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EFFECTS OF CHANGES IN THE ACCOUNTING STANDARDS ON THE ACCOUNTING AND TAX TREATMENT OF PROVISIONS FOR SEVERANCE PAYMENTS

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ABSTRACT

The change made to the International Accounting Standard 19 "Employee benefits" has influenced the change of the Slovenian Accounting Standard 10 "Provisions". By the end of 2015, companies could use the simplified method of calculating and measuring retirement severance payments. The identified actuarial gains or losses related to severance payments, changes in costs of the past and current employment and interest could immediately be recognised in their income statements. The change in the standard has caused that the companies must now show one part of the formed severance provisions in the income statement and the other part in the comprehensive income. While doing so, they must also determine for the tax purposes the portion of recognised and unrecognised provisions and the resulting deferred taxes.

Key Words: Provisions for severance payments, accounting standards, tax, deferred tax

Introduction

In this survey, we present the changes in the accounting and tax fields that are required in an individual country once the international accounting standard is changed. In our case, it is Slovenia. We present the influence of the changes made to the International Accounting Standard 19 "Employee benefits" that has influenced the change of the Slovenian Accounting Standard 10 "Provisions" and the change of the Corporate Income Tax Act. The article presents income statements for business and tax purposes as well as deferred taxes prior to and after the change of the standard. The article gives simulations of business and tax balance sheets, the effects of various corporate income tax rates on net profit, the effects of different amounts of tax-recognized cost and the consequent deferred taxes.

The change in the standard in combination with the tax laws may turn a relatively simple tax calculation into significantly more demanding and time-consuming one. This causes additional work, administration and costs for the companies.

1 Materials and Methods

1.1. Legal basis

The Slovenian companies keep their business ledgers in accordance with the regulations of the Companies Act – ZGD-1 (Official Gazette of the RS, 2015). Item 1 of Article 54 of the Companies Act states that companies and entrepreneurs must maintain their business ledgers and complete them once per year in accordance with this act and the Slovenian Accounting Standards - SAS or the International Financial Reporting Standards (IFRS, 2004). Items 10 and 11 of the same Article describe which types of companies are required to maintain business ledgers in accordance with the IFRS:

- Companies, that are required to prepare consolidated statements;
- Banks;
- Insurance companies;
- Other companies if so decided by the shareholders' assembly but no less than for a period of five years.

Other companies are required to maintain their business ledgers in accordance with the Slovenian Accounting Standards (Official Gazette of the RS, 2015). Under Item 8 of Article 54 of the Companies Act the Slovenian Accounting Standards by design cannot contradict the International Financial Reporting Standards.

Until 31 Dec 2015, the formation of provisions for long-term earnings such as retirement severance payments have been covered by the Slovenian Accounting Standard 10 (Official Gazette of the RS, 2005), the International Accounting Standard 19 (IFRS, 2004) and Clarification 1 to the Slovenian Accounting Standard 10 (Official Gazette of the RS, 2007). Clarification 1 to the Slovenian Accounting Standard 10 states the following:

For the purposes of SAS 10.44, the retirement severance payments and jubilee bonuses are categorised as part of the "Other long-term employee benefits". Consequently, when calculating and measuring the retirement severance payments and jubilee bonuses the simplified method is used, according to which the identified annual actuarial gains and losses related to jubilee bonuses and severance payments are recognised immediately in the income statement and the rule of a predefined band is not used. Also, all changes in changes in costs from previous employment are recognised in the income statement immediately; they are measured as a change in the present value of the liabilities (provisions) that are incurred in the current period as a consequence of implementation or change in the post-employment benefit programme. Changes in costs from past employment decrease the operating result of the current accounting period if the earnings (the present value of the rights towards severances and jubilee bonuses) are introduced or increased. However, changes in the costs of past employment can also increase the operating result of the current accounting period. This is the case if the earnings (the present value of the rights towards severances and jubilee bonuses) are discontinued or reduced.

On the balance sheet day, a company determines and recognized in the income statement income or expense related to recalculation of provisions in the amount determined by consolidating

- The amount of additionally formed provisions for costs of current employment related to severance payments and jubilee bonuses for the current year;
- The calculated interest related to the provisions;
- The amount of actuarial gains or losses;
- The amount of increased or decreased existing provisions in the case of introduction or change of the programme (changes in the costs of past employment);
- Effects of all limitations or reductions in provisions.

The above simplified method was simple for accounting purposes, as all the formed provisions in the financial statements have been immediately recognized within the costs, and in the tax statements in the amount that was tax-recognized in accordance with the Corporate Income Tax Act – ZDDPO (Official Gazette of RS, 2004). The act remained in force until the end of 2006 and stated the following in Article 16 with regard to treatment of provisions:

1) To determine the tax base and/or recognizing income and expenses formation of provisions is not taken into account, unless provided otherwise by this act.
2) Elimination and use of provisions is taken into account by excluding incomes and recognizing expenses so that the tax base does not include the incomes and expenses that have previously been taken into account to increase the tax base unless otherwise provided by this act.

