FROM THE PERSPECTIVE OF ACCOUNTING THEORY: BANKS' LOAN LOSS PROVISIONS AND TAX LEGISLATION IN ALBANIA

Avenir Lleshanaku[*] and Mustafa Üç[**]

Abstract

Tax authorities often are doubtful on the regulation of accounting and they fear to accept the tax treatment of bank loan losses which it reduces income taxes paid by banks. The banks and bank regulators generally want the tax rules for recognizing loan losses to conform closely to regulatory accounting in order to encourage banks not to under-provision for loan losses and to ensure a current tax benefit from loss provisions. In recent years, a sharp increase in the level of Non Performing Loans (NPL) in the banking system triggered mainly by the effects of the economic crisis but also emphasized by other internal and external factors. Other problems are present in the environment such as: lack of reliable financial information, clients' poor business planning and execution, inefficient collateral collection processes etc. (Deloitte-Albania, 2013) In this paper, accounting theory will help us to understand and evaluate better the actual practice of loan loss provisions and their tax treatment in Albania. Also it will show us the way how to address for the actual debate between the banks and tax authority regarding the fiscal treatment of loan loss provisions. This paper aims to explain, when and how loan losses provisions should be recognized as a deductible expense for tax purposes by using the accounting theory. To address these issues financial accounting, according to International Financial Reporting Standards (IFRS) and regulatory accounting, according to central bank in Albania, Bank of Albania (BoA) of loan losses provisions must be considered.

Keywords: loan losses provisions, tax treatment, financial and tax accounting

[*]Avenir Lleshanaku Avenir Lleshanaku has been graduated from Marmara University, Istanbul, Turkey, from the Faculty of Economics and Administrative Sciences in 2001.. He also holds "Master of Science" degree in "Public Finance".In 2006 he finished his MBA studies at UNYT – IUKB. Actually he is a PhD student at Epoka University in Banking and Finance Department. From September 2001 he has been working for different banks within Banking Sector in Albania and currently holding the position Manager of "Liability Products` Operations Department" in Head Office at Banka Kombetare Tregtare. Also from 2009 and on he is working as a part time lecturer at Epoka University.

[**]Mustafa ÜÇ Mustafa Üç is Head of Business Administration Department in Epoka University. He completed a PhD in Business Administration at the Afyon Kocatepe University Turkey in 2009, and prior to that was a Research Fellow at the University of Bremen, Germany (through the Erasmus program). Courses he has taught in the past two years are Introduction Business, Financial Accounting at undergraduate level, and graduate level Managerial Accounting and Financial Statement Analysis. Research interests include International Business, Accounting Theory, Accounting Education and Auditing.

1. INTRODUCTION

Tax authorities often are doubtful on the regulation of accounting and they fear to accept the tax treatment of bank loan losses which it reduces income taxes paid by banks. The banks and bank regulators generally want the tax rules for recognizing loan losses to conform closely to regulatory accounting in order to encourage banks not to under-provision for loan losses and to ensure a current tax benefit from loss provisions.

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In this paper, accounting theory will help us to understand and evaluate better the actual practice of loan loss provisions and their tax treatment in Albania. Also it will show us the way how to address for the actual debate between the banks and tax authority regarding the fiscal treatment of loan loss provisions. This paper aims to explain, when and how loan losses provisions should be recognized as a deductible expense for tax purposes by using the accounting theory. To address these issues financial accounting, according to International Financial Reporting Standards (IFRS) and regulatory accounting, according to central bank in Albania, Bank of Albania (BoA) of loan losses provisions must be considered.

