

SUBSIDIES - FISCAL AND ACCOUNTING TREATMENT

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Abstract

In the actual context of the international economic and financial crises, the necessity for capital is deepening. Subsidies represents a form of financial assistance given by the government, representing a transfers of resources to an entity in return for past or future certain conditions. They exclude those forms of government assistance which can not be assigned reasonably to a specific value, and those transactions with government which can not be distinguished from normal business operations of the entity.

Subsidies represent amounts received for free (non-refundable and non-interest bearing) from the government, government agencies and similar institutions at national and international level. They are intended to cover capital expenditures, price differences for certain products and commodities, or other lawful purposes, provided that the terms for which they were granted. Regardless of their destination, subsidies should not be recognized in the accounts by the time it is clear that the legal entity shall comply with the conditions for granting them and they will be received. This article constitutes a theoretical and practical approach to different categories of subsidies, emphasizing their role as financial aid, a financing solution at national and international level. This article proposes a theoretical approach of the main categories of subsidies and their particularities and their reflection in accounting. To capture their specific features, I will analyze, distinct, the two categories of aid, the accounting policies for recognizing subsidies related to assets and subsidies related to incomes and their fiscal treatment thereof.

Cuvinte cheie: subsidies, financial support, fiscal treatment, subsidies related to assets, subsidies related to incomes

Clasificare JEL : M40, M41, M48

1. Introduction

The current period is characterized by an increase in the number of the entities, from different areas of activity, that request government subsidies, situation which leads to the necessity of establishing accounting policies regarding the subsidies adapted to the specificity of the activity.

Government subsidies can be: subsidies related to assets and subsidies related to incomes, or, in other words, subsidies for investments and subsidies for exploitation. The subsidies related to assets regard the acquisition, the construction or the procurement in another way of assets for a long term. The subsidies related to incomes comprise other subsidies, different from the ones for assets, which regard sustaining the exploitation activity.

National legislative amendments are the result of aligning the practices recommended by international bodies for the promotion of transparency and comparability of financial statements issued by Romanian economic entities. The means of accounting for and presenting subsidies may differ depending on each company accounting policy, which can involve applying either national accounting regulations, or International Standards of Financial Reporting (IFRSs). The proper use of accounting and fiscal treatments represents the premise for disclosing information that is verifiable, reliable and relevant for all users.

The accounting procedures for the development of grant funds are determined in accordance with the accounting treatment, wich can be apply to assets related grants and also to subsidies related to revenues. The basic rule used requires proper correlation with income from grants provided within the expenditure of the money.

2. Theoretical aspects regarding grants received or receivable from the government, government agencies and national and international similar institutions

Government grants are defined as the assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions, relating to the operating activities of the entity. They exclude those forms of government assistance which can not be reasonably to assign a certain value, and transactions with government which can not be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity, that is qualifying for them, should purchase, construct or otherwise acquire assets. Also, there may be circumstances that restricting the type or location of the assets or the periods during which they are to be acquired or held.

Reimbursable loans are loans which the lender undertakes to waive repayment of it under certain prescribed conditions.

Fair value is the amount for which an asset could be exchanged, or a liability settled between stakeholders informed, in a length objective transaction.

Government assistance takes many forms varying both in the nature of the assistance given and in the conditions which are usually attached to it. The purpose of the assistance may be to encourage an entity to embark on a course of action that normally would have taken if the assistance would not have been granted.

Receipt of government assistance by an entity may be significant for the preparation of financial statements for two reasons. Firstly, if resources have been transferred, we must find a suitable method of accounting for the transfer. Secondly, it is desirable to give an indication of the extent to which the entity has benefited from such assistance during the reporting period. This facilitates comparison of an entity's financial statements with those of prior periods and with other entities.

Subsidies are a non-refundable financial help granted to a person, an institution or business of the automotive industry etc. to mitigate the social effects of economic structural changes. In other words, non-refundable grants are transfers of resources from the state budget or from other national and international institutions to a certain area or certain enterprises.

From an accounting perspective, subsidies are a specific form of debt allocations (amounts received for free) from the government or from other similar national or international institutions.