For the companies this meant that in the year the provisions for severances were formed, they were able to exclude 100% of the formed provisions from the tax statement.

In 2007, the Corporate Income Tax Act - ZDDPO-1(Official Gazette of RS, 2006) was changed that states the following under Article 20:

1) While determining the tax base and/or recognition of expenses of a taxpayer, the formation of provisions in accordance with Article 12 of this Act is recognized as an expense in the amount that corresponds 50% of the formed provisions, unless otherwise provided under this act.
2) Under this article, provisions include given guarantees upon the sale of products or services rendered, provisions for reorganisation purposes, provisions for expected losses from controversial business deals, provisions for retirement, provisions for jubilee bonuses and provisions for retirement severance payments. Contingent long-term liabilities do not count as provisions.

3) Elimination or use of provisions under Paragraphs 1 and 2 of the same article that have not been recognized as expenses are treated within a tax period so that:
    - Exempt from the tax base are the incomes from the elimination or use of provisions in part where the formation of provisions has not been recognized as expense and
    - The expenses related to the use of provisions are recognized in part where the formation of the provisions has not been recognized as an expense.

The change of the Corporate Income Tax Act enables companies to reduce their tax base in the tax statements by 50% of the formed provisions in accordance with Article 20.

As of 1 Jan 2016, the new 2016 Slovenian Accounting Standards - SAS 2016 (Official Gazette of the RS, 2015), came into effect. The basis for the change of SAS 10 – Provisions was the partial change of the International Accounting Standard 19 – Employee benefits. The basis for the change of IAS 19 was Directive 2015/2343 of the European Commission (Directive, 2015) dated 15 December 2015. This Directive amends Directive (EC) 1126/2008 (Directive, 2008) o adoption of some international accounting standards in accordance with Directive (EC) 1602/2002 (Directive, 2002) of the European Parliament and Council. SAS 10.35 is in line with IFRS 19 and states the following under Item 10.35:

On the balance sheet day, an organisation determines and recognizes in the income statement the incomes and/or expenses related to recalculation of provisions of retirement severance payments based on:

- The amount of additionally formed provisions for costs of current employment related to severance payments for the current year;
- The amount of increased or decreased existing provisions in the case of introduction or change of the programme (changes in the costs of past employment);
- The calculated interest related to the provisions (as additional cost of provisions);
- The effects of all limitations or reductions in provisions for retirement severance payments.

Actuarial gains and losses from retirement severance payments are not recognized in the operating results; instead, they are recognized directly within the capital as part of provisions generated through valuation at fair value. Provisions generated through such valuate at fair value may also be negative in value. Provisions formed on this basis are incorporated into the net operating result proportionately to when the provisions for retirement severance payments are recognized for the employees that have left or retired.

Since the actuarial gains and losses are never recognized in tax statements, a change of the Corporate Income Tax Act – ZDDPO-2 (Official Gazette of the RS, 2015) and an interpretation thereof by the Financial Administration of the Republic of Slovenia (Ministry of Finance, 2016) were necessary.

1.2. Deferred taxes

Since the tax provisions formed in 2006 were not recognised in the 100% amount and are recognized at 50% of the formed amount since 2007, the companies must form deferred taxes in the amount of unrecognized provisions.

The area of deferred taxes is not regulated by special accounting standard in Slovenia; instead, deferred taxes are covered by multiple standards. They are SAS 5, SAS 9, the introduction to the Slovenian Accounting Standards and the framework of the Slovenian Accounting Standards.

Deferred tax is a tax amount that the taxpayer will pay in the future tax periods or vice-versa, will be refunded to the taxpayer in the future tax periods.

A company must determine the differences between the business and tax statements and decide which of these differences should be recognized in its business statements. Deferred taxes should be recognized if and only if it is deemed likely that the temporary differences will be resolved within the foreseeable future.

1.3. Baseline data for the simulation

To simulate the calculations that are presented in the results chapter, the amounts necessary for the calculation and display of business and tax statements have been determined.

The following assumptions for each year presented have been made: the company had an income of 50000 EUR, costs in the amount of 15000 EUR and expenses in the amount of 5000 EUR. The company formed the provisions for retirement severance payments in the amount of 4000 EUR and the data related to the formation of these provisions are shown in Table 1.

	Income statement	
Costs of current employment	Costs	1.200
Costs of past employment	Costs	200
Net interest on the net liability for certain earnings	Costs	320
Actuarial profit or loss	Costs	2.280
Formation of provisions		**4.000**

Table 1: Provisions for severance payments in accordance with SAS 2006.

