

DEPRECIATION UNDER THE LAW OF THE SLOVAK REPUBLIC AND ITS RECENT CHANGES IN RESPONSE TO THE ETHICAL ASPECT OF PUBLIC FINANCE

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Abstract: In general “depreciation” is considered as a book-keeping cost item, representing the costs related to the consumption of investments throughout the transformation process. On one hand, depreciation is also the source for financing technological growth of the enterprise, on the other hand, application of depreciation results in the decrease of the tax obligation. A reasonable manager follows all changes in the accounting and tax codes of the country where a manager has his/her tax obligations. At the same time, Corporate Taxes are an important part of the state budget, and therefore every change in the legislation governing depreciation affects the quality of the business environment and also the revenue part of the state budget. Adequate and proportionate settlement of the depreciation legislation is very important for both corporations and the state. In this article we are presenting recent and latest changes in the Slovak legislation in terms of depreciation, the reasons for such changes and the corporate opinions about them.

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Reikšminiai žodžiai: Nusidėvėjimas, įstatymai, viešieji finansai, verslo finansavimas.

1. Slovak legislation in the area of depreciation

The Slovak legislation defines two main groups of depreciation - accounting depreciation and tax depreciation.

Accounting depreciation is defined in § 28 of Act No. 431/2002, Collection 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 a plan of depreciations; under that plan it will execute depreciations to the level of their initial price. Accounting depreciations are booked every month, and booking cannot be interrupted.

Tax depreciation is governed by Income Tax Act No. 595/2003, Collection of Laws. Annex No. 1 of the Income Tax Law determines the classification of fixed assets on the basis of depreciation groups. Article 26 defines depreciation periods, depending on the depreciation group. Under current Slovak tax legislation it is possible to apply balanced or accelerated depreciation methods. Depreciation method selected for particular asset cannot be changed over the whole depreciation period. The Law on Income Tax provides the option to interrupt booking of tax depreciation, without setting the time limit for the duration of interruption. Tax depreciation is annual. Through the provisions of § 23, the Act defines the property excluded from depreciation (e. g. land, levees, national movable cultural heritage).

1.1 Tax depreciation methods

According to Act No. 595/2003, Collection of Laws, Income Tax Code, two basic depreciation methods are distinguished:

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

Table 1. Straight-line method of depreciation

Depreciation group	Annual depreciation
1	$\frac{1}{4}$
2	$\frac{1}{6}$
3	$\frac{1}{12}$
4	$\frac{1}{20}$

Thus, $OC / 4$ - if a property belongs to the first depreciation group.
 $OC = \text{cost}$

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

Table 2. Accelerated depreciation method

Depreciation group	The coefficient for accelerated depreciation		
	In the first year of depreciation	In the subsequent years of depreciation	For increased residual price
1	4	5	4
2	6	7	6
3	12	13	12
4	20	21	20

The accelerated method of depreciation write-offs determine:

- in the first year the depreciation is as follows: OC/factor in the first year of depreciation
- depreciation in the subsequent years is 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 to note that under the Law on Income Tax a tangible asset can be depreciated only by accounting depreciation, and it is tax deductible. In the case of tangible property, tax costs are recognised 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, the Code of Income Tax defines annual depreciation for opening of pits (e. g. stone-pits, sand-pits or clay-pits). It defines annual depreciation of technical or spoil bank reclamation or recultivation of landscapes, unless they are not 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 product classification codes 25.73.6, 28.92.1 in case of a machine for forming foundry molds from the sand, and 28.96.1 and 25.73.5 codes the annual depreciation is determined as a percentage of the entry price for a particular life cycle or a specified number of castings or extrusions produced.

In case of fixed assets leased under financial lease, other than land, over the term of lease the lessee can depreciate up to 100% of its value. In determining the depreciation method the accounting entity can apply neither the balanced nor accelerated depreciation method. The amount of depreciation equals to the proportionally equal part for every month of lease, plus lease-related expenses.

2. Changes in depreciation in general

Any change in the laws on income tax will affect both the revenue of the state budget and the revenues of natural persons and legal bodies.

This is a never-ending fight between public and private sector in terms of taxes. After 2008, facing the consequences of the financial crisis governments around the world developed efforts for the introduction of legislation to cope with the crisis. It is a whole package of items for consideration, like cost cuts, tax increases, finding various ways to better use public money, searching for solutions to manage complicated relations with the banking system.

On 17 February 2009 the Slovak National Council approved amendment of the Law on Income Tax, which came into force on 1 March 2009. By this amendment, the value of tangible fixed asset was raised from €996 to €1.700 and the value of intangible assets was raised from €1660 to €2400. In addition to the above-mentioned changes in depreciation, the possibility of spreading fixed assets in to separable parts was introduced, where the entry price of each detachable component was higher than €1 700.

