

Legal and accounting aspects of a contribution of a business or part thereof in Slovakia

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Abstract: *A contribution of a business or part thereof is a relatively frequent type of business combinations. As part of a broader issue of certain types of undertakings joining into larger economic or legal units, a significant space in the relevant legislation and the specialist literature is devoted to this issue. This paper aims to present and analyse the contribution of a business or part thereof in the Slovak Republic from a legal and accounting point of view. The paper clarifies the contribution of a business transaction as one of the possible business combinations, explains the relationship between the contributor and the contribution recipient, explains the transfer of things, rights and property values forming a business in accordance with the Commercial Code. This paper also presents and analyses the contribution of a business in Slovakia from legal and accounting perspectives.*

Keywords: *assets, liabilities, business, contributor, contribution recipient*

JEL codes: M40, M41

1 Introduction

A contribution of a business or part thereof ("contribution of a business") is a specific type of non-monetary contribution (Vomáčková, 2004). The contribution of a business, the same as other types of non-monetary contributions, may be executed into a business during the establishment of a new company and when increasing the share capital of an existing company (Máziková, Ondrušová, Seneši, 2016). The contribution of a business in Slovakia is classified as a business combination (Farkaš, 2020). The increasing occurrence of business combinations primarily occurs in the recession and expansion phases of the economic cycle (Krišková, Užík, 2016). We are currently experiencing a more pronounced economic slowdown in the Slovak Republic due to declining exports, weaker investment demand and consumption, and slower growth in employment and wages. We expect an increased incidence of business combinations of various types in this period. The importance of the issues addressed in the presented paper is also increasing in proportion to the number of realised business combinations globally and in Slovakia.

The paper's objective is to present and analyse the legal and accounting aspects of the contribution of a business in Slovakia based on currently valid legislation concerning this issue.

The paper focuses on the legal and accounting aspects of this issue. Understanding the relationship between the contributor of the business and the contribution recipient from an economic perspective is extraordinarily important for ensuring the proper recording of the contribution of a business transaction in accounting. Given that accounting must provide an accurate and fair presentation of the given transaction, if we do not understand the substance of the transaction and its legal consequences, it is nearly impossible to ensure a fair and actual recording of the given transaction in an entrepreneur's accounting.

2 Methodology and Data

The paper presents and analyses the legal and accounting aspects of the contribution of a business in Slovakia as they are currently treated under current legislation, specifically in accordance with Act No. 513/1991 Coll., the Commercial Code as amended ("Commercial Code"), Act No. 431/2002 Coll. on Accounting, as amended ("Accounting Act") and Ministry of Finance of the Slovak Republic Decree No. 23054/2002-92 of 16 December 2002 which defines details of accounting procedures including the chart of accounts for entrepreneurs using double-entry accounting, as amended ("accounting procedures for double-entry accounting"). Therefore, we primarily analysed the provisions of this legislation in writing the paper. We found inspiration in preparing this paper in book publications and professional journals mentioned in the References section.

3 Results and Discussion

3.1 Legal aspects of a contribution of a business or part thereof in Slovakia

In the process of forming a company or increasing a company's share capital, a partner's contribution may be paid up using a monetary contribution ("monetary contribution") or other valuables with a financial value ("non-monetary contribution" in accordance with the Commercial Code. By contributing to the company, the partner participates in the result of the company's business activities. Details concerning non-monetary contributions are laid down in Articles 58 to 60 of the Commercial Code.

A non-monetary contribution must be paid up prior to registration of the share capital in the Commercial Register. A non-monetary contribution may be simply assets whose economic value can be determined (Pakšiová, Kubaščíková, 2015).

The Commercial Code defines a business as a set of tangible and personal and intangible items for business purposes. Parts of a business are also the objects, rights and other assets that belong to the entrepreneur and are designated to conduct business activities intended to serve such purpose by their very nature.

If a business or a part thereof functions as a contribution, the provisions on the contract of sale of a business apply in kind to the transfer of rights and obligations. All rights and obligations, all assets and liabilities related must be assigned to the business so that some are not intentionally or unintentionally omitted.

Rights and obligations from existing legal relationships transfer to the contribution recipient. The transfer of rights means a change in the person of the creditor. Instead of the contributor, the contribution recipient becomes the creditor. How a non-monetary contribution is paid up depends on its substance and if the change in title to the subject of such non-monetary contribution is recorded in a special register.