2. Results

2.1 Formation and use of provisions in accordance with SAS 2006

Since the simplified rules for the recognition of provisions was valid until 2016, the company has recognized the total amount in its costs and consequently in the income statement for the year in which the provisions were formed. Table 2 shows and example of how to a formed costs of provisions for severance payments affects the income statement for the business and tax purposes and deferred taxes for 2006 and 2014.

	31.12.2014		31.12.2006	
	Financial	Tax	Financial	Tax
% of tax in the country		17%		25%
Revenue	50.000	50.000	50.000	50.000
Costs	-15.000	**-13.000**	-15.000	**-11.000**
Expenses	-5.000	-5.000	-5.000	-5.000
Profit before tax	**30.000**	**32.000**	**30.000**	**34.000**
Incometax	-5.440		-8.500	
Deferred tax	**340**	2.000	**1.000**	4.000
Net profit or loss for the period	**24.900**		**22.500**	

Table 2: Formation of provisions for severance payments in accordance with SAS 2006.

In 2006, the tax rate was 25% and in 2015 it was 17%. In 2006, the formation of provisions for retirement severance payments was 100% unrecognized and in 2014 it was 50% recognized. Therefore, the costs included 4000 EUR of provisions for retirement severance payments. Since they were not tax-recognized in 2006, they are excluded them from the tax statement and the deferred taxes are recognized. In 2014, the 50% of the formed provisions were unrecognized; consequently, the costs are reduced by 2000 EUR and deferred taxes are recognized. The table also shows the consequences of various income tax rates and the effect on the calculated tax and net profit.

Table 3 shows an example of use of the formed provisions in the income statement for business and tax purposes and the effect on the deferred taxes in 2015.

	31.12.2015	
	Financial	Tax
% of tax in the country		17%
Revenue	50.000	50.000
Costs	-15.000	-15.000
Expenses	-5.000	-5.000
		-5.000
Profit before tax	**30.000**	**25.000**
Incometax	-4.250	
Deferred tax	**-850**	-5.000
Net profit or loss for the	**24.900**	

period		

Table 3: Use of provisions for severance payments in accordance with SAS 2006.

In its business statements the company has the same income, costs and expenses as in 2006 and 2014. In 2015, it paid the employees that retired 6000 EUR in severance payments. Since in 2006 the provisions were 100% unrecognized, the tax statement for 2015 needs to be reduced by 4000 EUR and by 1000 EUR for provisions that have been formed in 2014 and were 50% tax-recognized. We decrease the deferred taxes by the same amount of unrecognized provisions.

2.2 Formation and use of provisions in accordance with SAS 2016

The change of the Slovenian Accounting Standard 10.35 requires that the actuarial gains and losses are never recognized in the income statement for the current year; instead, they affect the retained profits or losses. Other changes in calculating provisions for severance payments such as costs of current employment, costs of past employment and net interest on the net liability for certain earnings the company still recognizes in its income statement but within different categories. Table 4 shows data on how to form provisions for retirement severance payments for 2016.

	Income statement	Balance sheet	
Costs of current employment	Costs		1.200
Costs of past employment	Costs		200
Net interest on the net liability for certain earnings	Expenses		320
Actuarial loss		Provisions generated through such valuate at fair value	2.280
Formation of provisions			**4.000**

Table 4: Provisions for severance payments in accordance with SAS 2016

As is show in Table 4, formation of provisions affects different item categories in the accounting statements. If the full formation of provisions by the end of 2015 took place in costs, since 2016 such formations are recognized in costs, expenses and provisions from revaluation. Provisions from revaluation are never transferred to the operating result of the current year; instead, they are always transferred into profits or losses from previous years. This makes work and records for tax purposes significantly more difficult. Table 5 shows an example of how to form provisions for severance payment in 2016.

	31.12.2016		Balance sheet	
	Financial	Tax		
% of tax in the country		17%		
Revenue	50.000	50.000	Actuarial profit or loss	- 2.280
Costs	-16.960	**-16.260**		
Expenses	-5.320	-5.160		
		-1.140		
Profit before tax	**27.720**	**27.440**		
Incometax	-4.665			
Deferred tax	**340**	2.000		
Net profit or loss for the period	**23.395**			

Table 5: Formation of provisions for severance payments in accordance with SAS 2016.

