

Bonus accrual: corporate tax treatment (2/44/20)

We wrote a while ago about available [corporate income tax \("CIT"\) reliefs, including the possibility of deducting provisions made at the end of 2017 from taxable income](#). This article explores the CIT treatment and issues around a bonus expense accrued at 31 December 2017.

Provision or accrued liability?

In practice we have faced a situation where an accrued liability is classified as a provision and used for reducing the taxable base. We have already written that according to the SRS, neither an estimated liability to employees for [accrued unused vacation days in the financial year](#) nor [an allowance for slow-moving inventory](#) is considered a provision, and consequently CIT relief is not available.

A company accrued a bonus expense at the end of 2017. Can the company classify this as a provision and take CIT relief? The company asked the SRS to provide an opinion on this matter at the end of 2018.

The SRS opinion

On 8 January 2019, the SRS published an advance tax ruling explaining that the company's board bonus accrual according to its economic substance is not recognised as a provision within the meaning of [section 32\(1\) of the Company and Consolidated Accounts Act](#). Also, the SRS finds that the accrual does not meet the conditions for recognising a provision specified by [paragraph 146](#) of the Cabinet of Ministers' Rule No. 755 of 22 December 2015, *Application of the Company and Consolidated Accounts Act*. According to the SRS, a bonus accrual for the company's performance in 2017 is an expense accrued for amounts payable to board members and not a provision, so the company cannot take CIT relief.

Unfortunately the tax ruling only refers to the legal framework but fails to set out the arguments forming the basis for the SRS's position. So reading the ruling leaves us with many unanswered questions.

The CIT treatment is still obscure because "provision" is not clearly defined in the CIT Act or [the Cabinet of Ministers' Rule No. 677 of 14 November 2017, Application of the Corporate Income Tax Act](#). And the SRS has not published any guidelines for analysing provisions.

Case law

Background

On 26 March 2008 the Administrative Division of the Supreme Court heard case [No. A42166205](#). This involved a dispute because the SRS claimed that an accrued expense for staff bonuses should be treated as a provision that must be added back to taxable income for CIT purposes. The SRS Director-General upheld the audit decision made by the Audit Division of the SRS Large Taxpayers Board, yet the Director-General's decision was overturned by the District Administrative Court. The Supreme Court upheld the ruling of the District Administrative Court.

Key findings of the ruling

Although the ruling is 12 years old, the facts and circumstances that helped overturn the SRS Director-General's decision can be relevant today. Below we list a few arguments from the court ruling explaining why a bonus accrual does not qualify as a provision:

1. A bonus accrual is a liability with a certain timing and an estimated amount to be spent on bonuses, and therefore the accrual is not a provision;
2. The bonus scheme is known to all the employees;
3. The Ministry of Finance has also expressed an opinion that staff bonuses according to their economic substance are part of the employment remuneration scheme and do not generally create a taxable item;
4. On payment of annual bonuses, personal income tax ("PIT") and national social insurance ("NSI") contributions are withheld and the employer portion of NSI paid, so from this perspective, too, an accrued expense for a future liability is not a provision to be taken into account for CIT purposes;
5. Section 4(4) of the Taxes and Duties Act provides that the same income cannot be charged to PIT and CIT at the same time unless the particular tax law provides otherwise.

Conclusions and recommendations

We urge you to consider whether your company might be at risk as a result of having wrongly deducted a bonus accrual from the taxable base when the new CIT regime came into force. You still have time to file an adjustment to your CIT return for 2017 and minimise the adverse effect likely to arise if the SRS discovers this during a tax control measure. However, before adjusting the CIT return, we would recommend obtaining written confirmation from the SRS because the adjustment would lead to a reduction in your CIT liability for 2017.

Please let us know if you are struggling with the CIT treatment of accruals and provisions.