2. THEORETICAL BACKGROUND

In accounting theory one of the constraining principles, Conservatism, or otherwise called "the dominant principle of accounting" holds an extremely important place in the ethos of accountants. Conservatism principle is defined as the attempt to select "generally accepted" accounting methods that result in any of the following: 1)slower revenue recognition, 2)faster expense recognition, 3) lower asset valuation and 4) higher liability valuation. (Wolk, Francis & Tearney, 1984)

Both financial and tax accounting are based upon the premise of measuring income, but their goals are somewhat different. Financial accounting, particularly prudential rules, are based on conservatism, that is, to delay recognition of income as long as possible and to anticipate expenses and losses as soon as possible. Therefore, income is taxed as soon as it belongs to the taxpayer. Thus, it would be normal to tax prepayments of rent as soon as received, regardless of the fact that they relate to a period beyond the tax year. Similarly, tax accounting defers deductions until it is clear that the liability will actually be incurred. Various reserves allowed for financial accounting generally are not allowed for tax accounting. The two exceptions would be loan loss provisions for banks—the focus of this paper—and the required reserves of insurance

companies. In both cases, the tax authority can rely on the regulatory authority for banks and insurance companies to determine the reasonableness of the reserve. (Sunley, 2002)

Regarding reserves, according to Sunley (2002), there is also a suspicion among tax officials, that the reserves are set on the high side to be conservative, to protect the capital of the banks, and to reduce overly risky behavior. If the bank regulator fears that banks may not properly classify loans, the required provisions for each category may be set at a higher rate in order to partially offset the tendency to misclassify loans. Moreover, required reserves for regulatory purposes are minimums, as the bank regulatory authority wants to make certain that banks do not understate their losses. The regulatory authority is also concerned that banks do not have "hidden reserves" in order to smooth income. Any reserve for future losses should be accounted for as an allocation of retained earnings; that is, below the line. The tax authority, however, wants to ensure that banks do not overstate reserves. Instead of being minimums, the regulatory reserves should be maximums, if allowed for tax purposes.

Acording to the "Consistency Principle" a bank must use the same accounting policies, valuation methods and reporting standards from one period to another. In order that financial statements can be comparable with each other, those should be prepared based on the same standard. A mixture of a standard with another one would cause a deformation of company financial results.

Outstanding loans are recorded on asset side of a bank`s balance sheet. The loan loss reserves account is a "contra-asset" account, which reduces the loans by the amount the bank`s managers decide how much to add to the loan loss reserves account, and charge this amount against the bank`s current earnings. This "provision for loan losses" is recorded as an expense item on the bank`s income statement. (Balla, J.Rose & Romero, 2012)

A bank could shift income from good quarters to bad quarters by taking large provisions when income is high and small provisions when income is low. Managing earnings in this way could help publicly held banks maintain higher stock prices, and help bank managers meet their compensation targets. Empirical studies suggest that banks have used loan loss reserves to manage income. (Wall & Koch, 2000)

According to International Accounting Standards (IAS) 30.43, banks are required to provide detailed information about loan losses. This information includes the manner of which the provisions and losses on uncollectible loans are determined, mutations in the course of a provision during the period covered by the financial statement (additions, write-offs of uncollectible loans and the collections on write-offs) and the aggregate amount of the provision at balance date (Moison, 2007)

While according to the "Bank Accounting Manual", which is a publication of Ernst & Young, (1998), and used as an official accounting manual from the banks in Albania, when an installment is not paid in full or in part, and if no risk of non recovery is foreseen (for example, the loan is fully guaranteed), the amount not paid (the arrears) should be automatically

reclassified into the past due standard loans account. Arrears are not considered to represent a risk a priori. It is only when a certain past due delay is reached and/or a loan presents a risk of not being repaid that the receivable is reclassified in the various "receivable at risk" accounts. In that case, a provision for depreciation is then recorded based on the probability to not recover the funds. By analogy with the accounting of the risk on receivables with customers, this account can be sub-divided based on the various degrees of risk:

- special mention,
- sub-standard,
- doubtful,
- lost.

In the event a loan is reclassified from one to another of these categories, the total outstanding amount of the loan and all related amounts (principal outstanding, accrued interest, late-payment interest, penalties, commissions) should be posted in the new category, whatever the amount of the potential loss and even if such loan is secured and not merely to callable amounts. When loans are classified as substandard, doubtful or lost loans, no more interest should be calculated and accrued. As a rule, this applies when delinquent payment is over 90 days.

Also according to official Bank Accounting Manual by Ernst & Young (1998) a provision for statistical risk is calculated on standard loans and on special mention loans. The provision must be documented and computed based on statistics which determine the amount of probable losses to be incurred on the population which might be globally considered as representing a risk.

