

VEHICLES - ADJUSTED VAT AND THEIR ACCOUNTING VALUE

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The most recent Romanian legislation set new rules for deducting VAT in case of vehicles. Also since 2007 there were some situation for fixed assets in which VAT was not to be deducted and, if it was deducted, was to be adjusted, starting with May 2009 VAT for cars used by administrative employees is not to be deducted anymore. How does that influences their accounting values? We will illustrate the answer in the following article.

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1. Introduction

Due to the financial crisis, Romanian budget was severely affected by the lack of revenues. In order to collect more money, the Romanian government increased most of the taxes, introduced a minimum tax on profit or income and restrained the right to deduct VAT for most of the taxpayers.

In some situation, stated by the Romanian Fiscal Code, taxpayers must adjust in their favor or not the VAT deducted (or not) related to the capital goods. All these situations are described and illustrated by the fiscal code and its methodological norms. The most important definitions and legal aspects are presented below.

2. Definitions and legal fiscal aspects⁵¹⁷

Capital goods are all the fixed tangible assets, as well as the operations of construction, transformation or modernization of the fixed tangible assets, except the repairs or maintenance works on such assets, even if such operations are performed by the beneficiary of a rental, leasing or any other contract by which the fixed tangible assets are made available to another person.

Fixed tangible assets are any tangible asset that is held for use in the production or delivery of goods or in the provision of services, for rental to others, or for administrative purposes, if the asset has a normal period of use of more than one year and has a value of more than the limit provided by the law (for the moment the limit is 1,800 RON).

The deductible tax related to the capital assets is the tax paid or due related to any operation in connection with purchase, production, construction, transformation or modernization of these goods, except the tax paid or due related to the repair or the maintenance of such goods or the tax related to the acquisition or the spare parts for the repair or the maintenance of the capital goods.

The deductible tax related to capital goods, shall be adjusted:

A) for a period of 20 years, for the construction or purchase of an immovable good, such as for the transformation and the modernization of a immovable good, if the value of the modernization of at least 20% of total value of immovable transformed and modernized good.

B) for a period of 5 years, for the capital goods purchased or produced, other than immovable goods;

The adjustment of the deductible tax is performed:

a) if the capital good is used by the taxable person:

1. integrally or partially, for other purposes than economic activities;

517 Law 571/2003 Romanian Fiscal Code;

2. for the performance of operations that do not allow the right of deduction of the tax;
3. or the performance of operations that do not allow the right of deduction of the tax in a different proportion compared to the initial deduction;

b) if certain modifications of the elements used for the computation of the deducted tax occur;

c) if a capital goods with a imitated, partially or wholly, right of deduction is the subject of any operation for which the tax is deductible. In the case of a delivery of goods, the additional value of the tax that is to be deducted is limited to the value of the collected tax related to the acquisition of the respective good;

d) if the capital good ceases to exist, except the cases in which it is proved that the respective capital good was the subject of a self purchase or delivery for which the tax is deductible;

Besides, starting with May 2009⁵¹⁸, VAT related to the acquisition (i.e. either local purchase, intra-community acquisition or import) of motorized road vehicles, as well as the one related to the

acquisition of fuel destined for the vehicles having the characteristics mentioned below, owned or used by taxpayers, is non-deductible. The rule applies only to motorized road vehicle that are exclusively used for passenger road transportation, weighing no more than 3,5 tones and with a maximum of 9 seats (including the driver's seat). However, vehicles used for commercial/resale purposes, used for paid passenger transport including taxi, the ones used for supply of services against consideration (e.g. rental to third parties, subject to financial or operational lease agreements, etc.), as well as those exclusively used for special destinations (e.g. for interventions, security and protection, courier services, transport of employees to and from the place of performing their activities, vehicles used by sales-agents, for delivery services , for recruitment of personnel services, as TV reporting vans, etc.) do not fall under the above VAT non-deductibility provisions⁵¹⁹.

3. Adjusted VAT, part of the carrying value of the asset ?

In some case it might be part, in other not. Let us take a look in Romanian accounting regulation, naming Order 1752/2005. According to paragraph 54, the initial acquisition cost comprises its purchase price, including import duties and other non-refundable purchase taxes, delivery and handling costs and any costs directly attributable to the acquisition of the asset. Trade discounts and rebates are not to be part of the initial cost⁵²⁰.

More detailed rule are stated in the paragraph 91 to 94, related to the acquisition cost of fixed assets. According to above mentioned paragraphs, when first recognizes, fixed tangible assets should be measured at their initial cost, whose form depend on the way the assets was obtained. As for examples of cost allowed to be capitalized in the carrying amount, as they are directly attributable to the acquisition of the asset, we can name:

- a) salaries expenses, social securities expenses and other related costs;
- b) cost with raw material;
- c) costs of site preparation;
- d) initial delivery and handling costs;
- e) installation and assembly costs;
- f) expenses for authorizing the construction;
- g) professional fees;

The initial carrying value may include the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity

518 OUG 34/2009;

519 HG 44/2004 Methodological norms for the Fiscal code;

520 Order 1752/2005;

incurs either when the item is acquired or as a consequence of having used the item during a particular period and the evaluation is plausible.