The changes include the following:

- Another change was the option to book detachable components individually where technical and value data, including data declaring time-related information about eventual loss and gain or change of the asset can be recorded and shown upon request.
- Installation costs can be booked directly to costs, and without any regret to the height of these costs.
- Amendment of Annex 1 to the Law on Income Tax brought the possibility to transfer certain tangible assets from the 2nd depreciation group to the 1st depreciation group. The depreciation period of the original 6 years to 4 years was shortened in the result of the amendment.

Table No. 3 below shows the negative impact of the above-mentioned changes on the state budget. The largest impact in this negative tendency is coming from the change in the level of value of tangible and intangible assets that is almost double. The consequence is that accounting unit can book all value of the tangible asset up to the value of €1.700 and intangible asset up to the value of €2.400 in one year, if total value of the assets does not exceed the said amounts.

Table 3. Effect of changes of the amendment of the Income Tax Law
(ESA EUR 95 thousand)

Category of legal change	Quantification of impact of legal changes on the state budget of the Slovak Republic in million Euros				
		2009	2010	2011	2012
Component depreciation of fixed assets (new)	legal persons + individuals	-199	-2 124	-4 282	-6 971
The increase in entry price for tangible assets	legal persons	-11 452	-15 833	-13 145	-3 386
	Individuals	-730	-1 029	-830	-232
Increase in input prices for intangible assets	legal persons	-963	-1 261	-963	0
	Individuals	-66	-66	-66	0
Accounting for formation expenses to costs directly	legal persons + individuals	Negative impact on state budget income			
Transfer of certain assets of 2 to 1 depreciation of the	legal persons + individuals	Negative impact on state budget income			

Source: Slovak National Council (explanatory memorandum to the amendment of the Income Tax Law)

As mentioned at the beginning of this chapter, the changes are affecting not only state budget but also private budgets.

The data in Table No. 4 show that investments (expressed in % of GDP) over the crisis period of 2008-2010 went down elsewhere than in the Slovak Republic. This

means that the existing working capital was amortized over the period 2008-2010 but enterprises did not reinvest all the depreciated amount into new assets.

Table 4. Enterprise investments in the Slovak Republic, compared to the EU Member States in 2008-2010.

Region	Year		
	2008	2009	2010
Belgium	20.7	19.5	18.6
Bulgaria	28.0	23.9	18.7
Czech Republic	18.4	16.6	16.1
Denmark	18.9	16.1	14.1
Germany	17.5	16.1	16.4
Estonia	23.1	16.5	15.0
Ireland	16.9	11.3	7.4
Greek	Data not available	Data not available	Data not available
Spain	24.7	19.7	18.9
France	18.7	17.4	17.2
Italy	18.4	16.5	17.3
Cyprus	19.9	16.5	14.8
Latvia	24.7	17.2	14.2
Lithuania	20.4	13.2	11.4
Luxemburg	17.2	13.9	12.9
Hungary	18.7	18.1	16.3
Malta	15.0	12.8	14.4
Holland	17.2	15.3	14.2
Austria	20.9	19.9	19.5
Poland	17.7	16.0	13.9
Portugal	19.5	16.9	15.4
Romania	25.3	20.1	16.9
Slovenia	24.4	19.4	18.4
Slovakia	22.9	18.3	17.7
Finland	18.9	16.5	16.0
Sweden	16.7	14.2	14.4
United Kingdom	14.5	11.9	12.0

Source: Eurostat data

3. Recent changes in depreciations

As mentioned above, in case of fixed assets leased under financial lease, other than land, over the term of lease the lessee can depreciate up to 100% of its value. In determining the depreciation method the accounting entity can apply neither the balanced

nor the accelerated depreciation method. The amount of depreciation equals to the proportionally equal part for every month of lease, plus lease-related expenses. This was true until 31 December 2011. From 1 January 2012, based on the amendment of the Tax Code, the lessee can depreciate fixed assets by using the balanced and the accelerated method as well. The lessee has to respect the period of depreciation set by the Tax Code, no regard being had to the length of the lease contract. If the lease contract for property belonging to the depreciation group 2 (depreciation period of 6 years) lasts from March 2012 to October 2015, then the period of depreciation lasts for 6 years, and in the course of 2012 the taxed entity can depreciate only a proportionate part of the annual depreciation relevant to the period from March 2012 to December 2012. The property is recorded in the books of the lessee in the value equal to the principal value in the lessor's books (introductory price). Purchase costs, or other costs relevant to the acquisition of the subject-matter of the lease contract, born by the moment of lease (such as lease contract fee, transportation costs, assembly costs, duty, etc.) are included in the introductory price. The price for which the lessee purchases the leased property at the end of the lease period is part of the introductory price as well.

The new amendment of the Tax Code (Act No. 595/2003 Z.z.), introduced from 1 January 2012, laid down a new approach to the uniform and accelerated method of depreciation. Under former legislation that was valid by the end of 2012, a taxed entity could book all annual value of the depreciation, even if the property was purchased in December 2012. From 1 January 2012 only the proportionate amount of the annual depreciation can be recorded in the books.

The reason for introducing the above-mentioned changes is based on ethical principles of law creating process. The legislator upholds the opinion that it is unfair to buy property on the last day of the year, to use it only for a day, but to include the whole value of the annual depreciation to the books.