The establishment of a statistical provision will meet the following conditions:

- The population studied includes a great number of elements of a similar nature whose risk assessment case by case would be costly,
- The reasons for the probable losses to be incurred are deemed homogeneous for the population studied,
- The reasons for the losses have been identified and the probable loss has been assessed based on the study of historical data truly observed and updated frequently,
- No element of the population would lead to a potentially significant loss in relation with the whole population or the entity's results.

While according to IFRS, loan loss provisions are calculated on basis of expected payments (cash flows), following customer`s financial situation and strategy pursued by the bank to recover loan obligation. These expected payments (cash flows) are based upon a real possibility

to include a payment or restructuring agreement, and in the absence of those, through the expected cash flows from loan collateral or guarantee enforcement. In contrast, according to BoA standards in Albania, loan loss provisions are calculated on basis of loan classification into five categories, as well as provision rates for each category. These categories are established according to days in arrears and customer`s financial situations. (Polo, 2012)

Balla et al. (2012) found that despite the potential to use loan loss reserves to achieve objectives other than ensuring safety and soundness, prudential considerations suggest that higher reserves, all else equal, enable the bank to absorb greater unexpected losses without failing.

The accounting guidelines for loan loss reserves could make banking more procyclical. If loan loss reserves are relatively low during good times, banks would have to rapidly increase their loan loss provisioning when an economic downturn occurs and defaults become more common. (Laeven & Manjoni, 2003)

3. SOME COUNTRY APPLICATIONS

The evidence, administration and reporting of provisions fund (including provision expenses and reversals) from banks in Albania is done with two standards: 1) according to IFRS and 2) according to Regulatoins of Bank of Albania (Central Bank of Albania refered as BoA). Both standards are audited and certified from independent external auditors and from BoA`s auditors.

Based on two above standards a bank is obliged to calculate a provision fund with two methods:

1) According to IFRS and
2) According to Regulations of BoA where loans are classified in 5 risk classes with respective provisions as below (Ernst & Young, 1998):

- ***Standard Loan : 1% (interest + principal)***
- ***Special Mentioned Loan (delay of 30-90 days) : 5% (interest + principal)***
- ***Substandard Loan (delay of 90-180 days) : 20% principal, 100% interest***
- ***Doubtful Loan (delay of 180-360 days) : 50% principal, 100% interest***
- ***Lost Loan (delay of over than 360 days) : 100% principal, 100% interest***

Regarding the fiscal treatment, before 2011, only the provisions calculated according to BoA`s method were taken in consideration. While, from 2011 and on, due to a change at Fiscal Law, bank loan loss provisions are calculated according to both standards and only that which is smaller will be taken in consideration for purposes of calculating annual taxable income. Under both standards any reversal of those reserves or provisions is added to taxable income.

The tax treatment of loan losses is treated differently among countries. Some countries (United States for large banks—more than $500 million in assets, Malaysia, Philippines, and Singapore)

only allow the *charge-off method*, under which loan losses are recognized only when loans become worthless. In determining whether a loan is worthless, all pertinent evidence, including continual non-performance, adequacy of collateral and the financial condition of the debtor should be considered. Under the charge-off method, if an amount previously charged off as uncollectible is later recovered or the loan again becomes performing, the amount previously written off is restored to income. (Dziobek, 1996)

In the Philippines, loan losses are allowed only for worthless and uncollectible loans that have been charged off the books of account of a bank as of the end of the taxable year. The tax authority allows a debt to be written off for tax purposes once it has been written off by the bank with the approval of the Central Bank of Philippines. Some countries (Japan and Thailand) set limits on the tax deduction for loan losses. In Thailand, banks can deduct loan loss provisions from taxable income up to 25 percent of net income or 0.25 percent of total outstanding loans, whichever is less. Loan losses may be written off for tax purposes only when civil action has been brought against the debtor, the debtor has declared bankruptcy or died. (Beattie, 1995)

