

# TAX AND ACCOUNTING TREATMENT CONCERNING THE VAT RELATED TO COMPENSATIONS RECEIVED FOR DETERIORATED OR PARTIALLY DAMAGED GOODS

**Ecobici Nicolae**

*Constantin Brâncuși University from Targu Jiu, Faculty of Economic Sciences, Targu Jiu, no. 24, Victoriei Street, Gorj, Romania, nicu.ecobici@utgjiu.ro , Phone number 0726212780*

**Bușan Gabriela**

*Constantin Brâncuși University from Targu Jiu, Faculty of Economic Sciences, Targu Jiu, no. 24, Victoriei Street, Gorj, Romania, gabi.nebunu@utgjiu.ro , Phone number 0729944533*

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*Keywords: compensation, value-added tax, accounting treatment, tax treatment*

## Introduction

The companies (registered as VAT payers) that receive compensations from insurance companies are faced with the dilemma whether to collect or not the value-added tax related to these amounts. In other words, we can put the problem this way: “to collect or not to collect?”. In the following pages we'll try to solve this problem, both from a tax and accounting point of view.

## Short history

For a start a short history is necessary. Until June 1, 2002 the problem was regulated by the Government Emergency Ordinance no. 17/2000 and its application norms which stipulate that the compensations also contain the value-added tax. Implicitly, the taxpayers registered as VAT payers had to collect the VAT for the amounts representing compensations received from insurance companies.

Therefore, in taxpayers' accounting records, the collection of insurance compensations in the amount of lei 1.190 was registered as follows:

	*		
<b>5121 "Cash at bank in lei"</b>	=	<b>%</b>	<b>1.190,00</b>
		<b>7581 "Claims and compensations, fines and penalties"</b>	<b>1.000,00</b>
		<b>4427 "Output VAT"</b>	<b>190,00</b>
		*	

Considering that the company did not record in the administrative period other taxable operations as concerns the VAT, based on the VAT return (with a pro rata of 100%), the VAT adjustment is reflected as follows:

	*		
<b>4427 "Output VAT"</b>	=	<b>4423 "Payable VAT"</b>	<b>190,00</b>
		*	

and the VAT payment to the state budget, according to the payment order:

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	*		
<b>4423 "Payable VAT"</b>	<b>=</b>	<b>5121 "Cash at bank in lei"</b>	<b>190,00</b>

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### Tax and accounting treatment after 1 June, 2002

After 1 June, 2002, with the repeal of the Government Emergency Ordinance no. 17/2000, the regulations on the VAT related to compensations received from insurance companies are made in compliance with the Law no. 345/2002 on VAT and then with the Law no. 571/2003 on the Fiscal Code as the tax treatment was radically changed.

Therefore, as from 1 June 2002, taxpayers who receive insurance compensations are the recipients of VAT exempt operations (whereas insurance companies make, in accordance with the law, VAT exempt operations) and therefore they do not have to collect the VAT related to the compensations received.

The reasoning seems simple and can be compared to the one applicable to the interests received by companies for the cash accounts.

However, in practice, the accounting and tax professionals translate differently the issue of the VAT related to the compensations received, proceeding erroneously to VAT collection.

### Accounting treatment exemplification

Next we shall present the correct solution for a situation frequently encountered in practice<sup>342</sup>, that is compensations received for goods deteriorated or degraded from various reasons, including reasons of force majeure or natural disasters and which require repair work before being used.

For instance, SC X SRL receives a compensation of 1.190 lei from an insurance company for repairing a damaged transport means (which makes the object of an insurance agreement previously concluded).

The situation can be solved by also taking into account the aspects related to the manner in which the repair work is performed, which is in the repair shop of the owner, of the user or of the leasing company, or in the repair shop of an automotive service facility (other than owner, user or the leasing company).

Therefore, if the repairs are performed by the owner (user or leasing company) in their own repair shop (by themselves), the latter will deduct the VAT related to the purchase of goods and services necessary to make the repairs, receiving from the company insurance the compensation, exclusive the VAT already deducted upon the input operations. In the same time, the companies that make repairs in their own repair shops do not have the legal possibility to invoice these repairs to the insurance companies since services to the insurance company are not performed like this (the settlement is made based on the repair list which will not include the deductible VAT related to the purchase).

From the accounting point of view, here are the things:

- ✓ The purchase of spare parts necessary to make the required repairs is reflected in the owner's (user's or company leasing) accounting, according to the fiscal invoice and to the acceptance and difference inspection report, in the amount of 1.190 lei, including VAT:

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	*		
<b>3024 "Spare parts"</b>	<b>%</b>	<b>=</b>	<b>401 "Suppliers"</b>
<b>4426 "Input VAT"</b>			<b>1.190,00</b>
			<b>1.000,00</b>
			<b>190,00</b>

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- ✓ The payment of the spare parts supplier is reflected, according to the statement of account and payment order:

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<sup>342</sup> The examples are purely theoretical, meant to point out the accounting and tax treatment, making some abstractions, such as bank charges etc.