According to section 392-395 of OMFP no. 1802/2014 the subsidies are as follows:

a) Subsidies related to assets:

- Amounts received free of charge provided that the beneficiary to purchase, construct or acquire assets;
- Transfer of non-cash assets, in which case the asset is carried at fair value;
- Donations for investments;
- Pluses on inventory like tangible and intangible assets.

Those are accounted as investment subsidies.

b) Subsidies related to incomes- subsidies for other, than assets:

- subsidies to cover price differences on certain goods and services (relating to turnover);
- subsidies for the jobs provided by employers that employ graduates of educational institutions or unemployed, according to art. 80-86 of Law no. 76/2002 on the unemployment insurance system and stimulation of employment, as amended and supplemented.

After their source of funding, the two categories of subsidies presented above are accounted distinctly, as:

- Government subsidies;
- Non-refundable loans, similar with subsidies;
- Other amounts received like subsidies.

These subsidies are detailed in IAS 20 as follows:

- “Government subsidies are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with government which cannot be distinguished from the normal trading transactions of the entity.

- Non-refundable loans, are loans which the lender undertakes to waive repayment of under certain prescribed conditions.”

IAS 20 also specifies that a “forgivable loan from government is treated as a government grant when there is reasonable assurance that the entity will meet the terms for forgiveness of the loan.”

- Other amounts received like subsidies represent the amounts given free of charge like performance bonuses for subsidized projects, tax refunds for assets built in disaster areas etc.

From 1 January 2016, with the approval of the new Tax Code, by Law no. 227/2015, as further amended and supplemented, new rules were introduced regarding the definition of microentities and their taxation, the tax rate of 3% being replaced with a system of differentiated rates depending on the number of employees. Regarding the subsidies as income, no change in terms of imposing them were made. Therefore, from 1 January 2014 to present no subsidy were not included in the calculation basis of microenterprises income tax.

From the point of view of corporate tax, we have a deductible- taxable treatment, according to whom the expenses incurred for carrying out activities that were financed through subsidies are deductible if they comply with the rule in art. 25 para. (1) of the new Fiscal Code, namely: „(...) are considered deductible expenses costs incurred for business purposes, including those covered by laws in force (...)”. Therefore, under this approach even the ineligible expenses may be deductible if there are affected in order to achieve performance indicators assumed through the financing contracts.

3. General approach on the government grants accounting treatment

We can distinguish two broad approaches to the accounting treatment of government grants: the capital approach, under which a grant is credited directly to shareholders' interests, and the income approach, under which a grant is taken to income over one or more several periods.

Those who support the capital approach argue as follows:

a) government grants are a financing device and should be treated as such in the balance sheet rather than be passed through the income statement to offset the items of expenses that they finance. Since there is no repayment required, they should be credited directly to shareholders' interests;

b) it is inappropriate to recognize government grants in the income statement, since they are not earned but represent an incentive provided by government without related costs.

Arguments in favor of the income approach are as follows:

a) since government grants are receipts from a source other than shareholders, they should not be credited directly to shareholders' interests but should be recognized as income in a appropriate period;

b) government grants are rarely gratuitous. The entity earns them through compliance with their conditions and meeting the envisaged obligations. Therefore, they should be recognized as income and matched with the associated costs which the grant is compensation;

c) as the income tax and other taxes are charges against income, it is logical to deal also with government grants in the income statement, which is an extension of fiscal policies.

In the the approach based on incomes, it is fundamental that government grants to be recognized as income on a systematic and rational basis over the periods necessary to match them with the related costs. Income recognition of government grants on a receipts basis is not in accordance with the approach required by the accrual accounting under IAS 1 "Presentation of Financial Statements", and would only be acceptable if no basis existed for allocating a grant to periods other than that in which it was received.

In most cases, the periods over which an entity recognizes the costs or expenses related to a government grant are readily ascertainable and thus grants for specific expenses are recognized as income in the same period as the relevant expense. Similarly, grants related to depreciable assets are usually recognized as income over the periods and in the proportions in which depreciation on those assets is charged.

Grants related to non-depreciable assets may also require the fulfillment of certain obligations and would then be recognized as income over the periods which bear the cost of meeting the obligations. For example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognize it as income over the life of the building.