Many countries allow a reserve method (that is, provisioning) for accounting for loan losses for tax purposes in addition to requiring it for regulatory purposes. However, only a few countries attain full conformity between financial and tax accounting for loan losses. Many countries (e.g., United Kingdom, France, and Germany) grant tax deductibility to specific allowances or charge-offs in the year they occur, but not for general allowances. Serbia allows a tax deduction only for the specific allowance but gives the allowance a “haircut.” Under the new Serbian income tax, banks are allowed a tax deduction equal to 90 percent of the addition to the loan loss provision required by the National Bank for non-performing loans. The Russian Tax Code establishes its own reserve rules (related to the rules of the National Bank). A reserve is allowed for loans past due only 45 days, and the total reserve cannot exceed 10 percent of the gross receipts of the tax year. In the Kyrgyz Republic, banks may establish a reserve based on the experience of the leading banks of the world. The reserve shall not exceed 10 percent of the loans outstanding. (Escolano, 1997)

According to Sunley (2002), the bank regulatory agency in many countries specifies a scheme for classifying loans and setting minimum reserves. The guidelines for the various loan categories—for example, special mention, substandard, doubtful—are often set in terms of past due payments. More forward-looking criteria include the credit worthiness of the borrower.

For example, in broad outline, Turkey requires specific provision of:

• 20 percent of loans with limited potential to recover or 90 days in arrears

• 50 percent of loans unlikely to be recovered or 180 days in arrears

• 100 percent of loans deemed irrecoverable or with arrears over one year.

These required provisions are reduced to the extent that doubtful or bad debts are covered by guarantees or collateral. The amount of this reduction varies according to the quality of the guarantee or collateral. In addition, there must be a general provision of 0.5 percent of cash loans and 0.1 percent of contingent liabilities.

The Central Bank of the Philippines requires specific reserves ranging from 5 to 100 percent:

• 5 percent for “loans especially mentioned” (loans that have potential weakness—past

due for 30 to 90 days)

• 25 percent for “substandard loans that are unsecured” (loans that involve a substantial and unreasonable degree of risk to the institution because of unfavorable record or unsatisfactory characteristics—past due more than 90 days)

• 50 percent for “doubtful loans” (loans that have the weakness inherent in substandard loans, with the added characteristics that the existing facts, conditions, and values make collection or liquidation in full highly improbable and in which substantial loss is probable)

• 100 percent for “loss” loans (loans considered uncollectible and worthless, and that are past due for a period of at least six months).

In addition to the specific reserve, the Central Bank of Philippines requires a general reserve equal to 2 percent of a bank’s unclassified loan portfolio.

4. CASE OF ALBANIA

Due to the law no. 9228, date. 29.04.2004 “On Accounting and Financial Statements”, starting from 1 January 2008, banks are obliged to prepare and report their financial statements according to IFRS. Also, they are required to prepare these statements, according to Albanian Tax Law and Bank of Albania`s regulations. This procedure is based upon the Law no. 9662, dated 18.12.2006 “On Banks in the Republic of Albania” and in the respective BoA`s regulation. When comparing both standards it`s obvious that, certain identical items in financial statements may appear with different figures during reporting.

According to Kazazi Consulting (www.kazaziconsulting.com) such differences result from different methodologies, both standards use when calculating these items. Loan loss provisions are one of those items where the difference between two standards is quite significant because of the below methodology:

1. According to IFRS: Provisions, according to IFRS has as a base the principle of reality by attempting to measure the real cost of loan risk based mainly on a) coverage of loans with collateral and b) excpected cash flow for the loan repayment (the realised value of these

two indicators is actualised at the date of balance sheet/report). The difference between the net value in balance sheet and that of actualised value of the above this two indicators (depending on circumstances or management decision) could be taken in combination or can be chosen one of the indicators, that which ensures an easier and more reliable measurement. For an easier way and suggested from a practise, already accepted broadly, Banks divide their loan portfolio in “big and problematic loans” (which are tested individually for impairement by combining the two indicators above) and “loans with similar risk factors/characteristics” (which are tested for impairement in group base – by pooling system)

The elements which banks determine as factors of actualisation of the above two indicators, and mainly that of realised actual net value from the loan hypothetical liquidation, include: the period of realization in cash for the collateral or the loan itself by assuming that it may not be in compliance with the loan back repayment plan, costs of collateral liquidation (7% bailiff fee etc. in case of Albania), possible discounts on collateral value (20% after the first auction in case of Albania, etc.) and at the end, the consideration of a more realistic collateral value at the actual statement (maybe by change of official evaluation which may not be updated).