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	*		
<b>401 "Suppliers"</b>	=	<b>5121 "Cash at bank in lei"</b>	<b>1.190,00</b>

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- ✓ The spare parts previously purchased are given to consumption, according to the consumption note:

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	*		
<b>6024 "Spare parts"</b>	=	<b>3024 "Spare parts"</b>	<b>1.000,00</b>

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- ✓ There is registered the payment of the compensation through transfer made by the insurance company, based on the list previously made for the repairs performed in one's repair shop, list that does not include the VAT previously deducted, according to the statement of account and payment order:

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	*		
<b>5121 "Cash at bank in lei"</b>	=	<b>7581 "Claims and compensations, fines and penalties"</b>	<b>1.000,00</b>

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- ✓ The VAT adjustment is reflected, according to the VAT return (supposing there are no other taxable operations related to VAT in that period):

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	*		
<b>4424 "VAT receivable"</b>	=	<b>4426 "Input VAT"</b>	<b>190,00</b>

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- ✓ The VAT receivable is received (making abstraction from the dispositions on the level of the VAT receivable amount):

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	*		
<b>5121 "Cash at bank in lei"</b>	=	<b>4424 "VAT receivable"</b>	<b>190,00</b>

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We can notice that after closing the income and expenses accounts related to the repairs and compensation (6024 and 7581, equal amounts) the accounting profit and taxable profit are not influenced, and as concerns the cash flow statements, as the amount received as compensations (1.000 lei) and the VAT receivable (190 lei) is equal to the amount due to the spare part supplier (1.190 lei), the operation is neuter (the account 5121 is balanced, balance 0).

The same reasoning is used if repairs are made in the repair shop of a specialized service facility (other than the owner, user or leasing company) and the latter invoices the repairs to the owner or to the user.

- ✓ The repairs invoiced by the service facility is registered, in amount of 1.190 lei, including VAT:

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	*		
%	=	<b>401 "Suppliers"</b>	<b><u>1.190,00</u></b>
<b>611 "Maintenance and repair expenses"</b>			<b>1.000,00</b>
<b>4426 "Input VAT"</b>			<b>190,00</b>

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- ✓ The service facility payment is reflected, according to the statement of account and payment order:

**401 "Suppliers" = 5121 "Cash at bank in lei" 1.190,00**

\*

- ✓ There is registered the payment of the compensation through transfer made by the insurance company, based on the invoice received from the service facility, according to the statement of account and payment order, if the insurance company accepts a copy of the service invoice; the compensation does not include the VAT which is deducted by the owner or user:

\*

**5121 "Cash at bank in lei" = 7581 "Claims and compensations, fines and penalties" 1.000,00**

\*

The other operations related to VAT adjustment, payment of the VAT receivable from the budget, closing of the income and expenses accounts are identical to those presented for the case when repairs are made in the owner's repair shop (user's or company leasing), with the same effects.

You should notice, if the insurance company requires the service invoice in original, considering that the owner or the user will not be able to deduct the value-added tax related to repairs because it cannot be accounted for with the original invoice, the compensation will also include the VAT:

\*

**5121 "Cash at bank in lei" = 7581 "Claims and compensations, fines and penalties" 1.190,00**

\*

and in the same time, the input VAT becomes non-deductible (it cannot be accounted for with the original invoice):

\*

**635 "Other taxes, duties and similar expenses" = 4426 "Input VAT" 190,00**

\*

Therefore, the account 4426 "input VAT" is balanced and the VAT adjustment operation remains without object. Therewith, the effects are the same (the account 5121 is balanced, as liquidities are not influenced, the accounting and taxable profits are 0 and the expense accounts 611 and 635 compensate in amount the income account 7581).

If the insurance company pays the repair work directly to the third specialized service facility, without settlement and through the company which holds or uses the damaged/deteriorated good, then the latter shall not register any operation in its accounting, related to the damage and repairs performed.

## Conclusions

In conclusion, currently in Romania, regardless whether the compensations received from the insurance company include the VAT (1.190 lei or 1.000 lei for the example presented), the recipient of the compensation (owner, user or leasing company) does not have to collect the VAT related to insurance (the account 4427 "Output VAT" will not be used).

## **Bibliography**

1. Government Emergency Ordinance no. 17/14.03.2000 on the value-added tax (and its application norms) published in the OJ no. 113/15.03.2000
2. Law no. 345/01.06.2002 on the value-added tax, published in the OJ no. 371/01.06.2002
3. Law no. 571/22.12.2003 on the Fiscal Code, published in the OJ no. 927/23.12.2003, republished, as further amended and supplemented.