

## **SUBSIDIES - CONCEPT, RECOGNITION AND TAX IMPLICATIONS**

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**ABSTRACT:** *Even if, theoretically speaking the specialty literature accepted and validated the concept of perfect competition, this remains, only a hypothetical issue that cannot be met in its pure form - in the real economy. The impossibility of the market to regulate itself as well as the anti-competition practices or unfair competition make absolute necessary the intervention of the state at the economic level in order to re-establish the market equilibrium and to relaunch the economic growth. But this intervention - both at world level as well as at EU level - or more specific at the Romanian level - takes place in a controlled way based upon some specific regulations. Such regulations aim at the domains of state intervention, type and quantum of aid, concession conditions, as well as at the reflection in the beneficiaries' financial situations of the aid received and their influence upon the economic - financial results. We try hereafter a brief presentation of the concept, recognition and fiscal implications of the most used form of state aid in the economy: subsidies.*

**KEY WORDS:** *state aid, government assistance, subsidy, tax advantage, public expenditure, state guarantee*

### **1. THE STRUCTURE OF PUBLIC EXPENDITURE FOR TARGETS AND ECONOMIC ACTIONS**

Public expenditure express economic relations - social in the form of money, which manifests itself between State, on one hand and individuals and companies, on the other hand, during distribution and use of State financial resources in order to accomplish its functions [2].

This expenditure is materialized in payments made by the State for purchase of goods or provision of services to achieve Government objectives:

- education;
- health;
- maintenance of the army;

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- general public services;
- social-cultural actions, etc.

Expenditure regarding economic activity represents a special role within public expenditure. It is intended for financial support of independent public companies or companies with State capital, private or mixed, or points to achievement of certain actions or important goals for the country.

Mainly, the costs for economic actions are directed towards public sector enterprises, corporate sector comprising State-owned capital or majority State capital companies having as object of activity - the production of goods or services of national interest (local) and where State has the power to decide.

Financing mechanism of public sector enterprises is similar to that of private enterprises. But the fact that they are still owned by the State give them a certain specificity in the sense that besides the development of activity in profitable conditions, they follow and meet certain public utilities for which prices or rates are not a result of interaction between the demand and supply, but are controlled or determined by the State.

This leads to a conflict between the need of liberty for decision, autonomy and enterprise marketing dynamism, on one hand and responsibility of the public authority in the general evolution of prices, relative to purchasing power of the members of society, which leads to ensure satisfaction of the public interest, on the other hand. So, raises the need for compensation by the State, through financial aids of the insufficient income of these enterprises, generated by not covering through prices or tariffs, of the specific costs of production.

Another characteristic of public sector enterprises is related to the financing of investments and the creation of own funds. In principle, the resources for their financing should be provided through self-financing.

But, in case the prices set at another level of decision than the enterprise do not provide at least the covering of the costs, in most cases the State is to support the enterprises of public interest in this regard.

The financial flow between public enterprises and State is achieved actually in both directions. The State allocates to the enterprises the funds to finance current expenditure or capital. In turn, the enterprises discharge at State budget a number of taxes, levies, duties, fees related to concession contracts, payments from profit, etc.

State supports from financial point of view, outside the public sector also the privately owned enterprises, to which it gives aids for development, for environmental protection or for supporting the economical sectors in which they are part and in which State is interested.

The forms of State aids for economic activities can be classified into:

- *direct forms* of intervention by making payments;
- *indirect forms* which, without involving an effective transfer of funds from the State have the effect of financially supporting of the beneficiaries.

The main forms of *direct financial aids* are:

- subsidies;
- investments;
- subsidized loans;
- aids for the broadcasting of information, marketing studies, organizing of exhibitions;
- repayable advances.

*Indirect financial aids* are mainly in the following presentations:

- tax benefits;
- loans guaranteed by the State.

In the following chapters, we will discuss the concepts, recognition and fiscal implications of the main forms of financial support from the State given for economic objectives: subsidies on products and investment allowances.

## **2. CONCEPT, RECOGNITION AND FISCAL IMPLICATIONS OF THE SUBSIDIES**

The most used and most important direct State aid is represented by subsidies.

The subsidy is, in essence, a non-reimbursable grant that the State provides to economic agents, to support their operation in conditions where their work is ineffective, but is of public interest. This type of aid is granted without contra-work, but conditioned (for example the obligation to produce and deliver energy coal at a price set by State).

Subsidies can be granted for activities both internally and for export.

*Intern subsidies* (of functioning or operating) are named so because they do not intend to cover losses of the companies caused by differences between selling prices (imposed by the State) and production costs.

Regarding the operating subsidies, even they are given in many countries and are amounted to a significant amount, there are points of view according to which these are ineffective, that do not provide real protection to the economic beneficiary.

It is estimated that for the products made, companies should be left to set real prices, according to the costs of production and market demand, and subsidy to be given to the beneficiaries of these products that can not handle the actual level of prices.

