# THE MAIN PECULIARITIES OF TAX AND FINANCIAL ACCOUNTING OF FIXED ASSETS

**Zhuzhuna Tsiklauri-Shengelia**
**GTU, Assoc. professor, PHD**
**Natia Shengelia**
**GTU, Senior Teacher, PHD**

Financial Accounting generally plays a significant role in companies . Fixed Assets are an important part and they can be regarded as one basis for development of an organization. IAS **20** Government Grants , IAS **40** Investment Property and IAS **23** -Borrowing Costs , IFRS **5** Non-current Assets held for Sale and Discontinued Operations should also be discussed in connection of non-current Assets, but the key principles of their financial accounting are discussed in International Accounting Standard (IAS) 16. This covers all issues referring property , plant and equipment, but does not apply to :

a) Biological Assets of agricultural activity

b) Mineral rights and mineral reserves, such as oil, gas and etc.

At first , the following 4 issues are important to discuss and should be explained shortly:

1) Initial Recognition

2) Depreciation

3) Revaluation

4) Derecognition (disposals)

**Property , plant and Equipment** are tangible assets that:

- are held for use in the production process or supply of goods or services, for rental, or for administrative purposes; and

- are expected to be used during more than one period.

**Initial Recognition** means that non-current assets should be initially measured at cost , that capitalizes all costs to bring an asset to its present location and condition for intended use. This Cost include:

⌘ Purchase price(less any trade discounts),

⌘ directly attributable cost of :

- site preparation
- initial delivery and handling costs
- professional costs (Installation and Testing … for architects, engineers)

⌘ initial estimate of dismantling and removing asset and restoring ,

⌘ borrowing costs in accordance with IAS 23.

A simple accounting double entry of acquiring a tangible assets will be:

Debit 2100 Non-current asset value

Credit 1210/1110/3100 Cash , Cash at Bank or Accounts Payable

In the Chart of Accounts applied in Georgia Tangible assets are united in the following group with code: 2100 and their deprecation 2200 ; For example :

2100 - Land,

2130 Buildings

2160- Office Equipment

2170 Furniture and Fixtures ……

2230-Accumulated Depreciation of Buildings

2260 Accumulated Depreciation of Office Equipment

2270 Accumulated Depreciation of Furniture and Fixtures and so on;

However in America's Chart of Accounts you could meet tangible assets with code 1500 , deprecation -1591 etc :

| SAMPLE CHART OF ACCOUNTS FOR A SERVICE ORIENTED BUSINESS | |
|---|---|
| NAME | ACCNUM |
| Cash Accounts | 1000 |
| Cash Accounts:Bank of America - 49NNNNNNN | 1001 |
| Cash Accounts:Bank of America - 49NNNNNNN | 1002 |
| Cash Accounts:Petty Cash | 1099 |
| Accounts Receivable | 1200 |
| Other Current Assets | 1300 |
| Undeposited Funds | 1400 |
| Fixed Assets | 1500 |
| Fixed Assets:Computer & Electronic | 1510 |
| Fixed Assets:Computer & Electronic:Hardware | 1520 |
| Fixed Assets:Computer & Electronic:Software | 1530 |
| Fixed Assets:Furniture & Fixtures | 1540 |
| Fixed Assets:Machinery & Equipment | 1550 |
| Fixed Assets:Computer & Electronic:Accum Deprec | 1591 |
| Fixed Assets:Accumulated Amortization | 1593 |
| Fixed Assets:Accumulated Depreciation | 1595 |

**or for a UK -based business :**

Extract of Chart of Accounts-Tangible Assets :

0030 Office equipment
0031 Office equipment depreciation
0032 Computers
0033 Computers depreciation
0040 Furniture
0041 Furniture depreciation

**Depreciation** applying the accruals concept is systematic allocation of the depreciable amount of an assets over its economics useful life. There exist 4 methods; Let discuss one simple example : Value of a car is 20 000 Gel, residual (scrap ) value- 2 000 Gel, rate - 20 % Useful economic life-4 years:

1) Straight -line method - Annual depreciable amount will be :

% on cost ( 10 000 GEL *20% ) or

Cost-residual value = ( 20 000- 2 000) = **4500** Gel
Useful Economic life 4 y.