The rights and obligations under employment agreements with the business employees also transfer to the contribution recipient (Tumpach, Užík, Juhászová, 2014). All rights related to industrial or other intellectual property relating to the business activities of the business involved in the contribution except in instances where it would be contrary to a contract to exercise industrial or other intellectual property rights, or by the substance of such rights themselves, transfer to the contribution recipient. If receivables transfer to the contribution recipient, the transfer of such receivables are governed by the provisions on the assignment of receivables. All appurtenance and all related rights transfer with a receivable to the contribution recipient. The contributor is obliged to notify the debtor of the transfer of receivables to the contribution recipient without undue delay.

Assumption of financial liabilities by the contribution recipient means that the contributor is relieved of the obligation to pay the related debt, and the contribution recipient instead assumes this obligation and becomes the new debtor. Creditor approval is not required for the transfer of a liability. The contribution recipient does incur an obligation to inform the creditor of the assumed liability.

However, the legal transfer of rights and obligations related to the contribution of a business from the contributor to the contribution recipient only concerns the rights and

obligations of a private law nature arising under the rules of private law, and not rights and obligations arising under the rules of public law. The contribution recipient does not receive any trade license or other license, or permit granted to the contributor for business activities.

Title to the contributions or part thereof paid up before establishing the company transfer to the company on the date of its formation (Antalová, 2016). Portions of the contributions of partners paid up before the establishment of a company are managed by the founder, who is authorised by the partnership agreement ("contribution administrator"). After the establishment of the company, the person administering the contributions is obliged to provide them to the company without any undue delay (Marci, Juhászová, 2016). They are required to return the contributions if the company is not established. The contributor's declaration is the basis for the contribution recipient's submission of the petition to register ownership rights in the real estate cadastre.

In the case of a contribution of a business into a company, the contributor and the contribution recipient should conclude, for instance, the contract for the contribution of a business which specifies the individual transferred components of the company's items - rights, other assets and liabilities forming the subject of the contribution and defining the moment at which the contribution of a business is paid up. If no such contribution contract is concluded, it is possible to prepare a declaration on the handover and acceptance of a business, include a list of all components comprising the contribution of a business, and provide this declaration to the contribution administrator.

The non-monetary contribution to the company and the determination of the amount of money in which the non-monetary contribution is included in the partner's contribution must be stated in the articles of association, the memorandum of association or the charter (Stanková, Marci, 2016). This applies during the formation of a company and later in a subsequent increase in the company's share capital. In most cases, the value of a non-monetary contribution and the monetary amount in which the non-monetary contribution is included in the partner's contribution are the same. There are situations where this is not the case. It is crucial that the subject of the non-monetary contribution be valued correctly. Therefore, an expert opinion is required to determine the value of the non-monetary contribution. In addition to the value of the non-monetary contribution, it must also contain a description of the non-monetary contribution, the method of its valuation, an indication of whether its value corresponds to the issue price of subscribed shares repaid by this contribution or the value of the assumed liability for the contribution to the company. The value of the contribution expresses the extent to which the contributor participates in the company's share capital.

3. 2 Accounting aspects of a contribution of a business or part thereof in Slovakia

The accounting of a contribution of a business made by an accounting entity that uses double-entry accounting in Slovakia is laid down in Article §27a of the accounting procedures for double-entry accounting.

In the case of the contribution of a business, the individual items of assets and liabilities in their carrying amount are written off from the accounting of the contributor of the contribution of a business with a corresponding entry on the debit or credit side of account 367 – Liabilities from subscribed and outstanding shares and ownership interests and contributions (Blahušáková, 2016). The difference between the value of the non-monetary contribution included in the partner's contribution ("recognised value of the contribution") and its increase by other contributions ("paid-up contributions to the capital fund from other contributions, the allotment to the legal reserve fund from capital contributions or the share premium, if so agreed upon in the relevant contract (the articles of association, the memorandum of association or the charter) and the carrying amount of the individual items of invested assets and liabilities, is accounted, depending on its nature, on the debit side of account 568 – Other expenses related to financial activities or on the credit side of account 668 – Other income from financial activities (Vašeková, 2016). Depending on the

difference between the carrying amount of the invested assets and liabilities (carrying amount of the invested company) and the recognised value of the contribution increased by other contributions, the contributor recognises a profit or loss from the company's contribution. The contribution of a business is therefore an income statement transaction for the contributor.

The contributor records the financial investment transaction related to the contribution of a business into the relevant financial investment account and account 367 – Liabilities from subscribed and outstanding shares and ownership interests and contributions. Transactions involving other contributions agreed upon in the given contract are also recorded on the relevant financial investment account.

