

Accounting and tax treatment of discounts

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Abstract: *In a competitive market environment, the execution of sale-purchase transactions involves operating with discounts intended to reward a customer's loyalty, early repayment of a debt and, last but not least, to incite the customer to buy, all this leading to an increase of the turnover. The analysis we have done in this article presents the most important rules on discounts regulated by the legislation in force, which must be taken into account in accounting such transactions. The distinction between the different types of discounts is important and should be made from the beginning in order to apply the appropriate accounting and tax treatment.*

Key-words: *discounts, accounting treatment, tax treatment*

1. Overview

In the accounting theory there are trade discounts and financial discounts.

Trade discounts are:

- a) rebates – they are received for quality defects; they are practiced on the selling price;
- b) volume discounts – they are received in case of sales higher than the agreed volume or if the buyer has a preferential status;
- c) refunds – they are discounts calculated on all transactions made with the same third party over a specified period.

Financial discounts are in the form of settlement discounts granted for the settlement of the debts before the normal due date.

2. Accounting treatment of discounts

Discounts are different for many reasons, which is why the way of recording in the accounting is different and therefore we will analyze them separately.

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In order to identify the accounting treatment of trade discounts, consideration should be given to when they are received / granted, as follows:

- if granted at the time of invoicing and written on the purchase invoice,
- are subsequently invoiced and written on another invoice;
- represent events subsequent to the date of the balance sheet.

The trade discounts granted at the time of invoicing and written on the purchase invoice, according to the Order of the Minister of Public Finance no. 1802/2014, at the buyer, adjust in the sense of reducing the cost of purchasing the goods. If these reductions fully cover the value of the purchased goods, they are recorded at the fair value either on current earnings in the case of inventories or on the expense of the pre-emptive assets in the case of non-current assets. The earnings in advance relating to these fixed assets are reversed to the income statement over their useful lives.

At the seller, the revenue from the sale of goods or services is adjusted to the amount of the granted discounts.

The discounts granted after invoicing include those related to goods as well as those related to services.

In the case of trade discounts related to goods, the buyer analyzes two aspects in order to determine the way of recording them in the accounting:

- if the purchase of products and the receipt of the discount are treated together; for this situation the trade discounts adjust the purchase cost of the goods;
- if the goods to which the discounts are related are still in the accounting.

If the stocks for which the subsequent discounts were received are still in the accounting, the trade discounts received after invoicing correct the cost of the inventory they are referring to.

On the other hand, if the stocks for which the subsequent reductions were received are no longer in the accounting, the reductions are shown separately in the accounts (account 609 'Received trade discounts') on behalf of third-party accounts.

The seller, in order to determine how discounts are recorded, analyzes them from a single point of view, namely whether the two operations, the sale and the discount granted, are treated together, more precisely if they take place at the same time. In this situation, the discounts granted after invoicing adjust the sales revenue.

The trade discounts granted after invoicing, regardless of the period to which they refer, whether given at the time of sale or separately, are shown separately in the accounts (account 709 'Granted trade discounts') on behalf of third-party accounts.

The trade discounts related to the services received/given after the invoicing, irrespective of the period to which they refer, whether or not received/given together with the services, whether treated together or not, are shown separately in the accounts, at the buyer by means of account 609 'Received trade discounts', and at the seller by means of account 709 'Granted trade discounts' on behalf of third-party accounts.

If trade discounts represent subsequent events to the date of the balance sheet that lead to the adjustment of the annual financial statements, they are reflected in the financial statements of the year for which the reporting is made, based on the supporting documents, and they are recorded at the date of the balance sheet in the case of the buyer in account 408 'Suppliers – un-received invoices', and in the case of the seller in account 418 'Customers – invoices to be issued'. The reductions to be received, recorded at the date of the balance sheet in account 408, correct the cost of the inventories to which they refer to, if they are still in the accounting.

As regards the accounting treatment of the financial discounts, they shall be recorded in the accounts as follows, irrespective of the period to which they relate:

- at the buyer, they represent income of the period and are recorded in account 767 'Income from discounts obtained';
- at the seller, they are expenses of the period and are recorded in account 667 'Expenditure on discounts granted'.

3. Tax treatment of discounts

As regards the value added tax, there are the following situations:

- discounts granted at the time of delivery / invoicing

According to art. 286 par. (4) lit. a) from the updated Romanian Fiscal Code (22 September 2017), the taxation base for goods and services rendered within the country does not include discounts, draws, rebates, refunds and other discounts granted by suppliers directly to customers at the time of the exigibility of the tax;

- discounts granted after delivery / invoicing.

According to art. 287 lit. c) from the updated Romanian Fiscal Code (22 September 2017), the taxation base shall be reduced if the discounts, draws, rebates, refunds and other discounts provided in art. 286 par. (4) lit. a) are granted after the delivery of the goods or the provision of the services.

As regards the corporate income tax, according to art. 25 par. (1) of the Law no. 227/2015 regarding the Fiscal Code, subsequently amended and supplemented (22 September 2017), for the determination of the fiscal result, the expenses incurred for the economic activity, including those regulated by the normative acts in force, as well as the registration fees, the contributions and the contributions due to the chambers of commerce and industry, the employers' organizations and the trade unions' organizations are considered deductible.

The discounts, whether trade or financial ones, are made for the purpose of conducting the economic activity. Therefore, the costs of the granted discounts are deductible in the calculation of the corporate income tax and the revenues from the received discounts represent taxable income.

Regarding the tax on the income of the microenterprises, according to the updated Fiscal Code, the taxation base on which the tax rate applies is the income from any source less the amount of the trade discounts granted after invoicing, recorded in account 709 'Granted trade discounts' and the amount of the trade discounts received after invoicing is added in account 609 'Received Trade Discount'.