Even voting in the Slovak Parliament showed that deputies were of very different opinions about that amendment of the Code. According to the statistics of the Slovak House of Deputies (the parliament), 143 deputies out of 150 were present at the voting time in the parliament. Out of them, 79 deputies voted 'for' the amendment, and 60 'against' the amendment, with 4 abstentions.

The above-mentioned legislative changes are affecting all businesses. The level of impact of such changes was analysed based on a sample of 200 business entities, 100 small business entities and 100 small size corporations. They were asked if they were aware of the above-mentioned changes, and what was their opinion about those changes. 65% of respondents did not have any information about the amendment. 35% of the respondents were following the new upcoming legislation and were aware of that particular piece of legislation. 10% of the respondents told that they found it fair and ethical. 27% of the respondents answered that they were not in a position to provide a fair statement on the ethical aspect, as far as they knew that it seemed unfair to the business but might be fair for the public financing, 63% of the respondents told that they did not find it as friendly to the business environment, especially if they are "punished" for the profit by an obligation to pay an advance payment of the tax for the next

year. According to the practice in Slovakia, if a company gains profit in particular year, it pays not only a tax on this profit, but must also pay an advance payment of the tax for the next year, while it is absolutely unclear whether there will be profit next.

4. Conclusions

Efforts of every government should be directed towards entrepreneurs on one side, in order to help them cope with crisis through amended legislation governing depreciation which enable them use the tools for depreciation that will give them a chance to increase their competitiveness by investing in new technologies. On the other side, more value will be depreciated; less amount of money will be collected to the public budget. Is that so?

Businessmen stated that if they invest more in new technologies, they will have more chance to be competitive. And in the long run it will give them better chance to create jobs, generate profit and pay taxes. Therefore, in the long run it seems that both sides will be happy.

It is very important that depreciation legislation is managed properly. The experience in the Slovak Republic was when computers were classified in the category of 4 years depreciation, and at a certain time, even in 6 year depreciation period. Prices of PCs were falling by decades of percentage every year, in addition to that, we were facing incredible technological progress. Therefore, the enterprises that wanted to keep their competitiveness via technological growth had to replace computers far before they could deduct them tax wise into the costs of the company. That made their production more expensive.

It is very important to manage depreciation legislation in line with physical and moral amortisation of assets. Sometimes the need for technological changes results from incorrect management decisions taken in the past, or from market volatility or even from existing correct management decisions. Market value of the technology that is to be sold out very often is lower than the residual value in books. In such cases it would be good if entrepreneurs had an instrument as to how to depreciate and deduct this financial difference from earnings, especially in a situation where they can prove that the technology was replaced by a new one.

The facts to the effect that there is no chance to apply tax depreciation of plots can also create a problem. The example can be found in developed economies. Often depopulated areas can be found, for example, in Detroit, Michigan (the USA). When only companies of the same scope of activities are located in certain areas, when the cycle of the product produced or the service supplied by them is over, the companies are moving or closing down. The price of such plots has negative value. There is no buyer, and such plot is only a money eater. However, a few years ago the price of that plot could be enormously high. Having a tax depreciation instrument in such a situation could make sense.

It is useful that the proposed new amendments of the Tax Code are based on a thorough analysis. We need an analysis with algorithms that would be able to provide a picture about the short-term and long-term financial effects of the amendments on the businesses and on public finances as well.

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NUSIDĚVĚJIMAS PAGAL SLOVAKIJOS RESPUBLIKOS ĮSTATYMĄ IR JO PASKUTINĮ PAKEITIMĄ, SIEKiant ATSPINDĖTI VIEŠŲJŲ FINANSŲ ETINIUS ASPEKTUS

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Santrauka. Nusidėvėjimas – buhalterinė sąvoka, atspindinti kaštus, susijusius su investicijų vartojimu transformacijos procese. Nusidėvėjimas taip pat gali būti laikomas įmonės technologinės plėtros finansavimo šaltiniu, o iš kitos pusės, nusidėvėjimo apskaita yra susijusi su mokesčių įsipareigojimų sumažėjimu. Protingas vadybininkas seka visus buhalterinės apskaitos ir mokesčių kodų pakeitimus šalyje, kurioje jis moka mokesčius.

Pelno mokesčiai yra svarbi valstybės biudžeto įplaukų dalis. Ir kiekvienas pokytis nusidėvėjimo apskaitos įstatymuose turi įtakos verslo aplinkos kokybei bei valstybės biudžeto pajamoms. Adekvatūs ir proporcingi sprendimai nusidėvėjimo apskaitą reguliuojančiuose įstatymuose yra labai svarbūs ir verslui, ir valstybei. Straipsnyje apžvelgti naujausi Slovakijos Respublikos įstatymų, reguliuojančių nusidėvėjimo apskaitą, pakeitimai bei šių pakeitimų priežastys, taip pat verslo požiūris į šiuos pakeitimus.

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