In the case of the contribution of a business where the accounting entities involved in this transaction are under no obligation to prepare financial statements under valid accounting legislation, it remains in the interests of such accounting entities to prepare financial statements. The contribution of a business process for the contributor includes the execution of extraordinary reconciliation procedures for assets, liabilities, and equity, as the protocols from physical count and confirmation procedures, will function as the basis of an inventory of the individual components of the transferred business. Physical count and confirmation procedures identify all assets and liabilities that are not included in the contribution or missing assets, which avoids problems in transferring the business to the contribution recipient.

Upon contributing to a business, the contributor becomes a partner in the contribution recipient or increases ownership interest if already a partner in the company. The contributor loses the contributed assets and liabilities in their carrying amount, which are replaced by financial investment in the amount of the recognised value of the contribution modified by other contributions.

In the case of a non-monetary contribution in which the individual received components of assets and liabilities comprising the contribution of a business are recorded on the to materially relevant accounts in the contribution recipient's accounting in the valuation according to the Accounting Act, i.e. at fair value regardless of if the recognised value of the contribution is increased by any other contributions (Juhászová, Markovič, Mokošová, 2014). The Accounting Act does not require the fair value of the individual components of assets and liabilities to be defined in an expert opinion; they may be defined by the accounting entity itself, in this case, the recipient of the contribution of a business. An expert opinion is required under the Commercial Code in the case of a contribution. The contribution recipient needs to know the fair value of each asset and liability component because it must account for each component separately. A list of the individual contributed components of assets and liabilities is a required part of the expert opinion.

A separate matter in the measurement of assets and liabilities by the contribution recipient is the contributor's internally-generated non-current intangible assets, which the contributor cannot capitalise except for capitalised development costs and software. This means that the contributor does not have these intangible assets recognised on the balance sheet as they were internally generated, and yet they may comprise part of the contribution as they exist.

The difference between the fair value of the individual items of assets and liabilities and the recognised value of the contribution is recorded in the contribution recipient's accounting as goodwill or negative goodwill. The value of other contributions, if agreed upon in the relevant contract, are added to the recognised value of the contribution when calculating this difference. Goodwill is recorded on the debit side of account 015 – Goodwill, and negative goodwill is recorded on the credit side of account 015 – Goodwill. Therefore, the contribution of a business or a part thereof is a balance sheet transaction for the contribution recipient.

When recording goodwill into accounts, a determination is made concerning how goodwill will increase economic benefits or, in the case of negative goodwill, decrease economic benefits in the future (Mokošová, Bednářová, Tkáčová, 2013). If future increases in

economic benefits are likely to be lower than the amount of goodwill recorded on account 015 – Goodwill, the corresponding part of the goodwill is written off during the contribution of a business. The resulting negative goodwill is written off on the credit side of account 551 – Amortisation of non-current intangible assets and depreciation of property, plant and equipment with a corresponding entry on the debit side of account 075 – Accumulated amortisation for goodwill. Under the Accounting Act, if the useful life of goodwill cannot be reliably estimated, the accounting entity must write it off within five years of its acquisition at the latest. Initial recognition of goodwill or negative goodwill in accounting is not subject to the deferred tax accounting requirement. Deferred tax accounting would apply to the temporary differences in goodwill or negative goodwill occurring after its initial recognition, e.g. as a result of various tax deductions and accounting write-offs if the initial recognition of the goodwill or negative goodwill did not result in a temporary difference (Juhászová, Domaracká, 2015). A deferred tax asset or deferred tax liability generated during the contribution of a business is recognised by the contribution recipient with a corresponding entry on account 015 – Goodwill.

Conclusion

This paper presents and analyses the contribution of a business in Slovakia from legal and accounting perspectives. The contribution of a business is a part of a broader issue of combining companies into larger economic and legal entities. The key to resolving the accounting aspects of a contribution of a business or part thereof is understanding that the contribution of a business must be seen as a transaction with the business as an economic entity. The contribution of a business is one of the options for acquiring an interest in the share capital of another company. The contributor loses the contributed assets and liabilities in their carrying amount, which are replaced by financial investment in the amount of the recognised value of the contribution modified by other contributions. Within the contribution recipient's accounting, the individual items of assets and liabilities are recognised at their fair value, which replaces the purchase price for individual items that are separately monitored in the accounts. The contribution of a business is recognised as an income statement transaction for the contributor, while the exact contribution of a business is a balance sheet transaction for the recipient.

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