Grants are sometimes received as part of a package of financial or fiscal aid and is accompanied by a number of conditions. In such cases, it is necessary to identify the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another a different basis.

A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognized as income in the period in which it becomes receivable.

In certain circumstances, a government grant may be granted rather the purpose of giving immediate financial support to an entity rather than as an incentive to undertake specific expenditures. Such grants may be confined to an individual entity and may not be available to a whole class of beneficiaries. These circumstances may warrant recognizing a grant as income in the period in which the entity qualifies to receive it, with disclosure to ensure that its effect is clearly understood.

A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognized as income of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood.

4. The accounting treatment of subsidies and their presentation in the financial statements

Companies applies from 1 January 2015 the accounting regulations consistent with European directives approved by Order no. 1.802 / 2014. Important to note is that with the entry of the OMFP no. 3.055 / 2009, the general chart of accounts has been modified, in sense of removal and introduction of accounts, including those regarding the accounting of subsidies (modification maintained also by OMFP no. 1802/2014). In other words, 1st degree synthetic accounts of Group 13 „Investment subsidies” 131 „Government subsidies for investments”, 132 „Non-refundable loans, similar with subsidies for investments”, 133 „Donations for investment”, 134” Inventory surpluses in the form of non-current assets” and 138 „Other amounts received in the form of investment subsidies” were replaced with 2nd degree synthetic accounts of the 47 settlements group, entitled now “Accruals, subsidies and similar accounts”: 4751 “Governmental investment subsidies”, 4752 “Non-repayable loans in the form of investment subsidies”, 4753 “Investment donations”, 4754 “Inventory surpluses in the form of non-current assets” and 4758 “Other amounts received in the form of investment subsidies”. Active operation accounts remain still the 445 ”Subsidies” account

analytics, namely 4451 „Government subsidies”, 4452 „ Non-repayable loans in the form of investment subsidies ,, and 4458 „Other amounts received as subsidies”.

According to OMFP no. 1802/2014, the subsidies related to assets are recognized in the balance sheet as deferred income (account 475 „Investment subsidies”). Deferred revenue is recorded as current income in the profit and loss account as recording depreciation expense or as scrapping or disposal of assets, (pt. 402 par. (2))

To ensure the compliance of expenditure financed through subsidies with the related income, the procedure may claim: the subsidy debt is recognized in correlation with the incomes from subsidies, if there were performed expenses incurred from these subsidies, or on account of deferred income, if these charges have not yet been made (pt. 397 para. (2))

Regarding the subsidies related to incomes, to ensure the correlation between the expenditures financed from subsidies with the relevant incomes, in the balance sheet, the debt from subsidies is recognized in correspondence with the income from the subsidies, and if they were made expenses incurred from these subsidies, or on account of deferred income if these charges have not yet been made.

5. Accounting registration of subsidies

A. Accounting registration of subsidies related to assets - practical example

The commercial company „X” S.A. ,, having the main activity the construction of homes for young families, receives in 2016 from Romanian Government 200.000 lei as a subsidie for modernizing the water supply of immovable property of ANL. The total cost for the upgrades amount to 400.000 lei. The remaining life of the facilities is 5 years and the amortization method is linear.

-Subsidie recognition as deferred income.

-receivable subsidie recognition by recognizing the debt on government and funding source as deferred income:

4451 = 4751 200.000
 „Government subsidies” „Governmental investment subsidies”

or

4451 = 472 200.000
 „Government subsidies” „Deferred income”

- receipt of the value of the debt:

5121 = 4451 200.000
 “Cash at bank in lei” „Government subsidies”

- transferring the funding source to incomes as the assets is realized at the end of each of the 5 years of use:

4751 = 7584 40.000
 „Governmental investment subsidies” “Amortisation of investment subsidies”

or

472 = 7584 40.000
 „Deferred income” “Amortisation of investment subsidies”

As mentioned above, the assets are done at a cost of 400,000 lei, of which only 200,000 lei were subsidized. Therefore, in the profit or loss account will be recognized a depreciation expense of 80,000 lei/year, 400,000 lei/5 years, and an income from subsidies of 40,000 lei/year, 200,000 lei/5 years. The effective value supported by the company to operate the asset is 40,000 lei/year, according to the following tables:

