

DEFERRED TAXES GENERATED BY THE CAPITALIZED INTERESTS IN THE AMOUNT OF THE FIX ASSETS IN THE CONTEXT OF MEETING THE PRINCIPLE OF PRUDENCY

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Abstract

According to the General Framework for preparing and presenting the financial statements elaborated by IASB, the utility of information is provided by attributes (qualitative features), such as: intelligibility, relevance, credibility and comparability. For being credible, the financial information shall be erroneous, shall not be biased or deforming the patrimony, and one of the elements representing and defining the information credibility is the prudence.

Thus, the prudential accounting treatments affect, on the one hand, the accounting information relevance and credibility, and on the other hand, equally, both the producers as well as the users of the financial information, due to the economic consequences which are generated. From this perspective and considering that the implied economic agents are not neutral in terms of their option concerning the neutral accounting practices, prudent or aggressive, we opined that it is useful to conduct a study aiming the relevance of the accounting information related to the deferred taxes generated by the capitalized interests in the amount of the fix assets, recognizing the value of these taxes having as result the compliance with the principle of prudence within the accountancy.

In this context, compared to the dominant accounting systems, respectively the continental system and the Anglo-Saxon system, within which the accounting information is characterized as legal, respectively addressed to the external users, especially to the investors, the conducted study aimed the following directions: the main differences between the provisions of the national, European, Anglo-Saxon accounting regulations and those of the international referential related to the prudence; the occurrence and evolution of the deferred taxes generated by the capitalized interests in the amount of the fix assets; informational benefits of the accounting prudence concerning the reflection of the deferred taxes established by the capitalized interests in the amount of the fix asset, directions on whose structure we conceived the conducted study, such that the modeled reality to be correctly and reasonably represented for the users of the financial statements.

Key words: *prudence, corporate tax, deferred tax, IAS, temporary differences.*

JEL Classification: *M40, M41, M48, M49*

1. Introduction

As an essential instrument of financial communication, the accountancy is different from a country to another by its content and ways of being applied [2], and the accounting regulation is applied to the economic operators from that country, aiming to provide the comparability concerning the financial statements of the companies. Thus, depending on the users, the accounting language, which is elaborated at the national level, is adapted for the local objectives, [1] and an indispensable requirement of the information included in the annual financial statements is represented by their reliability.

As the financial statements represent a component of the financial reporting process, being the final product of the accounting activity, classifying and synthetizing a series of financial transactions, representing the main means concerning the communication of the accounting information to the users outside the entity, the information released by them shall be useful and to reflect the reality of the patrimony of an entity, [3] and one of the elements representing and defining the credibility of information is the **prudence**.

The reason for which we chosen as approaching theme the deferred taxes generated by the capitalized interests in the amount of the fix assets, in the context of meeting the principle of prudence, resulted from the great importance of the accounting information concerning the deferred taxes in the activity of the economic entity, as the annual financial statements are credible only if they correctly show the financial position, the performance and the financial flows of the company. [4]

2. Main differences between the provisions of the national, European, Anglo-Saxon accounting regulations and those of the international referential concerning the prudence

The prudence is a main concept characterizing the accounting treatments specific to the European countries as due to the cultural and social features of those countries, they seek treatments for avoiding to transfer in the next periods the current uncertainty, susceptible to change the financial position and the results of a company.

To a comparative analyze of the provisions of the *Directive no. 2013/34/EU* (art. 6) with those of the old directives, we notice the importance given to the principle of prudence meaning that the Directive provides that the Member States may allow the recognition of the predictable debts and the potential losses. Thus, the elements presented and consolidated in the annual financial situations are recognized and evaluated according to general principles, among which we mention the principle related to the *recognition and evaluation conducted on a prudent base*, more exactly: (1) only the profits obtained on the balance sheet date may be recognized; (2) all debts occurred during the current financial year or during a previous exercise may be recognized, even if they become evident only between the balance sheet date and the date of its drawing and (3) all the negative adjustment of value are recognized, whether the result of the financial exercise is profit or loss. This as the annual financial statements should be prepared on a prudential base and should provide a true image of assets, debts, financial position and profit or loss of the company (point 9), and for providing the comparability and equivalence of the reported information, the principles of recognition and evaluation should also include the prudence (point 16). [15]