Table 5 shows that the costs of current and past employment that have been formed in the amount of 1400 EUR are excluded in the amount of the tax-recognized 700 EUR. Net interest are recognized in the expenses in the amount of 320 EUR and in reduced in the tax statement by 160 EUR. Since the actuarial loss in not recognized in the income statement, it must be maintained separated for tax purposes in an identical manner to other costs of provisions. This means that they are 50% tax-recognized in the year of formation. Consequently, the tax statement is reduced by 1140 EUR. Deferred taxes are formed in the amount equal to the tax-unrecognized provisions. Table 6 shows the use of formed provisions from 2006 and 2016.

	31.12.2017		Balance sheet	
	Financial	Tax		
% of tax in the country		17%		
Revenue	50.000	50.000	Actuarial profit or loss	- 1.710
Costs	-15.000	**-15.000**		
Expenses	-5.000	-5.000		
Unrecognized in 2006 and 2016		-4.500		
Profit before tax	**30.000**	**25.500**		
Incometax	-4.335			
Deferred tax	**-765**	-4.500		
Net profit or loss for the period	**24.900**		**Profit or loss from previous years**	**-570**

Table 6: Use of provisions for severance payments in accordance with SAS 2016.

Table 6 shows the use of provisions in the amount of 5000 EUR. These costs are not included in the business statement for 2017 as it represents a cash payment. Therefore, a correction of the tax statement is made for the amount of used provisions that have not been tax-recognized in the previous periods. First are used the provisions that have been formed in 2006 and have been 100% tax-unrecognized. The tax statement for 2017 is therefore decreased by 4000 EUR. Next, follows the use of provisions that have been formed in 2016 in the amount of 1000 EUR. Given that formation of provisions in 2015 was 50% tax-recognized, we decrease the tax statement for 2017 by an additional 500 EUR. The amount used to reduce the tax statement must also be used to reduce the deferred taxes. Actuarial losses formed in 2016 need to be reduced in reduced by an amount proportionate to the provisions used in 2017 and recognize the retained losses.

In addition to the examples show there are many other, such as elimination of unnecessary provisions. If unnecessary provisions that have been formed in the previous years need to be eliminated, a part of them will be recognized in the income of the current year (formed as costs of current employment, past employment and interest), the remainder that was formed as an actuarial gain or loss after 2015 will be transferred to the operating result just as it is done in case of use of provisions. Even though a part of the eliminated provisions is recognized as income this does not mean that it will be taxable. To calculate the tax statement for the year in which the provisions are eliminated, it is necessary to determine from the records in which year they were formed and whether or not they were included in the previous tax statements when formed. Also, the deferred taxes must be appropriately decreased. They must be decreased by the total portion of the eliminated and in the past unrecognized provisions even though a portion is transferred to income and the remainder into the retained result.

Conclusion

Slovenian companies maintain their business ledgers in accordance with the Companies Act that specified the types of companies that need to maintain their business ledgers in accordance with this act and the Slovenian Accounting Standards or the International Financial Reporting Standards. The act states that by design the Slovenian Accounting Standards cannot contradict the International Financial Reporting Standards.

The calculation and measuring of provisions for retirement severance payments are covered by the Slovenian Accounting Standard 10 "Provisions" and the International Accounting Standard 19 "Employee benefits". By the end of 2015, companies that maintain their business ledgers in accordance with the Slovenian Accounting Standards could use the simplified method. It enabled them to recognize the costs of current employment, costs of past employment, interest and actuarial gains or losses in the total amount in their income statements. In 2016, the amended Slovenian Accounting Standard 10 entered into force, which was in line with the amended International Accounting Standard 19. After this change, the expenses and surplus from revaluation had to be taken into account in addition to the previous single item in the costs.

When used or eliminated, the actuarial gain or loss that is recognized in the surplus from revaluation is recognized in the retained profits or losses and never enters the income statement.

For tax purposes, companies need to take into account the Corporate Income Tax Act that has been changed in the past. For this reason, companies have, while forming provisions for retirement severance payments and taking into account the then relevant laws, taken into account in their tax statements different levels of recognized costs of provisions. Differences in the formed provisions in the amount of tax-unrecognized provisions in the year of formation represent deferred taxes for the company. Deferred tax is a tax amount that the taxpayer will pay in the future tax periods or vice-versa, will be refunded to the taxpayer in the future tax periods.

As they transitioned to the Slovenian Accounting Standards on 31 Dec 2015, Slovenian companies formed provisions for employee severance payments that have been formed from retained earnings. Then in 2006, they formed them from the costs of the fiscal year and they were not fully recognized. Since 2007, 50% of the formed provisions remain unrecognized. However, since 2016 a portion of the formed provisions - i.e. the actuarial gains or losses - are transferred into the surplus from revaluation and upon elimination or use to the retained results.

Once we combine all these changes across the individual years and their correct inclusion into the tax statements, while meeting all the conditions and correctly keeping track of the deferred taxes, we are left with very demanding and time-consuming work as well as higher costs.

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