*Subsidies for export* are a form of State aid, used mainly in countries wishing to enter certain markets or remain on readily accessible markets.

The concrete and most often the export subsidies represent amounts paid by the State to the producers, determined as the difference between the highest price in the internal market of the product to be exported and the lowest price of the product on foreign markets.

However, may appear other forms to grant subsidies for export, such as: refunding a portion of taxes paid by exporters, granting of transport facilities for the exported goods, etc.

*Subsidies for investments* represent those financial aids that State grants for the development of public and private sectors, having as main objective the satisfaction of general interest and not achieving of profit.

The purpose of these aids is to promote (stimulate) enterprises for procurement or production of equipment or other goods of restraint nature, including the financing of long-term assets or to cover other expenses of investment nature [1].

Receiving subsidies represents for the enterprise a real advantage in goods and values that, as a rule, should not be reimbursed.

According to I.A.S. 20, Government assistance represents "the actions performed by the Government, in order to provide economic benefits, particular to an entity or categories of entities that meet certain criteria" [3].

Also under this standard, the Government subsidies are recognized as income in the periods corresponding to expenditure, which they are going to compensate. Two approaches of the accounting treatment are considered as applicable to subsidies:

- *in terms of capital* – according to it, a subsidy is an incentive given by Government that does not involve repayment or costs, being credited directly in the interest of shareholders and shown as such in the balance sheet and not in the profit and loss account;
- *in terms of financial outcome* - according to it a subsidy is to be included in the income, as represents an input from a source other than shareholders and properly reflected in the profit and loss account.

Most often, a Government subsidy is recognized as income in the same period with the relevant expenditure, as it is relatively easily identifiable. In case of subsidies related to depreciable assets, these are usually recognized as income over the periods in which depreciation of those assets is to be expensed.

Subsidies for activities, including non-monetary subsidies at fair value are recognized in the balance sheet as deferred income over the useful life of the asset. Another variant, considered acceptable, of preparation of the financial statements deducts the subsidiary to obtain the net accounting value of the asset, being recognized as income over the life cycle of the asset, by reducing depreciation expenses.

Regardless of the variant adopted, subsidies represent for their beneficiaries controlled sources, generating future economic benefits.

From the fiscal point of view, the incomes from subsidies are a source of income tax, the revenue account from subsidies being closed by taking the balances into the profit and loss account.

Similarly, the incomes from subsidies for investments are taxable, and depreciation costs of assets made from these sources are deductible.

But taking into account that the amortization effect is felt throughout the life of the assets and that such costs do not correspond to a real effort of enterprise – this should not influence the result of exercise where they are found.

To compensate this effect, in the account of income from investment subsidies is registered share of the received subsidy - in proportion to the depreciation noted into expensed (or full - in case of cassation or transfer of the assets before the expiration of the period of use).

There are exempted, according to the latest regulations (O.U.G. no. 34/2009 - M. Of. Nr. 249/2009 - Art. 18) the taxpayers whose income tax is less than minimum tax amount of total revenue for the corresponding tranche provided in the Law. In this situation, to situate the total revenues into corresponding tranche, are taken into account the revenues obtained from any source recorded on December 31 of last year, minus - among others - and the income from operations that represents the share of Government subsidies.

There are also exempted the micro-enterprises that choose to pay income tax on micro-enterprises income instead of taxes on profit. In this case the taxable sum from the taxes on micro-enterprises income is represented by the income from any source, less the share of Governmental subsidies (Law no. 571/2003 - M. Of. Nr. 927/2003 - updated, Art. 108 paragraph (1)).

In terms of value added tax, the tax base is constituted for goods and services supply - from all that represents the obtained counterpart - or to be obtained - by the supplier from the buyer - including subsidies directly linked to price of these operations (Law 6. 571/2003, updated M. Of. Nr. 927/2003, art. 137 paragraph (1)).

For subsidies to be considered directly related to price it is necessary to be fulfilled these conditions (H.G. no. 44/2002, updated - M. Of. Nr. 112/2009, Title VI, section 18):

- the value of the subsidies to depend on the quantity of the delivered goods/rendered services;
- the amount of the subsidies to be determined before this activity.

The subsidies that do not meet these two conditions - such as subsidies for covering local public transport expenses or grants for making own investments - do not enter into the tax base.

Regarding the deduction of the value added tax, this is not conditioned by the source of financing for acquisition of goods.

Repayment of subsidies connected to assets is register through reducing the balance of the delayed income with the reimbursable amount.

Repayment of a subsidy associated to incomes is made by reducing the associated delayed incomes, if any, or - in their absence - on the account of expenses.

To the extent that the reimbursed amount exceeds the delayed incomes, or if no such incomes surplus exist, respectively, the full returned value is immediately recognize as an expense [8].

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