Bulletin of the *Transilvania* University of Braşov • Vol. 3 (52) - 2010
Series V: Economic Sciences

TAX DEPRECIATION VERSUS ACCOUNTING DEPRECIATION IN ROMANIA AFTER JOINING THE EUROPEAN UNION

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Abstract: *In order to give a true and fair view, accounting should be led by its own principles, without being distorted by value adjustments for taxation purposes. To achieve this goal, accounting must be separated from taxation, i.e., the tax recognition of the magnitude of some expenditure should not be subject to their impact on accounting. Although formally accepted, the disconnection of taxation from accounting continues to experience difficulties. But a certain progress can be detected. The regime of the expenditure with tax depreciation of the fixed assets is an example of separating accounting from taxation.*

Key words: *accounting depreciation, tax depreciation.*

1. Introduction

Fixed assets degrade over time and, therefore, their replacement must be ensured. This is usually done by depreciation. Depreciation is therefore the equivalent of the irreversible reduction in value of an asset due to usage, wear and tear, action of natural factors, technological outdating or other reasons. Items which do not lose useful value over time cannot be depreciated, i.e. land or financial investments cannot be depreciated, their possible impairment being covered by adjustments for impairment or loss of value.

There are several views on depreciation.

According to the economic concept of depreciation, entities use the acquired assets to obtain benefits (economic benefits) over several periods. Under accrual accounting and segregation of financial years, the (accounting) entry value of the assets should be attributed so that each financial year may have expenses suitable for the economic benefits derived from the use of those assets.

From the financial point of view, depreciation is a way to recover the invested capital and, therefore, it emerges as a resource to the entity. The accumulation of annual depreciation has to allow the replacement of assets at the end of their useful life.

The legal concept considers that depreciation is related to the category of patrimony. In this respect, depreciation should be regarded as an accounting finding regarding the decrease in value of an element belonging to assets, resulting

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from its usage, passage of time, change of technique or any other cause.

IAS 16 "Property, Plant, and Equipment" states that depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Nowadays one can notice the more and more obvious trend to separate taxation from accounting in the Romanian accounting. In other words, accounting must be independent, a quality ensured by disconnecting it from taxation.

As regards depreciation, two categories are currently used: accounting depreciation and tax depreciation.

2. Accounting Depreciation

Accounting depreciation is a permanent adjustment to be entered in the accounts as expenditure, being determined according to accounting regulations and rules. The legislation governing it consists of a series of regulating acts, the latest of which is the Order of the Ministry of Public Finances, no. 3.055/2009, approving the Accounting Regulations in accordance with the European directives [3].

a) Depreciation rules

Depreciation lies in the content of Article 31 paragraphs (1) and (2) of the Order of the Minister of Public Finance no. 3.055/2009, as follows:

"(1) Value adjustments include all adjustments that take into account the reductions in values of the individual assets, established at the balance sheet date, whether that reduction is final or not.

(2) Value adjustments can be: permanent, referred to as depreciation, and/or temporary, referred to as adjustments for impairment or loss of value, depending on whether the adjustment of assets is permanent or temporary."

b) The value of depreciation

As far as the value of depreciation is concerned, it lies in Article 110 paragraphs (1), (2) and (3) of the same order, as follows:

"(1) The depreciation accounting is established by applying the value of depreciation allowances for tangible input.

(2) Depreciation of tangible assets is calculated from the following month after the first use until full recovery of their input. In determining the depreciation of tangible assets, their terms of economic use and conditions of use are considered.

(3) If tangible assets are recorded in conservation, according to the adopted accounting policy, the entity records a depreciation expense or an expense appropriate for the adjustment for the recorded depreciation."

For intangible assets, the entry value and the terms of economic use benefit from specific regulations, as we will further notice.

c) Period of depreciation

If we refer to the period of depreciation, we should mention that, when accounting harmonization considers the international accounting standards, the depreciation period should not exceed the useful life, which is synonymous with the lifespan in which economic benefits are expected to be obtained.

