CIT treatment of provisions made before 2018 (3/31/18)

Filing the first corporate income tax (CIT) return has raised some questions about the new CIT system and showed up some legislative shortcomings as well as technical errors on the electronic form of the CIT return. This article explores some of the issues we have identified in the CIT treatment of general provisions.

The legal framework

In our earlier articles on CIT, we have informed our MindLink subscribers about this issue (New CIT Act: general provisions in financial accounting). For your convenience, we have made a summary of the rules governing the CIT treatment of a decrease in provisions depending on which period the provision being decreased was made in:

CIT treatment of provisions made before 2018	CIT treatment of provisions made after 2017
1. The provision does not exceed the one made in FY2016. Dividends and deemed profit distributions are deductible from the tax base after applying a coefficient of 0.75 to the provision if it – • is recorded separately after 2017, and • was added to taxable income (Table 1.3 and line 19 – the total of column 3 in Table 1.3). 1. The provision exceeds the one made in FY2016. The excess is deductible from the tax base only from dividends after applying a coefficient of 0.75 to the provision (the table on line 16 and line 16 of the CIT return). There is no restriction on how long provisions made in past years can be written off.	No effect on taxable income.

Issues identified

<u>Issue 1</u>

Having examined Example 25 included in the SRS guidance, we understand that in order to identify the excess of the provisions for 2017 over the provisions for 2016, general provisions should be analysed by type of provision. This approach is different from the opinion the Ministry of Finance expressed originally.

Below we offer our own example of claiming this relief, in which we take the approach to the provision analysis used in the SRS Example 25.

PwC example

A company made provisions of 98,500 and 96,000 in 2017 and 2016 respectively, and one type of provision (B) had an excess (3,000) in 2017 over the provision for 2016 (73,000 – 70,000).

The company reduces its total provision for the first six months of 2018 by 15,000. The company does not have a tax base from dividends for the period but has a sufficient tax base from deemed profit distributions to use the provision decrease in full:

	Provision	Change	Provision	Change	Provision
	31.12.2016	2017	31.12.2017	First six months of 2018	30.06.2018
Provision A	9,000	*– 500*	8,500	-	8,500
Provision B	70,000	*3,000*	73,000	*– 13,000*	60,000
Provision C	17,000	-	17,000	*– 2,000*	15,000
Total	96,000	*2,500*	98,500	*– 15,000*	83,500

In calculating CIT, the company takes the following steps to deal with the provision decrease (15,000):

- The difference of 3,000 (73,000 – 70,000) is offset if there is a tax base from dividends for the period. The company attributes the unused provision decrease (2,250) to future tax periods when completing the table on line 16 of the CIT return:

No.	Excess of provision appearing on balance sheet at 31.12.2017 over provision appearing on balance sheet for FY2016	Provision deducted from tax base in tax period	Provision decrease attributable to future tax periods (2–3)
1	2	3	4
1	*2,250* *(3,000 x 0.75)*	-	*2,250*
	Total:		

- The remaining decrease (9,000 = (15,000 – 3,000) x 0.75) is deducted from the total tax base on line 19 of the CIT return. The figure 12,000 is the provision decrease (15,000) less 3,000, which is the difference between the provision made in 2017 and the one made in 2016 (73,000 – 70,000).

The table on line 1.3 of the CIT return should show:

1.3. Provisions made before 2018

No.	Balance of provision on balance sheet at 31.12.2017 x 0.75	Provision deducted from tax base in tax period	Provision attributable to future tax periods (2–3) ≥0
1	2	3	4
1	*71,625* *((8,500 + 70,000 + 17,000) x 0.75)*	*9,000* *(12,000 x 0.75)*	62,625
	Total:		

The total is imported from column 3 into line 19 automatically.

The table on line 19 of the CIT return shows:

19. The provision decrease if the provision was made before 2018 and reduced after 2017 (paragraphs 17 and 19 of the transition rules; the total of column 3 in Table 1.3 but not to exceed lines 17+7)	19	*9,000*

Please note that the CIT calculation will produce a different result when the provisions are analysed in total. Line 16 of the CIT return should show a lower amount: EUR 1,875 (2,500 x 0.75), while the provision balance deductible from the tax base arising from dividends and deemed profit distributions (Table 1.3) would be higher: 72,000 (96,000 x 0.75).

Unfortunately neither the CIT Act nor the Cabinet of Ministers' Regulation No. 677 explains how to approach the analysis of provisions. And the SRS representatives running a workshop on how to complete the CIT return were unable to clarify this issue.

Issue 2

CIT legislation does not explain what principle should be applied when it comes to reporting provisions on the CIT return if the company identifies a provision decrease for the tax period, has declared a dividend and has taxable items in the form of deemed profit distributions as well as a provision balance and a provision balance excess for 2016. What principle should be used by the company in splitting the provision decrease on Tables 1.3 and 16 if the provision decrease does not fully cover both tax bases?

Issue 3

The SRS guidance cites section 32 of the Company and Group Financial Statements Act, which provides that provisions must not be used for adjusting the value of assets. This potentially reduces the allowable amount of provision for reducing the tax base. This definition implies that a provision for slow-moving inventory is not considered a provision. The CIT Act lays down only two requirements for taking this relief: (1) provisions should be recorded separately after 2017 and (2) should be added to taxable income for the period they were made in. Paragraph 17 of the transition rules of the CIT Act fails to clarify the definition of provisions. Under the old CIT model, taxpayers were also required to add such provisions to taxable income. We therefore believe that the solution offered in the SRS guidance is contrary to the interpretation of the law according to its meaning and purpose: permission to reduce the tax base under the new CIT Act discriminates against taxpayers that in past tax periods added to taxable income any provisions used for adjusting the value of assets, including slow-moving inventory.

Please let us know if you, too, want answers to these questions about the CIT treatment of provisions.