Accounting, Taxation and Company Performance – Convergences and Contradictions

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Abstract
Know debate table matter, the accounting – taxation relationship instill land of convergences and divergences, of tolerance and intolerance, which makes the Romanian accounting practitioner to be in a constant state of study generated by the accounting information quality, attached to the study of taxation impact on business performance.

The analysis of the accounting - taxation relationship, in determining the outcome of the exercise, requires the evidence of taxation distortions on the accounting result registered by the company. In addition to the shared principles of accounting and tax rules you also have numerous contradictions between them. The most specific manifestation of it arises on the accounting result and on the tax income that year.

The company’s income taxation was a theme constantly discussed and interpreted, the relationship between accounting and taxation representing a conflict area since the fiscal principles and methods are not under company’s control. The accounting profit reflects the application of accounting principles for an accurate measuring of the company’s activity, while tax income reveals the interests of tax administration. Economic theory and practice demonstrates that accounting principles and tax rules and regulations are not always connected. Therefore, the result of a company’s activity can be highlighted as an accounting and fiscal result.

When the accounting interest is not in accordance with the tax interest is necessary to achieve reconciliation between accounting, as a representative of the company in dealings with third parties, and taxation, as a representative of the state.

Income taxes and other taxes related to the company imply a diminished outcome and claim the existence of a positive treasury to enable the fulfillment of tax obligations. The "tax cost" related to the company must not constitute a state budget free loan, in case of tax payment that is not due to take place.

The income tax is sometimes a significant expense for the company. Accounting for tax liabilities raises some questions, because the rules for calculating fiscal result are different from those used to calculate the accounting result, whence came the need to clarify the accounting treatment related to differences between accounting and fiscal results.

Deferred taxation is a possibility of convergence between accounting and taxation, and occurs when they are temporary differences between accounting and tax rules, which have only a temporary influence on the outcome.

Keywords: accounting result, fiscal result, accounting profit, tax profit, performance, convergences, contradictions
JEL Classification: E62, G32

Introduction

On relationships between accounting and taxation much has been written to underline the subordination of the first to the second. The tax system has had and still has a major influence on accounting principles. Tax law intervenes in accounting to set the assessing rules or the presentation methods for the annual financial statements.

The influence of taxes on income has been and still is one of the most debated issues in the accounting area, because in most countries the measurement and accounting rules applied to find the accounting and fiscal result have been traced taking into account different objectives: the accounting profit reflects the application of accounting principles to accurately measure the company’s activity, while tax income reveals the tax authority’s interests.

1. Research Methodology

Our approach aims at bringing into question the accounting - taxation relationship, and especially its influence on the economic performance recorded by the company.

This is because, unlike accounting, tax corresponds to a different logic, it has its rules and principles which do not always correspond with the accounting ones. Tax principles and methods are not under company’s control; however the company can use them to influence the tax burden.

In this respect, the research took into account, on the one hand, systematization and reconsideration and, on the other hand, a synthesis and an antithesis of the ideas found on this subject in the specialized literature, the regulations developed by various national and international authorities.

The research took into account the identification of the optimal relationship and the reconciliation between accounting and taxation, so that both companies and the state exist and thrive.

We reach the conclusion that the deferred tax is a possibility of convergence between accounting and taxation, this being found in the temporary differences between accounting and tax rules, which have only a temporary influence on the company’s outcome.

2. The deferred tax, a possibility of convergence between accounting and taxation

A discussed and interpretable matter, the accounting - taxation relationship is still a land of convergences and divergences, tolerance and intolerance, which makes the Romanian accounting practitioner to be in a constant state of study generated by the accounting information quality, attached to the fiscal impact study. The importance of accounting reasoning is obviously growing at present and more, this is amplified by the fact that accounting information is the basis for most of the taxpayer’s contributions.

Unlike accounting, taxation corresponds to a different logic, has its rules and principles that do not always correspond with the accounting ones. Hence the difficulties of reconciling the relationship between the two areas, tax principles and methods are not under the company’s control. The company, however, can use the tax principles and
methods to influence the tax burden. Thus, operating financially or investment-like the company can use methods and techniques their fiscal incidence providing, more or less, advantages materialized in a better liquidity state.