2 ) The Reducing Balance method : % on carrying value

| Year | Cost (GEL) | annual depreciation | Carrying Value |
|---|---|---|---|
| 1 | 20 0000 | 20 000* 20 %=**4 000** Gel | 20 000- 4 000 =16 000 Gel |
| 2 | 16 000 | 16 000* 20 %= **3 200** Gel | 16 000- 3 200= 12 800 Gel |

.....

3) The machine hour method: above mentioned same data and working hours 1year - 500 hrs, 2y- 800 hrs, 3y- 1000 hrs, 4y- 1700y.

Cost-residual value = (10 000- 2 000) = **2** Gel per hour
Total working hours 4000 hrs

| Year | w.hrs | depreciation |
|---|---|---|
| 1 | 500 | 500*2= **1 000** Gel |
| 2 | 800 | 800*2= **1600** Gel |

4) The sum -of-the digits method:

n = 1+2+3+4= 10 y.

| Year | cost | annual depreciation |
|---|---|---|
| 1 | (20 000 - 2 000) | 18 000 *4/10 = **7200** Gel |
| 2 | 18 000 | 18 000* 3/10= 5400 Gel…. |

A double entry for this will be same for each method differing in depreciable amounts:

Debit 7455 Annual Depreciation and Amortization ( Expense )

Credit 2200 Accumulated Depreciation ;

**Revaluation** is connected to the increase or decrease of the value of the tangible asset. IAS 16 permits 2 treatments:

- **The Cost Model (**carry an asset at cost less accumulated depreciation/impairments)
- **The Revaluation Model** (carry an asset at its fair(market) value at the revaluation date less subsequent accumulated depreciation/impairment.

For Example in January 2011 Year a building was bought for 500 000 Gel . The revaluation report by experts states that building is worth 750 000 Gel on 31.12.11(ignoring depreciation) ; And the value changed to 450 000 Gel on 31.12.12

1) Revaluation Gain on 31.12.2011 :

| | | |
|---|---|---|
| Debit Building Account | 250 000 | |
| Credit Revaluation Reserve | | 250 000 |

2) Revaluation Loss 31.11.12:

| | | |
|---|---|---|
| Debit Revaluation Reserve | | |
| (to maximum of original gain early recognized) | 250 000 | |
| Debit Income Statement | | |
| (any residual loss- 300 000-250 000) | 50 000 | |
| Credit Non-current Asset (loss on revaluation) | | 300 000 |

**Derecognition** takes place when property, plant and equipment is no longer expected to generate future economic benefit or it is disposed of, and gain or loss on disposal is also recognized. Let discuss based on one example: A building was sold for 26 000 Gel, its cost was 20 000, accrued acc. depreciation was 3 300, there was accrued salary for workers for dismantling 200 Gel.

| | | |
|---|---|---|
| 1) Debit 1210- Cash at Bank | 26 000 | |
| Debit 2240 Accumulated Depreciation | 3 300 | |
| Credit 8190 Disposal Account of Building | | 29 300 |
| 2) Debit 8190 Disposal Account of building | 20 200 | |
| Credit 2140 Building account | | 20 000 |
| Credit 3130 Accrued Salary | | 200 |
| 3) Disposal profit transfer from the disposal account | | |
| Debit 8190 Disposal account | 9 100 | |
| Credit 8130 Non-operating Profit | 9 100 | |

This double entries will be more clear on T-Account.