In order to summary the factors which affects on the realised collateral value, banks apply a percentage of impairement of collaterals which it might differ for some collateral types (biulding, land, apartment, factory, machinery, equipment, inventory, etc.) making so somehow a subjective element for evaluation and not a unified or easily measurable one, compared also among banks. Application of these indicators in the formula of realised value actualization affects sensibly this value and consecutively the net difference with the loan net value at balance sheet, which will represent the impairment amount or indicate that the loan is collateralised soundly. Related to the imparement of loans in group base (pooling system) with similar characteristics (after the individual impairement test is done), one of the main ways used is dividing of loan portfolio according to industry and their type and application on each sub-group of impairement rates based on macroeconomic indicators, or other relevant indicators.

2. According to Regulations of BoA: Provisions according to BoA is considered to be more prudent, aiming also prudent indicators for the capitalization of banks. This standard application is based on the loan performance, so the delays of loan repayment, by obliging bank to calculate provision fund depending on number of days in delay during the loan repayment. So, loans are classified in 5 risk classes with respective provision 1% (Standard), 5% (Special Mentioned), 20% (Sub-Standard), 50% (Doubtful) dhe 100% (Lost). This criteria, in practice, is corrected by taking in consideration also additional information like business cyclical behaviour of loantaker, financial situation, excpected

cash-flow irregularities etc. Which attempt to smooth the rigid criteria of repayments in delay.

From January 2011, some special amendments with regard to loan loss provision were effected in the tax legislation, which would significantly impact bank financial statements preparation and reporting. It should be mentioned, in parenthesis, that until end -2010, the Article 25 of the Law: "On Income Tax" stipulated as follows: "for purposes of calculating annual taxable income, bank loan loss provisions calculated according to BoA`s rules, are considered as deductible expenses. Any reversal of those reserves or provisions is added to taxable income". In December 2010, a special amendment was included in this article of the law, which became effective on January 2011. According to this amendment, the definition of bank loan loss provision is transformed to another meaning, as now the article stipulates that: "For purposes of calculating annual taxable income, bank loan loss provisions calculated according to International Accounting Standards (IAS), and certified without auditor remarks, but not exceeding, in any case, those prescribed by BoA`s rules, are considered as deductible expenses. Any reversal of those reserves or provisions is added to taxable income".

Because of different methodologies used the provision expenses, provisions fund and reversals will consist in different amounts for each of two methods used, but what is important in our case is the fiscal treatment according to Tax Legislation presented as below:

As it is seen from above, regarding fiscal treatment banks in Albania:

1) Up to the end of year 2010, beacues of Article 25 of Income Tax Law, banks had to recognise the "created provisions" in compliance with the regulation of BoA;

2) From year 2011 and on banks have to recognise the "created provisions" in compliance with IAS certified from external auditors, but, in any case by not exceeding the amount determined from the regulation of BoA.

Put it simply, in the process of calculating bank taxable incomes, loan loss provision expenses will range from those calculated under IAS to those under BoA standards, where the least calculated provision amount between the standards shall be accepted as a deductible expense.

Let`s put it more practical by giving a technical explanation with a simple example.

<u>Illustrative example</u>

As below there is an example in Albanian currency "Leke (ALL)" in order to understand how can influence the usage of different standards when calculating the provision fund:

	2008	**2009**	**2010**	**2011**

According to BoA				
Provision expenses	40	40	40	40
Provision fund in Dec. 31	40	80	120	160

According to IAS				
Provision expenses	20	20	20	20
Provision fund in Dec. 31	20	40	60	80

In example, from 2008 to 2010, the bank has calculated according to IAS an expense of 20 ALL per year, and according to BoA an expense of 40 Leke per year, while for fiscal reasons, based on Article 25 of Law 8438, has taken in consideration as deductible expense the amount of 40 ALL calculated according to BoA. Regardless of different accounting rates applied from bank (IAS and BoA, according to accounting legislation requirements), the provision amount according to BoA is that which will be recognised as deductable from the fiscal point of view up to the end of year 2010 and the provision according to IFRS for the aftercoming periods.