Following the model of the European approach, at the national level the implementation of the Directive no. 2013/34/EU was conducted by the Order of the Ministry of Public Finances for approving the Accounting regulations concerning the individual annual financial statements and the consolidated annual financial statements [*Order of the Ministry of Public Finances*] no. 1802 of 29 December 2014, and according to the art. 51 “(1)...When preparing the annual financial statements, the recognition and evaluation shall be conducted on a prudent base and especially: a) the profit and loss account may include only the profit achieved on the balance sheet date; b) the debts occurred during the current financial exercise or those of a previous exercise are recognized, even if they become evident only between the date of the balance sheet and the date of its drawing; c) the depreciations are recognized, whether the result of the financial exercise is profit or loss. The registration of adjustments for value depreciation or loss is made on the base of the accounts of expenses, whether their impact on the account of profit and loss, (2) The assets and revenues shall not be overvalued, and the debts and expenses, undervalued. However, the exercise of the prudence does not allow, for example, the establishment of excessive provisions, the deliberated undervaluation of the assets and revenues, but nor the deliberated overvaluation of debts or expenses, as the financial statements would not be neutral any more, and would not have any more the quality of being credible.” [9]

The British accountancy gives to the prudence a remarkable place, even if it is conceptually related more to the American accountancy than to the European accountancy. In this context, the approach we find in the *Financial Reporting Standard [FRS] 18* according to which the prudence is a fundamental principle of the accountancy, together with the permanent character of methods, the continuity and accountancy of engagements [6], is extremely interesting as at international level, according to the *International Accountancy Standard [IAS] 1 “Presenting the financial statements”* the concept of prudence was taken as a feature of the financial and accounting information and not as a base of the accountancy. In this respect, the standard requests to present the valuable and descriptive information by companies when provisions are made, as well as the estimations sources which are conducted under conditions of uncertainty as they may generate significant adjustments with respect to the assets and debts recognized during the next exercises. [7]

Starting from the above mentioned issues, we consider as opportune and necessary to present a practical example by means of which we shall highlight the compliance with the principle of prudence within the accountancy, including the influence on the information presented in the annual financial statements by the account of profit and loss, but also by the receivables/debts concerning the deferred tax.

3. Deferred taxes generated by the capitalized interests in the amount of the fix assets

As the relevance and credibility of the accounting information is affected by the prudential accounting treatments, an objective of this study concerning the compliance with the principle of prudence within the accountancy consisted of studying the possibility of accounting the deferred taxes as a result of the existence of some capitalized interests in the value of the fix assets, and by means of a practical example we shall highlight the occurrence and evolution of the deferred taxes, generated by the capitalized interests in the amount of the fix assets.

Thus, by registering the capitalized interests in the amount of the fix assets, temporary differences may occur, situation which determines receivables/debts concerning the deferred tax, the recognition of the value of these taxes having as result the compliance with the principle of prudence within the accountancy.

Example: An entity ALFA executed by itself until the end of the current financial exercise (N) a fix asset in the amount of 150.000 lei, of which the interest to the capital loaned for financing the construction of the asset with a long cycle of manufacturing is of 10.000 lei. According to the national referential, according to the accounting policy (the good being procured before 2015) the entity did not opt for including the interest into the cost of that asset. Instead, according to IAS 23 “Borrowing costs” the interests calculated using the method of the effective interest, as described in IAS 39

“which may be awarded directly to the procurement, construction or production of an asset with a long cycle of manufacturing shall be capitalized as part of the cost of that asset”. In this context, the fix asset is amortized based on the method of the linear amortization along the useful lifetime, estimated at 5 years, the normal operation duration being the same from the tax point of view.

In this situation, the annual accounting amortization is of 30.000 lei (150.000 lei / 5 years), and the annual tax amortization is of 28.000 lei (140.000 lei / 5 years).