8190-Disposal Account

| | | | |
|---|---|---|---|
| Cost of Building | 20 000 | cash at bank | 26 000 |
| Dismantling Exp(salary) | 200 | Accumulated depreciation | 3 300 |
| bal. fig. | 9 100 | | |
| | 29 300 | | 29 300 |

Tax Accounting of Fixed Assets has it special peculiarities in difference with financial accounting of Fixed Assets. There exist the differences between tax profit and accounting profit. Depreciation charges for fixed assets used in economic activities are deductible for tax

purposes in accordance with the rates of the Georgian tax legislation (please see the chart below).

The depreciation method used for corporate income tax purposes is the reducing

balance method ;

**Fixed Assets Depreciation Rates Chart 1**[1]

| Group | Assets | Rate |
|---|---|---|
| 1 | **Passenger cars; automobile equipment for use on roads; office furniture; automotive transport rolling stock; trucks, buses, special automobiles and trailers; machinery and equipment for all sectors of industry and the foundry industry; forging and pressing equipment; construction equipment; agricultural vehicles and equipment** | **20** |
| 2 | **Special instruments, inventory and equipment; computers, peripheral devices and data processing equipment; electronic devices** | **20** |
| 3 | **Railway, naval and river transport vehicles; power vehicles and equipment; thermal technical equipment, turbine equipment, electric engines and diesel generators, electricity transmission and communication facilities; pipelines** | **8** |
| 4 | **Buildings and premises** | **5** |
| 5 | **Assets subject to depreciation not included in other groups** | **15** |

Furthermore depreciations are not assessed on land, works of art, museum items, historical objects (except buildings), fixed assets with a value below GEL 1,000, biological assets, etc.

Fixed assets with a value below GEL 1,000 can be fully deducted from total income in the year of their exploitation, when it was incurred. For example purchasing separately computer cables, small stationary shelf , frames etc.

Fixed assets are allocated to groups, which are depreciated as whole units. Each building

represents a separate group.

**1 Tax Code-www.mof.ge**

The value of a particular group at the end of a tax year equals its value at the end of the previous tax year, increased by cost of added fixed assets and other capital expenditures, reduced by tax depreciation charges of the previous tax year. To explain it shortly will be like calculating the average :

$$= \frac{\text{NBV of Fixed Assets at beg. of year} + \text{NBV of Fixed Assets at year end}}{2}$$

Notably, full annual depreciation can be charged to all assets of the group irrespective of the purchase date. Taxpayers may apply accelerated depreciation rates for groups 2 and 3, but these rates cannot be more than twice the amount of the rates set for the respective groups. Each fixed asset supplied under lease is recorded as a separate group by the lessor . Fixed assets supplied under lease are amortized according to the discounted value of lease payments, where the latter are determined according to the lease terms and the book value of the respective group.

Moreover, Taxpayers may use an alternative method to compute the deduction of expenditure on fixed assets. A company may fully deduct the cost of such assets in the year of their exploitation, including their capital repair expenses. Those fixed assets are not further included in the asset groups for depreciation. If such assets are sold later, the sales price (market price in case of gratuitous supply) is included in total income. If a company elects to use the alternative method, it must be used for all purchased (produced) fixed assets for at least 5 years. Moreover , it should be mentioned that if we deduct all purchased tangible assets immediately according to this policy , we must still use them in calculating *the Porperty Tax***.** We are considering all values of those deducted tangible assets multiplying by 1 % .

As for Leasehold improvements incurred on rented assets that do not reduce the rental payments are capitalized as a separate tax depreciation group. Such improvements are deductible from total income over the rent period by applying the 15% diminishing balance method. Upon expiry or early termination of a rental agreement when the rented asset is returned

to the lessor, the book value of the group is equal to zero, while the

remaining balance is not deductible from total income.

In summary , there were discussed the features of Tax and Financial Accounting of Tangible assets. Majority of businesses cannot exist without fixed assets which are used in the production process, for normal functioning or for other purposes. They should be accounted in detail.

Furthermore, for Tax purposes non-current tangible assets and their depreciation take part in calculating and then determining the profit and Profit Tax, Property tax etc. Thus both accounting treatments are important and should be paid a great attention to them.