4. Practical aspects and discussions

4.1. Trade discounts registered on the purchase invoice

A business entity has negotiated a 5% discount with a raw material supplier whenever they order more than 1000 pieces at a single order.

The unit price was 10 lei / piece, the entity ordering 2000 pieces.

This discount is a trade one, i.e. a volume discount.

With regard to the value added tax, as mentioned in the article, the volume discounts and the other discounts are not included in the taxation base of the tax if they are granted to the purchaser's benefit at the time of delivery and do not in fact constitute remuneration for a service or a delivery.

As a consequence, the VAT rate will be applied to the net invoice value.

At the buyer:

- Purchase of raw materials according to the invoice

%	=	Suppliers	22610
Raw materials			19000
Deductible VAT			3610

Basic price: 2000 pcs. x 10 lei/piece = 20000 lei;

Volume discount registered on invoice: 1000 lei;

Net value: 19000 lei.

At the seller:

- delivery of finished products according to the invoice

Customers	=	%	22610
		Income from the sale of finished products	19000
		Collected VAT	3610

4.2. Trade discounts received after the purchase invoice

A business entity had in stock on 01.09.N 100 pieces of 'Y' goods valued at the unit cost of 5 lei / piece.

During the month the following transactions took place:

- 10.09.N: purchase of 200 pcs. according to the invoice at the unit cost of 8 lei / piece, 19% VAT;

- 15.09.N: sale of 50 pcs. on the invoice basis at the unit price of 10 lei, volume discount of 5%, VAT 19%;

- 20.09.N: receipt of a 10% discount for the purchase of 10.09.N on a subsequent invoice.

We assumed that the outputs from the stock were evaluated using the FIFO method (first in - first out).

- on 10.09.N the purchase of the 200 pieces of 'Y' goods according to the invoice

	%	=	Suppliers	1904
Goods				1600
Deductible VAT				304

- on 15.09.N sale of 50 pcs. 'Y' goods according to the invoice

Customers	=	%	505.75
		Income from the sale of goods	425.00
		Collected VAT	80.75

Selling price: 50 pcs. x 10 lei/piece = 500 lei;

Volume discount: 25 lei;

Net value: 425 lei.

The volume discount written on the invoice diminished the amount recorded in the proceeds from the sale of the goods.

- at the same time the goods are sold, the accounting is discharged

Expenditure on goods	=	Goods	250
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The cost of the goods sold according to the FIFO method (first in – first out):
50 pcs. x 5 lei/piece = 250 lei.

- on 20.09. N receipt of a 10% discount for the purchase of 10.09.N with a subsequent invoice

We assumed that the 200 pcs. of the goods purchased on 10.09.N were still within the entity and consequently, the received trade discount corrected the cost of the goods.

Suppliers	=	%	190.40
		Goods	160.00
		Deductible VAT	30.40

4.3. Trade discounts granted subsequent to invoicing

A business entity launches a promotional campaign through coupons that reduce the percentage of the value of the purchase according to the purchase value. The coupons can be found in the stores that ensure distribution. The discounts are granted to buyers by the stores selling the promotional products.

The business entity issues distinct discount invoices to the distributor stores. For example, we assume the following: an issued discount invoice of 5950 lei, including VAT.

At the business entity that launched the promotional campaign:

- issuing the discount invoice for the store

%	=	Customers	5950
Granted trade discounts			5000
Collected VAT			950

The trade discounts granted subsequent to invoicing were recorded distinctly via account 709 'Granted trade discounts' on behalf of third-party accounts.

The taxation base for VAT was adjusted accordingly.

At the distributor store:

- receiving the discount invoice:

Suppliers	=	%	5950
		Received trade discounts	5000
		Deductible VAT	950

We assumed that the goods for which the subsequent discounts were received were sold, in which case the discounts were evidenced by account 609 'Received trade discounts'.

On the other hand, if the goods had still been in the accounting of the distribution store, the discounts received subsequent to invoicing would have corrected the cost of the stocks.

4.4. Trade discounts that represent subsequent events to the date of the balance sheet

At the end of year N, a business entity must benefit from a trade discount of 5000 lei from one of its suppliers for the goods purchased in the fourth quarter. It receives the discount invoice at 05.01.N + 1. At the end of year N, 50% of the goods purchased from that supplier were still in the stock.

The business entity must record for the year N the reduction to be received as follows:

Suppliers – un-received invoices	=	%	5000
		Received trade discounts	2500
		Goods	2500

4.5. Financial discounts

A business entity sells goods in the amount of 10000 lei, 19% VAT to another business entity. Under the contract, the settlement term is 2 months. As a result of the buyer's willingness to settle immediately, the seller gives him a discount of 3%.

At the seller:

- the sale of the goods according to the invoice

Customers	=	%	11900
		Income from sale of goods	10000
		Collected VAT	1900

- the pre-maturity discount

%	=	Customers	357
Expenditure on discounts granted			300
Collected VAT			57

At the seller the discount generated a financial cost. The collected VAT was affected by adjusting the taxation base. If the discounts were granted after the delivery of the goods or services, the taxation base would have been adjusted accordingly.

At the buyer:

- purchase of goods according to the invoice

%	=	Suppliers	11900
Goods			10000
Deductible VAT			1900

- the discount received

Suppliers	=	%	357
		Income from the obtained discounts	300
		Deductible VAT	57

At the buyer the discount received for a pre-maturity settlement led to the recording of a financial income.

5. Conclusions

In order to apply fair treatment, both an accounting and a tax one, at first, it has to be considered whether the discount is indeed a trade one or a financial one or it is in fact a rendered service.

The confusion may have a negative impact on the result of the financial year because the mistaken record of trade and financial discounts may alter the operating result and thus the business entity will no longer present a true and fair view of the financial statements.

6. References

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