Table no. 1

The presentation on the balance sheet

Elements	Year	2016	2017	2018	2019	2020
Water supply instalations		400.000	400.000	400.000	400.000	400.000
Accumulated depreciation		80.000	160.000	240.000	320.000	400.00
Water supply instalations (balance sheet value)		320.000	240.000	160.000	80.000	
Recived subsidies		200.000				

Table no. 2

The presentation on the profit and loss account

Elements	Year	2016	2017	2018	2019	2020
Incomes from subsidies		40.000	40.000	40.000	40.000	40.000
Amortization expenses		80.000	80.000	80.000	80.000	80.000
Result		40.000	40.000	40.000	40.000	40.000

B. Accounting registration of subsidies related to incomes - practical example

The commercial company „Y” S.A. employ for a period of 12 months, a worker at a production department with a salary of 1,500 lei, the value of the subsidies received from the CAE (County authority for employment) is 757.5 lei, composed of:

- 7.5 lei (1500 * 0.5%) - the staff contributions to the Unemployment Fund
- 750 lei – the subsidy received from the CAE.

The accounting records of the subsidies as income are the following:

4458	=	7414	757.5
“Other amounts received as subsidies”		“Subsidies for wages and salarie”	
4371	=	4458	18.5
“Company’s contribution to unemployment fund”		“Other amounts received as subsidies”	
5121	=	4458	739
“Cash at bank in lei”		“Other amounts received as subsidies”	

6. Conclusions

The subsidies received are recognized on a systematic basis as income in the appropriate periods related to the costs which these subsidies are to compensate. They should not be recorded directly to equity and reserves. Regardless of the classification and their destination, subsidies should not be recognized in the accounts until there is certainty that the concerned legal person will comply with the conditions for granting them and they will be received. In this context, subsidies are granted only on the basis of documents, grant contracts, agreements, decisions, donation contracts etc. and relate thentity investment activity e. They will never be reflected as incomes when they are ascertained. Subsidies for assets, including non-monetary grants at fair value is accounted as investment subsidies and are recognized in the balance sheet as deferred income. Deferred revenue is recorded in the profit and loss as depreciation expenses of registration or scrapping or disposal of assets.

The modality to be recognize on accounting and the presentation in the balance sheet of the different categories of subsidies differs, depending on each national and international accounting rules that the company's applies. Subsidies for assets, including non-monetary grants at fair value is accounted as investment subsidies and are recognized in the balance sheet as deferred income. Deferred revenue is recorded in the profit and loss as depreciation expenses of registration or scrapping or disposal of assets.

Under IAS 20 and OMFP no. 1802/2014, the subsidies must be properly reflected in the financial statements because is the main source of accounting information for a wide range of users (investors, entrepreneurs, banks, financial administration).

Receiving the government grants by an undertaking company is has a significant importance to its financial statements, because:

- First, it must be found an appropriate method of accounting for recording the transfer of resources;
- Secondly, because of the external users that require information regarding the size of the government grants that benefited the company during the year.

The accounting for government grants can be carried out according to two different approaches: the balance sheet approach, after which the grant is written directly to reserves, and the approach based on results, that subsidy is entered in the income statement in an exercise or more exercise.

The balance sheet approach is based on the following arguments:

- Public subsidies are a means of financing; as such, they must be recorded in the balance sheet stocks, because they are not normally redeemable;
- It is unfair that subsidies to be recognized in the profit and loss statement because they do not represent a gain of the company, but an encouragement given by the public power, without financial obligations in return.

In opposition to the balance sheet approach, arguments advocate for income-based approach covers:

- Grants may not be entered in equity because they do not come from associates;

- Public subsidies are rarely free, because the company benefiting from it complies with certain conditions and comply with the requirements; for this reasons, they must be accounted to incomes and to be connected with the costs that the governmental grant is considered to compensates;

- How tax and fees are included in the income statement, it is logical that government subsidies to be the subject to the same annually account, because they are merely an extension of fiscal policy.

IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance" pleads for the second approach, requiring, so, government grants accounting in the profit and loss statement.

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