non-business expenses, the economic substance as well as the legal form of each transaction should be evaluated.

Non-business expenses: classification

The Act specifies business expenses and non-business expenses related to shareholders and employees. The most important innovation is an exempt cap on representation expenses and staff sustainability expenses. For this reason it will be especially important to classify expenses into the following categories:

- staff sustainability events;
- representation expenses; and
- non-business expenses.

The concept of staff sustainability events covers –

- expenses incurred in organising collective staff motivation or team-building events and other amounts spent on workforce motivation;
- expenses incurred in taking an employee from their home to work and back if that employee can commute by public transport;
- expenses associated with social infrastructure items, i.e. staff accommodation expenses if work is also done on night shifts, and expenses on facilities intended for sports, catering and looking after employees' children;
- funeral benefits;
- expenses incurred on events prescribed by a collective agreement that cannot be personalised.

These expenses, in aggregate for the financial year capped at 5% of the total gross employment pay on which national social insurance contributions were paid in the preceding financial year, will be excluded from the taxable base as long as they are recorded separately from other expenses.

The new Act clarifies the definition of representation expenses. These are expenses incurred in –

- building and maintaining the taxpayer's prestige at the level of publicly accepted standards;
- entertaining and providing meals to business partners;
- low-value items that bear the trader's brand and are distributed to popularise the taxpayer.

CIT is not chargeable on the taxpayer's advertising expenses and on expenses incurred in –

- creating and positioning his own brand;
- items that bear the trader's brand and are attached to a product being advertised as long as their value does not exceed the higher of EUR 70 or 5% of the value of that product;
- a gift voucher issued by the company and offered in a public advertising campaign run by the company that is usable only at the company's points of sale or service.

Non-business expenses

Non-business expenses as defined in the current law have been transposed to the new law. However, the list of non-business expenses now features new types of expenses or clarifications to fit the aims of the new CIT model:

- Acquisition, maintenance and other related expenses incurred on assets used for non-business purposes will be taxable at the time of acquisition;
- Depreciation charges, impairment losses and maintenance expenses on any assets that are acquired before 2018 and used for non-business purposes;
- Penalties disproportionate to the value of a transaction, or paid to a related party or to a party in a tax haven;
- Donations exceeding a specified limit.