Accounting regulations consistent with the European directives implement, as we have already noted, the concept of duration of economic use. In these regulations (Article 68 paragraph (3) of the Order of the Minister of Public Finance no. 3.055/2009), the "duration of economic use means the useful life, representing the period in which an asset is expected to be available for use by an entity or the number of units or the similar units that are expected to be obtained by using that asset."

The depreciation period for the tangible assets is the period of economic use, whereas for the intangible assets, it is specifically provided in accounting regulations consistent with the European directives. Thus:

"Article 76 (1): The set up expenses must be amortized within a period not exceeding five years.

Article 80 (1): Development costs are amortized over the contract period or during the use, as appropriate.

Article 81 (3): Patents, licenses, trademarks, rights and other similar assets are amortized over the expected duration of their use by the entity that holds them.

Article 83 (4): Goodwill is usually amortized within a not exceeding five year period. Entities can amortize goodwill during a more than five year period, provided that this period does not exceed the economic use of the asset and it is presented and justified in the explanatory notes.

Article 84 (2): Software is amortized over the expected duration of their use by the entity that holds."

d) Depreciation regimes

Articles 112 and 113 of the Order of the Ministry of Public Finance no. 3.055/2009 describe the depreciation regimes in detail, as follows:

"112 (1) Entities depreciate tangible assets using one of the following depreciation regimes:

- linear depreciation;
- digressive depreciation;
- accelerated depreciation;
- unit-of-production depreciation.

113 (1) Land is not depreciable.

(…)"

We notice that accounting regulations consistent with the European directives do not specify the use of a particular depreciation method for intangible assets.

3. Tax Depreciation

Tax depreciation is the depreciation determined under tax rules to replace accounting depreciation in calculating income tax. It is governed by the Fiscal Code [1] or other regulations, as we shall see further.

a) Rules for depreciation

Tax depreciation is regulated by Article 24 of the Fiscal Code with Rules for application, while provisions regarding their use are contained in the Catalogue of classification and normal operating times of fixed assets, too. [2]

Tax Depreciation relates mainly to the depreciation of fixed assets, as Article 24 provides:

"(1) The costs of acquisition, production, construction, assembly, installation or improvement of depreciable fixed assets is recovered for tax purposes by deducting depreciation.

(2) A redeemable asset is any tangible asset that meets the following conditions:

- it is owned and used in the production and/or supply of goods or services in order to be rented to third parties or for administrative purposes;
- it has a tax value larger than the limit set by a Government, at the entry date in the taxpayer's patrimony;
- has a normal duration of use of more than one year. (...)"

The same article, paragraph (17) stipulates:

"In the case of tangible assets which, at the date of coming into heritage, have a tax value lower than the limit established by the Government decision, the taxpayer may choose to deduct expenses related, to restrain or to recover these costs through depreciation."

We rally to the idea that the provisions of paragraph (17) lead to a differential treatment of the depreciation expenses, dividing them into: deductible expenses when calculating income (accounting provision) and non-deductible expenses in calculating profits (tax provision), which would harm the non-deductible uniform treatment of accounting depreciation.

The same article 24 further specifies: "for tangible assets which are used in lots, sets, or which form a single body, group or set to determine the damping value, the entire body, group or set is envisaged. For the components that come into a tangible structure, whose length differs from the normal use of the resulted asset, depreciation is determined for each component."

According to the same Fiscal Code, the following are also considered depreciable fixed assets:

"- investments made in fixed assets subject to leases, concession, management tenancy or similar location;
- partially fixed assets put into operation, for which no registration forms were drawn up as tangible assets;
- investments made in order to capitalize the discovered useful minerals, and the work of opening and preparing the underground and surface extraction;
- investments made in fixed assets existing as further expenditure made in order to improve initial technical parameters and leading to future economic benefits, by increasing the fixed asset value;
- investments made from its own sources, embodied in new goods, such as those in the public domain, and the development and modernization of publicly owned property;
- developing the land."

The following are not tax depreciable assets: land, including forest; paintings and works of art; goodwill; lakes, swamps and ponds which are not the result of an investment; public goods financed from budgetary sources; own rest homes, housing protocol, vessels, aircraft, cruise ships, other than those used for the revenue.

b) Depreciation value

The entry value (the depreciation value) of fixed assets may be represented, as appropriate, by one of the following values: the acquisition cost, the production cost or the fair value.

c) Duration of depreciation

The Ministry of Public Finances is drawing up rules regarding the classifications and the normal operating times of the fixed assets.

