Taxation Effect on Depreciation: Evidence from the Algerian Tax System

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Abstract:
In this article, we attempt to examine the fiscal impact of an important element among the three components of self-financing, namely: Depreciation allowances. In this regard we try to study the effect of taxes on each type of depreciation through the Algerian tax code. Through this study, we conclude that taxation influences the decision of the company regarding the choice of depreciation methods. This influence is felt by the implicit tax cost of each type of depreciation. Nevertheless, the introduction of deferred amortization should allow the company, especially in deficit period, to improve its financial situation. Moreover, this depreciation will not be lost. On the contrary, it can be deferred without limitation of time, as long as the results will remain in deficit.

Keywords: Depreciation - Tax – Algeria

1. INTRODUCTION:
Self-financing resources are one of the main elements of the company's financial strategy. It helps strengthen the financial structure of the company by increasing equity. Self-financing represents the company's ability to replace and grow economic assets. Similarly, it represents the wealth retained by the company itself which constitutes an internal resource intended to cover the financial needs of the enterprise (Raymond H. Peterson, 2002; Don R. Hansen et al, 2009)

In addition, cash flow represents the portion of the capital generated by the activity and retained within the company in the form of three components of the cash flow which are: depreciation and amortization expense, provisions net of write-backs, and net profits from undistributed exercises (Belverd E. Needles, Jr et al, 2007)

As a result, depreciation is the monetary expression of the depreciation suffered by depreciable fixed assets as a result of their use or ownership by the enterprise. It represents the accounting statement of the depreciations of investments in order to reconstitute the invested funds (Hugh Coombs et al, 2005; Robert Parrino et al, 2012).

In this sense, it is different from some other aspects such as:
- Financial amortization which consists of repaying the borrowed capital;
- Amortization of the capital which makes it possible to be refund to the shareholders all or some of the subscribed shares.

In this context, the purpose of our study is to present and analyze the tax treatment of depreciation in the Algerian tax system.

2. THE DEPRECIATION IN THE ALGERIAN TAX LEGISLATION:
Depreciation is the monetary expression of the decrease suffered by depreciable fixed assets as a result of their use or ownership by the enterprise. It is represented by the accounting statement of the investments' depreciation in order to reconstitute the invested funds (Menachem Berg et al, 2001; Anson T. Y. Ho, 2017).

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Self-financing only takes into account the concept and the valuation of depreciation because it constitutes a source of financing. This concept of depreciation will be detailed above through:
- The definition of depreciation;
- The elements and characteristics of depreciation;
- The economic and financial role of depreciation.

Depreciation in the broad sense is equivalent to an irreversible reduction, spread over a given period, of the amount brought to certain balance sheet items, for example amortization of a loan.

From this definition we can take the following three ideas:
- This is an irreversible reduction;
- This reduction is spread over a determined period equal to the probable duration of use of the items to be amortized;
- This reduction may affect asset items, such as depreciation of property, plant and equipment or intangible assets, as well as liabilities, for example, amortization of borrowings.

It is also an accounting statement of a decline in the value of an asset resulting from use, time, change of
There are generally three different conceptions of depreciation (Mervyn A. King, 1975; Moshe Kim et al, 1988; Salwa Hana Yussofa et al, 2014; Jongsang Park, 2016; Sasson Bar-Yosef et al, 1994):

1. Economic design (depreciation - distribution):
   Depreciation is a procedure for distributing the cost of an investment over the period of its exploitation.

2. Financial design (depreciation - renewal):
   The purpose of amortization is to provide the resources needed to renew capital assets. It constitutes a depreciation fund intended to finance the new fixed assets.

3. The legal and accounting concept (depreciation - depreciation):
   Depreciation is an accounting process that corrects the valuation of assets. It recognizes the depreciation of the value of fixed assets attributable to the passage of time, technical progress or any other cause.

By adopting this latter concept, the FAP (Financial Accounting Plan) defines depreciation as follows:

"Depreciation represents the recognition of the depreciation of investments making it possible to reconstitute invested funds".

Similarly, it consists in spreading the cost of the property over its probable duration of use according to a depreciation plan; any significant modification of the use conditions of the property justifies the revision of the plan being executed.

Therefore, depreciation is the recognition in accounting of the irreversible depreciation of fixed assets. This is due to use, time, and obsolescence. The purpose of the amortization is to allow the company to build up the capital needed to renew the asset.

According to NAP, the majority of fixed assets are gradually losing their value either because of obsolescence resulting from progress or the technological change in particular.

However, the depreciation is used to support the accounting entries of companies of this obsolescence or for any other reason. These depreciation allowances allow the company to set up, at the expiration of the probable useful life of the asset, the equality of the capital to the nominal value of its cost or acquisition cost.

In general, depreciation is the recognition of a diminution of the asset value resulting from the use, time or evolution of the techniques, or from any other cause. This allows the company to generate the necessary amounts for the renewal of the amortized assets.