So, the fiscal fund accumulated on 31 December 2010 has been equal with the accumulated fund according to BoA, 120 ALL (in compliance with law in force), regardless the provision fund calculated according to IAS/IFRS at the amount of 60 ALL.

A varying methodology in calculating provisions for tax purposes may trigger confusion and inequality in tax treatment, as regards the banking system financial results.

Technically and professionally speaking, using a different methodology causes practical problems when implementing it in the forthcoming activity periods, as it has happened really last months in Albania where there is a conflict between tax inspectors and bankers regarding the implementation of two methods starting from the beginning of 2011.

Firstly, obliging banks use those two different methods does not take into account the continuity and consistency principles logic of financial statements through years; a key and substantial element in preparing and reporting financial statements.

Also other questions are raised meanwhile like:

What will be the basis for calculating taxable results: should it be net provisions (which are lower according to BoA), or only a comparison between provision expenses will be used (which are lower according to IFRS), thus bypassing provision reversals? It should be noted that, Tax Authority has not released any guidelines yet; therefore tax inspectors give various interpretations in this regard.

Should we consider net provisions option to calculate taxable result for 2012, net income to shareholders (distributable income) or retained for recapitalization ends up being taxed twice? Such confusion may happen and hence be interpreted in different ways, in case of loan write-offs from the balance sheet.

5. CONCLUSIONS AND RECOMMENDATIONS

Given this wide diversity in tax treatment, there clearly is no generally accepted international standard as to the appropriate tax treatment of loan losses. In determining the tax treatment of

loan losses, a country should consider whether there should be full or partial conformity between the regulatory and tax treatment of loan losses. If the tax law is changed it should be allowed another method and explained how should the transition be treated for tax purposes.

There is not a standard international practice as the treatment of bank loan losses for tax purposes. Some countries use the charge-off method; other countries allow provisions for loan losses along the lines of the provisions required for regulatory accounting. Only rarely do countries have full conformity between book and tax provisions for loan losses.

A major advantage, according to Sunley (2002), of having a high degree of conformity between loan loss provisioning for financial and tax purposes is that the tax authority would not have to assess the reasonableness of the provision. Instead, the tax authority could rely on the bank regulatory authority to "audit" the loan loss provision. This would provide banks with greater certainty by reducing disputes between the banks and the tax authority. However, a high degree of conformity does not necessarily require full conformity. Administrative simplification would

still be obtained if only specific provisions are deductible for tax purposes or if the specific provision is given a "haircut," as in Serbia.

Conformity between financial and tax accounting for loan losses also would ensure that the tax system does not provide a disincentive for banks to adequately provide for loan losses. This may be particularly important in times of fiscal stress when banks have high rates of non-performing loans. It is somewhat ironic that during periods of fiscal stress, countries, mainly in Latin America, have often adopted bank debit taxes, which tend to encourage disintermediation (Coelho, Ebrill, and Summers, 2001).

Each dollar added to the reserve fund for financial or regulatory purposes would reduce taxable profits by a dollar and provide a current tax benefit, assuming the bank has positive taxable income.

Regarding the actual case of Albania we would recommend the followings:

1. **First, let us give both the tax and banks regulatory infrastructure on which our recommendations will be based**

Law nr. 8438, date 28.12.1998, "On Income Tax" (amended), with the changes included up to 31 December 2010, Article 25, ratifies:

Article 25

Special reserves for banks and insurance companies

"for purposes of calculating annual taxable income, bank loan loss provisions calculated according to Bank of Albania`s rules, are considered as deductible expenses. Any reversal of those reserves or provisions is added to taxable income".

Law nr.10364, date 16.12.2010 "For some additions and amendments on law nr.8438, date 28.12.1998 "On Income Tax" (amended), Article 3, ratifies:

"Article 3

Article 25 "Special reserves for banks and insurance companies" is amended as below:

Article 25

Special reserves for banks and insurance companies

"For purposes of calculating annual taxable income, bank loan loss provisions calculated according to IAS, and certified without auditor remarks, but not exceeding, in any case, those prescribed by BoA`s rules, are considered as deductible expenses. Any reversal of those reserves or provisions is added to taxable income".

