

Actions to be Taken by the Enterprises on 1 January 2007 or Right After Date

A new Corporate Income Tax Act (CITA 2007), effective since 1 January 2007 has been promulgated in the State Gazette issue 105, dated 21 December 2006. Requirements to be fulfilled right on 1 January 2007 have been provided for in the Transitional and Final Provisions of CITA 2007. The most important requirements concern the proper booking of the Tax Depreciation Plan (TDP). Generally, the list of the assets included in the TDP and their characteristics (depreciable/amortized cost, accumulated depreciation, carrying amount) as at 1 January 2007 shall be identical to these at 31 December 2006, where the exceptions of this rule are commented hereinbelow.

1. Writing off the revaluation reserve from the TDP

By means of § 9 from the Transitional and Final Provisions of CITA 2007 a requirement has been incorporated concerning the revaluation reserve, included in the TDP¹ on 31 December 2006 - to be written off on 1 January 2007. In addition, the enterprises have been given the opportunity to choose one of the following two methods of approach.

(1) First Method of approach

- The accumulated depreciation in the TDP for the asset is increased with the related revaluation reserve and respectively its tax carrying amount is decreased. If the revaluation reserve related to this asset is higher than its tax carrying amount, the respective asset should be written off and the difference between its revaluation reserve and its tax carrying amount shall be added to increase the accumulated depreciation of another asset(s) from the same category.
- If the tax carrying amount of the assets from the respective category is lower than the revaluation reserve related to these assets, the surplus may be used for amending the accumulated depreciation of assets from other categories.
- As a result of applying this method of approach the tax carrying amount of the assets included in the TDP as at 1 January 2007 shall be equal to the tax carrying amount of the assets included in the TDP as at 31 December 2006 less the revaluation reserve in the TDP as at 31 December 2006.
- If the revaluation reserve in the TDP as at 31 December 2006 is higher than the tax carrying amount of the assets included in the TDP, all the assets included in the TDP shall be written off, and the surplus from the revaluation reserve over the tax carrying amount should be indicated in the annual corporate income tax return and shall be taxed optionally for the

¹ This revaluation reserve should include the revaluation reserve formed during the period 1998-2001 and this one, formed during the period 2002-2003 when the tangible assets are carried at revaluation cost.

enterprise either as a lump sum during year 2007 or on equal payments during the following three years (2007, 2008, 2009). This surplus shall be taken into account when calculating the quarter advance payments for these years.

(2) Second Method of approach

- The characteristics of the assets included in the TDP are kept the same, but the whole amount of the revaluation reserve is indicated in the annual corporate income tax return and shall be taxed on equal parts during the following three years (2007, 2008, 2009), including when calculating of the quarter advance payments for these years.
- Optionally for the enterprise the taxation of the revaluation reserve may be completed also as a lump sum indicated in the annual corporate income tax return for 2007.

2. Assets that should be written off on 1 January 2007

According to § 6, para 2 from the Transitional and Final Provisions of CITA, the enterprises are obliged to write off some of the assets included in the TDP, namely:

- (1) Goodwill. Up to date, it was treated as a tax amortizable asset, regardless of the fact that if the enterprise applies the International Financial Reporting Standards it does not accrue accounting amortization (IFRS 3). On 1 January 2007 the goodwill should be written off from the TDP and in this relation there is no requirement for adjustment of the financial result with the accounting and the tax carrying amount of the enterprise. The goodwill, arisen after 1 January 2007 is not a tax amortizable asset and the losses resulting from its write down or write off are not recognized for tax purposes (Art. 49 CITA).
- (2) The assets, which on 31 December 2006 are classified as assets held for sale or assets being a part of a group for release, classified as held for sale. During the year 2006 in case of classifying assets as “held for sale” according to the provisions of IFRS 5, the enterprises did not have to write off these assets from the TDP, but only to suspend the tax depreciation accruing for them. CITA 2007 provides for these assets to be written off from the TDP on the date when the assets are classified as held for sale, and the commented transitional provision has been implemented because of this reason. When writing these assets off the enterprise is obliged to adjust the financial result with the accounting and the tax carrying amount of these assets.
- (3) Assets owned by enterprises entered into a liquidation procedure. On 1 January 2007 the enterprises, which have been wound up by means of liquidation or have been declared bankrupted should write all their assets off from the TDP. According to the CITA effective till 31 December 2006 these enterprises only suspended the depreciation/amortization accruing on their assets, but they did not write them off. According to CITA 2007 the assets of these enterprises are not amortizable/depreciable, they are to be sold in the course of the liquidation or the bankruptcy procedure and because of this fact they are treated equal as the other non-current assets, which are for sale. When writing these assets off the enterprise becomes obliged to adjust its financial result with the accounting and the tax carrying amount of these assets.

3. Assets not being used for the business activity

According to CITA effective till 31 December 2006 if a amortizable/depreciable asset is not used for the business activity for a 12-month period, then the enterprise should suspend accruing tax depreciations/amortizations for it, regardless whether amortizations/depreciations are accrued in the company accountancy. CITA 2007 provides for a period much shorter, when the assets are not used for the business activity and tax depreciations/amortizations are accrued for them. According to Art. 59 CITA 2007 when the respective asset is temporary not in use (does not contribute economic benefit) for a period longer than 3 months, the enterprise should suspend accruing tax depreciation/amortization for it since the month, following the month when the usage is suspended. The depreciation/amortization accruing resumes since the beginning of the month when the asset is being brought back into use. This rule should not apply in the case the temporary non-usage of the asset is caused by a specific characteristic of the production process (for instance, seasonal character or necessary periodic basic repairs to be done). Information should be kept in the TDP about the month of tax depreciation/amortization accruing suspension, the month of tax depreciation/amortization accruing resumption and about the circumstances that have caused it.

Pursuant to § 15 CITA an obligation for the enterprises is introduced **to review and identify the presence of assets, which have not been used in the business activity for more than 3 months** and respectively to suspend the tax depreciation/amortization accruing for these assets since 1 January 2007 without writing them off from the TDP. Meanwhile, we would like to remind you that when calculating the tax depreciation expense for the year 2006 and preparing the annual tax return for 2006, it should be identified whether there are assets not been used for a period longer than 12 months, as tax depreciation should not be accrued for them.

4. Information in the TDP

CITA 2007 provides for some amendments in the information kept in the TDP (Art. 52, para 3 CITA 2007) as well as in the way of accruing depreciation in the TDP. After 1 January 2007 the depreciation should be accrued on a monthly basis (Art. 58 CITA 2007), i.e. as of the beginning of the month of bringing into use till the beginning of the month of writing off the asset.

We draw your attention on these changes because they will cause relatively urgent change in the way of keeping the TDP. The present statement has the purpose to give a general view on the amendments made. It is possible that in the concrete cases additional facts and circumstances have to be considered. **Should any questions arise in relation to the aforesaid, please, do not hesitate to contact us on tel. 943 37 00, fax 943 37 07, e-mail address: office@afa.bg, or postal address: 38, Oborishte Str., Sofia 1504.**