IAS 16 *Property, plant and equipment* gives more details about the costs that can be part of the initial carrying value and about those that should be recognized as expenses when incurred. According to paragraphs 16 to 20, the cost of an item of property, plant and equipment comprises⁵²¹:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

As for examples of directly attributable costs:

(a) costs of employee benefits arising directly from the construction or acquisition of the item of property, plant and equipment;

(b) costs of site preparation;

(c) initial delivery and handling costs;

(d) installation and assembly costs;

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and

(f) professional fees.

Probably the most important difference between the Romanian rules and IAS 16 is that IAS 16 establishes the moment in which the capitalization in the carrying amount must stop. According to paragraph 20: "Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item."

Now, let us return to our question: when is VAT non deducted part of the carrying value of the car ? The answer is very simple: **only when VAT is adjusted in the beginning, and not after the first recognition of the asset, it may become part of the carrying value of the asset.**

Below there are some examples to illustrate that answer.

Example 1

A company bought a car for its CEO (Chief Executive Officer). As the car is to be used by the manager for its own transportation, it falls under the provision for non-deductibility of VAT, set by the Fiscal Code. From the beginning the company knows the usage of the car. No VAT might be deducted in this case. Since VAT is not to be recovered, it becomes part of the acquisition cost.

Example 2

A company (that manages a hotel and a casino) buys a car which is going to be used for both the hotel and the casino (according to the Romanian fiscal code, for activity as casino the company is exempted from VAT with no rights for deduction of VAT incurred). The last year VAT prorate was 80%. According to the fiscal code, the company must deduct VAT according to the VAT prorate as it is a mixed taxable person. VAT deductible for mixed acquisition (used for both

521 IAS 16 Property, plant and equipment, IASB, www.iasb.org;

taxable and non taxable operations) during the year is computed by using the VAT prorate determined for the previous year and at the end of the year the effective VAT prorate for the current year is to be computed and VAT deducted is to be adjusted.

When the car is bought, the company will consider VAT that could not be deducted as part of the initial carrying value (20% from the invoiced VAT).

Assuming that at the end of the year the effective VAT prorate is 50%, in our opinion the 30% difference from the VAT deducted and the VAT finally deductible is to be also part of the initial carrying amount. Even if Order 1752/2005 gives us no clues about how those difference must be considered and classified, in our opinion even if the car was bought months ago and started to be used, the new portion of the VAT non deductible doesn't show us a subsequent event, but more a estimation of a value made by the company. By the end of the year, as the real value could have been determined, the carrying value of the assets should be corrected.

Example 3

A company buys a car which it is intended to be used for transportation of employee between their houses and office, according to the Fiscal code. In the beginning the company deduct VAT in 100%. After 2 years, the car is given to the manager to be used in personal advantage. According to the Romanian fiscal code, VAT must be adjusted in this situation. But the VAT nondeductible is to be capitalize in the carrying value of the asset or not ?

In our opinion the answer is no. This is because this is a subsequent event, unrelated in any way to the initial recognition. So the adjustment should be recognized in the profit and loss account as an expense.

Example 4

A company (mixed taxable person) that uses a car for both activities (taxable and exempted). According to the fiscal code the VAT prorate should be determined yearly and the differences should be recognized. In our opinion, just like in the above example, because this is a subsequent event, unrelated in any way to the initial recognition, the adjustment should be recognized in the profit and loss account as an expense.

Example 5

A company acquires a car from a financial leasing company. In our opinion, as long as the financial leasing is defined as a service and not an acquisition according to the Romanian Fiscal Code, it is not under the provision of no deductibility of VAT for acquisition of cars. So the company may deduct VAT.

Yet, for the final payment (option price), as the title of ownership is transferred, the VAT is not to be deducted. Never the less, since the asset was initially recognized when the contract was signed and the asset was received, this final adjustment is also a subsequent event, unrelated in any way to the initial recognition, the adjustment should be recognized in the profit and loss account as an expense, and should not be part of the carrying amount.

5. Conclusion

Carrying amount of an assets measured at its first recognition should comprise the purchase price and all non-refundable purchase taxes, plus any costs directly attributable to bringing the asset to the location and condition. When VAT is adjusted when the asset is first recognized, then it becomes part of the initial carrying value. When VAT is adjusted after the first recognition of the asset, then it is an expense and the company should record it in the profit and loss account.

Bibliography

1. IAS 16 Property, plant and equipment, IASB, www.iasb.org;
2. Order 1752 / 2005;
3. Law 571/2003 Fiscal Code
4. Decision 44/2004 – Methodological norms for Romanian Fiscal Code