The normal duration of operation is the duration of use in which, in fiscal terms, the entry value of fixed assets is recovered via depreciation. It is natural that the duration of the normal operation is less than the physical life of the fixed asset. Under these circumstances, the category of tax depreciation generates difficulties in the timing of physical removal of the fixed asset in service. In our view, fiscal rules should be used only for tax purposes. The duration for disposal should be the duration of the economic use, synonymous with the useful life. Thus one can avoid some misunderstandings.

d) Depreciation regimes

The depreciation regime for a redeemable asset is determined according to the following rules (Fiscal Code, article 24, paragraph (6)):

"-for constructions, the method of linear depreciation applies;
- for technological equipment, i.e. machinery, tools and installations, as well as for computers and peripheral equipment thereof, the taxpayer may choose among the method of linear depreciation, digressive depreciation or accelerated depreciation;
- with any depreciable fixed asset, the taxpayer may choose between the linear

depreciation method and the digressive method."

In the case of the linear depreciation method, depreciation is calculated by levying the tax value of linear depreciation at the date of the entry of the depreciable fixed asset into the taxpayer's patrimony.

For the digressive depreciation method, depreciation is calculated by multiplying the depreciation allowances in line with one of the next coefficients: 1.5, if the duration of normal use of the redeemable fixed asset is between 2 and 5 years; 2.0, if the normal use duration of the redeemable fixed asset is between 5 and 10 years; 2.5, if the normal use duration of the fixed asset exceeds 10 years.

In the case of the accelerated depreciation, amortization is calculated as follows: for the first year of use, depreciation cannot exceed 50% of the tax value from the fixed asset's entry date into the taxpayer's patrimony; for the next years of use, depreciation is calculated by comparing the left value of the fixed asset depreciation with its left normal use.

With respect to the unit-of-production depreciation, this is calculated every five years for mines, quarries, oil extraction, as well as for the investment costs for stripping and every ten years in saline.

For depreciable fixed assets, depreciation deductions are determined without considering accounting depreciation. Gains or losses from sale or from the decommissioning of these fixed assets are calculated on the basis of their tax value, diminished by tax depreciation. For fixed assets with book value evident in balance on December 31, 2003, depreciation is calculated on the basis of the left undepreciable value, during the left normal use, using the depreciation methods applied to that date.

We found that the accounting regulations did not specify a particular depreciation regime for intangible assets. Instead, the Fiscal Code stipulates that those expenses related to the acquisition of patents, copyrights, licenses, trade marks or factory and other intangible assets recognized for accounting purposes, except for the costs of formation and goodwill, and the costs of development, which in accounting terms are intangible assets, are recovered through deductions of linear depreciation. The cost related to the purchase or production of software is also recovered through deductions of linear depreciation. However, the accelerated or digressive depreciation methods may be used for patents, too.

4. Conclusions

In Romania, accounting and tax regulations are generated by the same institutions, so there is a serious risk, i.e. to determine accounting to satisfy one interest only, that of the budget.

Separating accounting from taxation is a solution for this problem.

The authors of the article consider that the regime of the expenses for the tax depreciation of the fixed assets reflect maybe the strongest separation of accounting from taxation because tax regulations specifically state that, for depreciable fixed assets, depreciation deductions are determined without considering the accounting depreciation and any accounting review.

References

1. Law no. 571/2003 in conjunction with the Government Decision no. 44/2004 on the Fiscal Code with the Methodological regulations for application, with subsequent changes and additions, last update: according to the Government Decision no. 1620 of December 29, 2009.

2. Government Decision no. 1496/2008 amending the Annex to the Government Decision no. 2139/2004 for approving the Catalogue regarding the classification and normal operating times of fixed assets.
3. Order no. 3.055/2009 of the Ministry of Public Finances for the approval of the Accounting Regulations in accordance with the European Directives, Official Gazette of Romania, Part I, no. 766 bis/10.11.2009.