This example aims to highlight the *occurrence and evolution of the deferred taxes*, generated by the capitalized interest in the amount of the fix assets, according to IAS 39 (accounting value) which, from the tax point of view, [8] is not considered, according to the national referential, as a result of the fact that the investment was completed at the end of 2014 and the entity did not opt for including it in the asset cost (tax value)

✚ For the financial exercise N+1:

For meeting the proposed objective, firstly we shall establish the *debt related to the deferred tax related to the financial exercise N+1*, as follows:

- Accounting base = Accounting value – Accounting amortization = 150.000 lei – 30.000 lei = 120.000 lei;
- Tax base = Tax value – Tax amortization = 140.000 lei – 28.000 lei = 112.000 lei;
- Taxable temporary difference = Accounting base – Tax base = 120.000 lei – 112.000 lei = 8.000 lei;
- The initial debt with the deferred corporate tax = Taxable temporary difference x 16% = 8.000 lei x 16% = 1.280 lei;
- The initial debt with the deferred corporate tax = 0 lei;
- Expenses with the deferred corporate tax = Total debt with the deferred corporate tax – Initial debt with the deferred corporate tax = 1.280 lei.

Consequently, as a result of the calculations made by the company, **the balance sheet of the year N+1** shall recognize debts concerning the deferred corporate tax in the amount of 1.280 lei, which shall affect the account of profit and loss, in the accounting performing the following registration:

692 „Expenses with the deferred corporate tax”	=	4412 „Deferred corporate tax”	1.280,00
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✚ For the financial exercise N+2:

As at the end of the financial exercise N+2 the company has still to recover from the accounting value an amount of 90.000 lei (150.000 lei total accounting value – 60.000 lei accounting amortization recovered in the exercises N+1 and N+2) and taking into account that the resting tax value to recover is of 84.000 lei (140.000 lei total tax value – 56.000 lei tax amortization recovered in the exercises N+1 and N+2) taxable temporary differences shall occur in the amount of 6.000 lei (90.000 lei accounting base – 84.000 lei tax base), and **the balance sheet of the year N+2** shall *recognize debts concerning the deferred corporate tax* only in the amount of 960 lei (6.000 lei x 16%), calculated as follows:

- Accounting base = Accounting value – Accounting amortization = 150.000 lei – 60.000 lei = 90.000 lei;
- Tax base = Tax value – Tax amortization = 140.000 lei – 56.000 lei = 84.000 lei;
- Taxable temporary difference = Accounting base – Tax base = 90.000 lei – 84.000 lei = 6.000 lei;
- The initial debt with the deferred corporate tax = Taxable temporary difference x 16% = 6.000 lei x 16% = 960 lei;
- The initial debt with the deferred corporate tax = 0 lei;
- Revenues with the deferred corporate tax = Total debt with the deferred corporate tax – Initial debt with the deferred corporate tax = 1.280 lei – 960 lei = 320 lei.

In this situation, the company shall register a receivable concerning the deferred tax in the amount of 320 lei (1.280 lei – 960 lei), affecting the account of profit and loss, situation generating the following registration:

4412 „Deferred corporate tax”	=	792 „Revenues from the deferred corporate tax”	320,00
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✚ For the financial exercise N+3:

Taking into account that at the end of the financial exercise N+3 the company still has to recover from the accounting value an amount of 60.000 lei (150.000 lei total accounting value – 90.000 lei accounting amortization recovered in the exercises N+1, N+2 and N+3) and due to the fact that the tax value to recover is of 56.000 lei (140.000 lei total tax value – 84.000 lei tax amortization recovered in the exercises N+1, N+2 and N+3) taxable temporary differences in the amount of 4.000 lei shall occur (60.000 lei accounting base – 54.000 lei tax base), **the balance sheet of the year N+3** shall *recognize debts concerning the deferred corporate tax* only in the amount of 640 lei (4.000 lei x 16%), established as follows:

- Accounting base = Accounting value – Accounting amortization = 150.000 lei – 90.000 lei = 60.000 lei;
- Tax base = Tax value – Tax amortization = 140.000 lei – 84.000 lei = 56.000 lei;

- Taxable temporary difference = Accounting base – Tax base = 60.000 lei – 56.000 lei = 4.000 lei;
- The initial debt with the deferred corporate tax = Taxable temporary difference x 16% = 4.000 lei x 16% = 640 lei;
- The initial debt with the deferred corporate tax (N+2) = 960 lei;
- Revenues with the deferred corporate tax = Total debt with the deferred corporate tax – Initial debt with the deferred corporate tax = 960 lei – 640 lei = 320 lei.

