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Improve your cash-flow through accelerated depreciation!

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Upon the acquisition of new tangible fixed assets, a taxpayer may choose to use either straight-line depreciation, or accelerated depreciation. In addition, if the taxpayer is the first owner of assets classified in depreciation classes 1 to 3, the taxpayer may (or, as a recipient of an investment incentive, must) increase the depreciation charge by 10% in the first year of depreciation.

While the choice between straight-line depreciation and accelerated depreciation can significantly affect the tax expenses in future tax periods, a well-chosen method may bring a substantial cash-flow benefit, even in previous periods.

Under the accelerated depreciation method, the taxpayer will have a substantially higher depreciation charge in both the first year and the second year than under the straight-line depreciation method. The decision to apply accelerated depreciation may lead to a reduction of not only the tax liability, but also the tax advances for future tax periods.

The following table shows the difference in the amount of the depreciation charge under the accelerated and straight-line depreciation methods, as well as the tax savings in individual years, for assets with an acquisition cost of CZK 100 million included in depreciation class 2, using the 10% increase in the first year of depreciation.

Year	Depreciation charge under straight-line depreciation method, CZK millions	Depreciation charge under accelerated depreciation method, CZK millions	Difference, CZK millions	Tax savings under accelerated depreciation method, CZK millions
1	21	30	9.00	1.71
2	19.75	28	8.25	1.57
3	19.75	21	1.25	0.24
4	19.75	14	(5.75)	(1.09)
5	19.75	7	(12.75)	(2.42)

Accelerated depreciation is undoubtedly more complicated than straight-line depreciation and involves a higher probability of error. Potential future technical improvements, which may significantly extend the total depreciation period, also represent possible complication.

The preferred approach will always depend on the specific circumstances; in general, we would recommend considering accelerated depreciation for depreciation classes 1 to 3 rather than depreciation classes 4 to 6. In the latter, the difference between straight-line depreciation and accelerated depreciation is significantly lower than e.g. in the second depreciation class.

Consistent application of the 10% increase in the first year of depreciation will also lead to a cash-flow benefit. For assets with a cost of CZK 100 million, the tax-related cash flow benefit in the first year of depreciation is CZK 1.9 million.

If you report a tax loss (not only due to high tax depreciation) in the 2020 reporting period, according to the current draft amendment to the Income Taxes Act, you should have the option of tax loss carry back, i.e. to utilize the tax loss retrospectively to reduce the tax liability for 2018 and 2019. This will lead to further cash-flow benefit after filing a supplementary tax return for the above periods (which, on the other hand, may lead to an extension of the period for initiating a tax audit).

If the above topics are of interest to you, please contact the author of the article or your preferred tax advisor.



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