3. THE ECONOMIC AND FINANCIAL ROLE OF THE DEPRECIATION:

The total amount of depreciation applied annually by an enterprise constitutes an internal resource contributing to the financing of new investments. In addition to the result retained in the company, the depreciation amount forms the cash flow. The latter constitutes a global amount which represents an essential element of the management analysis of the company. Thus, it represents the overall self-financing capacity of the company. In addition, the company's annual depreciation mechanism allows it to renew its capital assets, since it guarantees that it will be kept in its assets equal to the value that has been subtracted to measure depreciation. In addition, depreciation is a source of financing available to the company as long as it is not needed to replace capital assets.

3.1. THE DEPRECIATION TAX SYSTEM:

Depreciation is an important element in the organization's self-financing. It depends on a large part of the annual endowments (Douglas A. Kahn, 1979; Paul K. Chaney et al, 1994; R. R. Officer, 1994). Since in taxation the annuity comes as a deduction from the taxable profit, the choice between the different systems of depreciation allowed by the Algerian tax legislation is not neutral for the amount of the final result, therefore on the self-financing of the company.

In this section, the following items are analyzed:
- The conditions of depreciation deductibility;
- The various depreciation techniques in the Algerian tax system;
- The limit of Algerian tax legislation on depreciation.

3.2. THE CONDITIONS OF DEPRECIATION DEDUCTIBILITY:

From an accounting perspective, depreciation is a charge deductible from the tax base, but this deductibility is subject to compliance with the necessary conditions. As such, depreciation is tax deductible under the following conditions:

1. Depreciation should only be applied to items subject to depreciation:
   In principle, depreciation should be justified by special circumstances. Similarly, they can only be related to items of fixed assets subject to irreversible depreciation. For the tax management, depreciation is the result of use and time.

If depreciation results solely from use and time, no proof of depreciation is required. On the other hand,
when depreciation is exceptional, to be admitted as a deduction, a justification is necessary. For example, some fixed assets do not depreciate either with use or with time. This is particularly the case for land and business assets. However, the costs incurred to renovate the equipment increase the value of the asset, which will increase the endowments due to the incorporation of these costs in the cost of the investment.

2- Depreciation should relate to goods listed in the asset side of the balance sheet:
Depreciable property can only be depreciated from the taxable income if it constitutes an asset value of the enterprise. Most of the time, this condition is satisfied if the company owns it. In certain particular cases, the property may be depreciated even though it is not owned by the company. For example, a company that simply has the enjoyment of property under a lease or lease is not allowed to deduct depreciation from its profits. These will be practiced by the owner.

3 - Depreciation must be recorded in the accounts:
Depreciation should not be applied only when the results are profitable. Even in the event of absence or insufficiency of profits, the depreciation is carried out so that the balance sheet is sincere. These deprecations must be recognized at the end of each financial year. In this case, depreciation should be recognized as an expense in the appropriate amortization expense account (formal requirement). In the opposite case, we are dealing with irregularly deferred depreciation which is not deductible. These depreciations recorded must be detailed in the table of fixed assets and depreciation. This must be attached to the accounting documents to be filed with the annual income tax return.

4- Depreciation must correspond to the actual depreciation suffered by the investment:
Exaggerated depreciation, particularly when the rate used does not correspond to the probable duration of use of the property, must be reintegrated into taxable income. In this case, the depreciation charge is calculated on the original value and the accumulated depreciation cannot exceed this value.

It should be noted that there is an exception for passenger vehicles. In this case, the basis for calculating deductible depreciation annuities is limited to a unit acquisition value of 1,000,000 DZD (including tax). This ceiling is applicable from 1 January 1997. It goes without saying that the company must, for the purposes of determining its accounting profit, calculate these depreciations on the basis of the actual acquisition value. If this is greater than 1,000,000 DZD and for the determination of the taxable result, the company reinstates the depreciation corresponding to the portion above this limit. It should be noted that the 1,000,000 cap does not apply when passenger vehicles are the main tool of the business. Examples include rental companies for passenger vehicles.

5- The use of the property must be in the normal course of business:
The depreciable property should not be used except in the normal course of business. This condition is that a charge is deductible only if it is deemed necessary for the operation.

4. THE DEPRECIATION IN THE ALGERIAN TAX SYSTEM:
According to article 174 of the code of direct and assimilated taxes, the linear system is depreciation of right. However, this article allows the use of declining balance depreciation and progressive depreciation. It should be emphasized that the Financial Accounting Plan (FAP) does not impose any specific method. Similarly, there are several types or methods practiced. As regards the depreciation methods used in the Algerian tax legislation, these cover:
- Linear or constant depreciation;
- Declining balance;
- Progressive depreciation.