This time again, the entity shall reflect a receivable concerning the deferred corporate tax in the amount of 320 lei (960 lei – 640 lei), affecting the account of profit and loss, in the accountancy registering the following result:

4412 „Deferred corporate tax”	=	792 „Revenues from the deferred corporate tax”	320,00
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✚ **For the financial exercise N+4:**

As at the end of the financial exercise N+4 the company still has to recover from the accounting value an amount of 30.000 lei (150.000 lei total accounting value – 120.000 lei accounting amortization recovered in the exercises N+1, N+2, N+3 and N+4) and taking into account that the tax value to recover is of 28.000 lei (140.000 lei total tax value – 112.000 lei tax amortization recovered in the exercises N+1, N+2, N+3 and N+4) taxable temporary differences in the amount of 2.000 lei shall occur (30.000 lei accounting base – 28.000 lei tax base), **the balance sheet of the year N+4 shall recognize debts concerning the deferred corporate tax** only in the amount of 320 lei (2.000 lei x 16%), calculated as follows:

- Accounting base = Accounting value – Accounting amortization = 150.000 lei – 120.000 lei – 30.000 lei;
- Tax base = Tax value – Tax amortization – 140.000 lei – 112.000 lei = 28.000 lei;
- Taxable temporary difference = Accounting base – Tax base = 30.000 lei – 28.000 lei = 2.000 lei;
- The initial debt with the deferred corporate tax = Taxable temporary difference x 16% = 2.000 lei x 16% = 320 lei;
- The initial debt with the deferred corporate tax (N+3) = 640 lei;
- Revenues with the deferred corporate tax = Total debt with the deferred corporate tax – Initial debt with the deferred corporate tax = 640 lei – 320 lei = 320 lei.

In this situation, the entity shall register a receivable concerning the deferred corporate tax in the amount of 320 lei (640 lei – 320 lei), affecting the account of profit and loss, in the accountancy registering the following result:

4412 „Deferred corporate tax”	=	792 „Revenues from the deferred corporate tax”	320,00
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✚ **For the financial exercise N+5:**

As at the end of the financial exercise N+5 the company has not to recover from the accounting value (the accounting amortization being recovered in the exercises N+1, N+2, N+3, N+4 and N+5) and taking into account that the tax value is recovered (by means of the tax amortization from the same financial exercises) there are no temporary differences and **the balance sheet of the year N+5 shall not recognize debts/receivables concerning the deferred corporate tax**, as follows:

- Accounting base = Accounting value – Accounting amortization = 150.000 lei – 150.000 lei – 0 lei;
- Tax base = Tax value – Tax amortization – 140.000 lei – 140.000 lei = 0 lei;
- Taxable temporary difference = Accounting base – Tax base = 0 lei;
- The initial debt with the deferred corporate tax = Taxable temporary difference x 16% = 0 lei x 16% = 0 lei;
- The initial debt with the deferred corporate tax (N+4) = 320 lei;
- Revenues with the deferred corporate tax = Total debt with the deferred corporate tax – Initial debt with the deferred corporate tax = 320 lei – 0 lei = 320 lei.

In this situation, the entity shall register a receivable concerning the deferred corporate tax in the amount of 320 lei (640 lei – 320 lei), affecting the account of profit and loss, in the accountancy registering the following result:

4412 „Deferred corporate tax”	=	792 „Revenues from the deferred corporate tax”	320,00
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4. Conclusions

If we take into account that the financial reports of companies are a primordial instrument of communication for satisfying the informational needs of a complex of users, in order to be useful, the accounting information within them shall meet those qualitative attributes (features), such as: intelligibility, relevance, credibility and comparability. In this context,

one of the elements representing and defining the information credibility is the prudence due to the economic consequences which are generated.

From this perspective and taking into account that the implied economic agents are not neutral in terms of their option concerning the neutral practices, prudent or aggressive, the conducted study aimed the relevance of the accounting information with respect to the deferred taxes generated by the capitalized interests in the amount of the fix assets and denotes that the recognition of the value of these taxes has as result the compliance with the principle of prudence within the accountancy and the achievement of an economic and financial information meeting the requirement of neutrality.

Thus, all the elements presented above, transformed in performance requirements related to the deferred taxes, lead to the correct information of recipients, respectively to the informational reliability.

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