Also, Article 16 of BoA`s regulation stipulates that: *"calculated reserve fund are registered as incomes from the reversal of reserve fund, while created reserve fund according to loan classification to a new category are registered as expenses of that year."*

It is important to define the terms of "calculated reserve fund" and "created reserve fund":

a) "calculated reserve fund" – refer to cases when during one year one loan is classified from a higher class (higher provision rate – higher number of days in delay – deterioation of creditor situation), to a lower class (lower provision rate – lower number of days in delay – improvement of creditor situation) from the beginning to the end of accounting period, 1 January to 31 December, then the change between two

calculated fund based on the same accounting principle “Intangibility of the opening balance”, will be recognized as provisions taken back;

b) “created reserve fund” - refer to cases when during one year one loan is classified from a lower class (lower provision rate – lower number of days in delay – improvement of creditor situation), to a higher class (higher provision rate – higher number of days in delay – deterioation of creditor situation) from the beginning to the end of accounting period, 1 January to 31 December, then the change between two calculated fund based on the same accounting principle “Intangibility of the opening balance”, will be recognized as provisions expensen back;

2. Fiscal Treatment

As it can be seen, based on the above laws with the respective amendments, from the fiscal point of view, banks had to recognise the “created provisions” in compliance with the regulation of Banka of Albania. (up to the end of year 2010, beacues of Article 25 of Income Tax Law) and starting from year 2011 and on banks have to recognise the “created provisions” in compliance with IAS, certified from external auditors, but, in any case by not exceeding the amount determined from the regulation of BoA.

Furthermore, starting from year 2011, there are three conditions that a provision amount can be considered as a deductible expense for the purpose of calculating the income tax:

1. **Provision amount will be calculated according to IAS/IFRS**;
2. **Provision amount calculated according to IAS/IFRS should not exceed the provision amount calculated according to BoA`s regulations**;
3. **Provision amount should be audited and certified from the external auditors;**

We should emphasize that based on the above two standards, beacause of the differences in the methods of calculation, when comparing the figures the consistency principle should be taken in consideration. Except this it should be applied the differentiation from the fiscal point of view in compliance with the above “Income Tax Law”.

So the Tax Authority should verify:
Provision expenses for year 2011 according to IAS (which consists from the positive difference of provision fund 31/12/2011 – 31/12/2010 calculated according to these standards;
Provision expenses for year 2011 according to BoA`s regulation (which consists from the positive difference of provision fund 31/12/2011 – 31/12/2010 calculated according to the above regulation;
To illustrate this recommendation with the same example presented as above we will have:

	2008	2009	2010	2011
According to BoA				
Provision expenses	40	40	40	40
Provision fund in Dec. 31	40	80	120	160
According to IAS				
Provision expenses	20	20	20	20
Provision fund in Dec. 31	20	40	60	80
Fiscal provision according to Income Tax Law				
Provision expenses	40	40	40	20
Provision fund in Dec. 31	40	80	120	140

So for year 2011, the provision expense amount to be considered as an deductible expense will be the lowest amount between the two standards, so equal to 20 ALL. While the provision fund at the end of 2011 will be calculated by adding to the provision fund at the end of 2010 plus the provision expense of 2011, so equal to 140 ALL.

This means that, even why the BoA`s provision fund differs from that calculated according to IAS/IFRS, as long as fiscal legislation does not allow the provision recognition depending on accounting standards, but determines by itself the amount of the provision which will be recognized from the fiscal point of view (concretely, the amount of the provision fund according to BoA up to the end of 2010 and the amount of the provision fund according to IAS/IFRS for the periods after 1 Januar 2011), the changes which happen in the calculated fund according to IAS/IFRS or other standards on which the financial statements are compiled, these chages will not influence the fiscal result.

Under these conditions, accounting amendments are not relevant for the fiscal treatment of the provision fund, which in every case will be calculated according to fiscal legislation in power, by ignoring the amendments at accounting standards.

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