When it comes to comparing the three methods of depreciation, declining balance is the method that allows the company to recover more quickly the sums invested. This advantage is even more important during periods of high inflation, since the company benefits from less depreciated funds than using the other two depreciation methods.

It should be noted that Algerian tax legislation has not addressed certain depreciation techniques, such as those used by certain countries such as Tunisia and France specified above. In this sense, it is specified that Tunisian and French tax legislation allow the practice of deferred amortization which means the possibility of deferring the depreciation allowances in the event of a deficit situation, while the latter is not incurred by the Algerian legislator (Project of National Accounting Plan, 2005). In this context, the deferred amortization in deficit period will not increase the deficit of the company and it can be used on the subsequent profitable years without limitation of duration. These allocations are deferred regularly to the extent that the cumulative depreciation already applied is at least equal to the cumulative linear annuities. As a result, loss-making companies have a certain fiscal advantage in terms of managing their results. As examples, the most significant techniques of non-recurring depreciation and deferred depreciation can be presented as follows:

1- DEROGATION:
1- Concept of exceptional depreciation: Non-recurring depreciation is a tax measure for investment aid; a
company can indeed from the first year, practice a massive depreciation which is justified by no particular
depreciation. This exceptional amortization takes the form of a tax subsidy which is refundable since the
subsequent annuities will be reduced by the same amount and the advantage is therefore only in cash. Truly, if
only for the sake of convenience, most companies consider declining balance depreciation as derogatory
amortization. If it ignores the depreciation in effect for a period of 12 months and in case of acquisition during
the year, the rest of the pro rata must be respected. It should be noted that the most important depreciation
measures are related to the following items:
- Software;
- Equipment intended to save energy;
- Anti-pollution buildings;
- Equipment intended to fight against noise;
- Electric vehicles.

2- The tax treatment of the derogatory depreciation: Technical depreciation and special amortization are subject
to the same tax regime:
- They must be accounted in such a way to be deductible from taxable results;
- The annual amortization is calculated taking into account both technical depreciation and amortization
allowances;
- The depreciation system deemed to be deferred may concern both technical amortization and exceptional
amortization;
- In the event of a sale, the capital gains or losses are calculated taking into account both the technical
amortization and the special amortization;

1. THE DEFERRED AMORTIZATION:
1- Principle and methods of recovery: If linear depreciation constitutes a minimum mandatory, declining balance
is only an optional maximum. Since it is depreciated at least on a straight-line basis, the company may, in a
given year, defer all or part of its depreciation. The possibility of deferred amortization offers the company
another technique to manage its results. One may doubt the interest of a company to defer its depreciation.
Depreciation deducted from the tax base results in a tax reduction. However, a rule of a sound financial
management should lead the company to postpone the moment of the payment of its debts (including its tax
debts). The advantage of deferring depreciation is however when the company is in deficit. By deferring
depreciation during a deficit period, the company does not increase its deficit, which has the consequence of
improving its financial image. In addition, the deferred amortization in a deficit period, far from being lost, may
be used by the company at its discretion and without time limit.

2- The advantages of deferred depreciation.
The interest of deferring depreciation in a deficit period is less obvious. As far as the tax is concerned, the
postponement of the deferred annuity is spread out in such a way that the depreciation is carried forward often
enough in time. On the other hand, the advantage of the deferred amortization period in deficit is, in fact, at the
financial level:
- The deferred amortization allows the company to equalize, to leave its result from one year to another and
having an almost constant result of giving a better economic image;
- It can also enable the company to increase earnings and distribute dividends;
- It generates a better financial return for the company and therefore can possibly allow it to obtain credit more
easily.

5. CONCLUSION:
Through this study, an attempt was made to identify the relationship between taxation and the depreciation of
assets, by reviewing the Algerian tax legislation in this area. Through what has been studied, we can say that
taxation influences the decision of the company in terms of choice of depreciation methods. This influence is felt
by the implicit tax cost of each type of depreciation. Nevertheless, the introduction of deferred amortization
should allow the company, especially in deficit period, to improve its financial situation. Moreover, this
depreciation will not be lost. On the contrary, it can be deferred without limitation of time, as long as the results
will remain in deficit. Through these conclusions, the study of the impact of taxation on depreciation shows that:
- In appearance, depreciation has no costs. Its explicit cost is zero, but it is an implicit cost or opportunity cost
that is difficult to avoid. This implicit cost represents the minimum profitability requirement of the shareholders;
- The adjustment of depreciation rates and the introduction of declining balance depreciation improve the status
of depreciation, which has a positive impact on self-financing;
- For a better tax management of the company, and for the choice of the means of financing at lower costs, one
can propose that the head of company must agree to treat the taxation like a variable of management in its own
right and that to all the stages of the life of the company;
- It is particularly interesting to note that sound tax management requires the entrepreneur to make his choice
after a detailed study of the economic, legal and financial consequences of each decision taken while taking into account the fiscal parameter.

REFERENCES:
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