The analysis of the accounting-taxation relationship, in determining the outcome of the exercise, requires evidence of the fiscal distortions introduced on accounting result. In addition to the shared elements between accounting principles and tax rules, you also have numerous contradictions. The most obvious manifestation of this arises on the accounting result, the fiscal result that year. The taxation of the entities’ profit was a theme constantly discussed and interpreted, the relationship between accounting and taxation representing a conflict area since fiscal principles and methods are not under the entity’s control.[V. Munteanu et al., 2015]. The accounting profit reflects the applying of the accounting principles to accurately measure the activity, while tax income reveals the tax authority’s interests.

The economic theory and practice reveal that the accounting principles are not always connected with the tax rules and regulations. Therefore, the work outcome should be highlighted as it follows:

- the accounting result;
- the tax (taxable) outcome.

The accounting result is calculated as a difference between the total revenues and the total expenditures of the entity, registered during the fiscal year and highlighted in the revenues and expenditures account, synthesized in the 121 account, "Profit and loss". The fiscal result (taxable income) is the taxable profit or the fiscal loss for the year in discussion, loss established under tax rules, representing the calculus basis for the income tax. The accounting result is the calculus basis for the fiscal result. The parity between the two exists only when the company records non-deductible expenses, respectively non-taxable incomes.

Given that the accounting result is determined by accounting rules, regulations and principles and the fiscal result by tax rules, regulations and principles, it is possible to find discrepancies in determining the outcome, in which case the income and the expenses will be restated outside the accounting system. In this case, you must take into account the accounting rules, regulations and principles dealing with the accurate picture, but at the same time you must not neglect the tax principles and regulations that promote the state's fiscal interest.

Most times, the tax interest prevails over the accurate picture. The cause for this situation is generated by linking tax to accounting, given that not all accounting principles are converging with those of taxation. Where accounting and fiscal interests contradict it is necessary to achieve reconciliation between the accounting, as a representative of the company in dealing with third parties, and taxation, as a representative of the government. The solution in this case is to find the optimum ratio between the two interests, so that both companies and government exist and thrive.

The Income tax and the other axes a company has to pay imply a diminished outcome and a positive tree surly to enable the full film into the company’s tax obligations. The concept of tax cost must not be a state budget free loan ,in case of tax payment that is not due to take place related to a certain period in time.

The emergence of the tax burden on enterprises has generated the need to introduce criteria for determining the tax base. Income taxes represent a significant expense for the company. Accounting this fiscal obligation raises some problems, because the rules for calculating fiscal result are different from those used in accounting, whence
the need to clarify accounting treatment for the differences between accounting and fiscal result.

The influence of taxes on income is one of the most debated issues in accounting, because in most countries the rules for measuring and accounting result and fiscal result were established according to different objectives. The accounting profit reflects the application of accounting principles of activity’s accurate measurement. The tax profit shows the interests of the tax authority.

Deferred taxation is a possibility of convergence between accounting and taxation and it occurs because of temporary differences between accounting and taxation rules, which only have a temporary influence on the result. This refers to losses or expenses accounted for during the year, and deducted from the taxable income during the following year, but which are possible to re-integrate later (fiscally non-deductible provisions); losses or expenses recorded during the year and deducted from taxable income the same year, but later re-integrated (regulated provisions, depreciation escape); profits or income that can be recorded in the year and integrated into a following year (displaying capital gains from the sale of assets over several years), profits or revenues that will be recorded in a subsequent year, but re-integrated in the taxable income for the year (revenue in advance); losses or expenses that will be accounted for in a future year, but deducted from the taxable income for the year (prepayments).

The differences arising between the accounting result and the fiscal result can be either permanent or temporary.

**Permanent differences** include the following types of income and expenses:
- Permanent non-deductible expenses
- Revenues that the IRS does not tax, because it comes from results already taxed (dividends received from a subsidiary);
- Tax relief granted to encourage certain economic activities promoted by the state.

**Temporary differences** originate from accounting for difference in time between an item and its inclusion in the fiscal result, which is usually reabsorbed during a subsequent year. Temporary differences are actually differences between accounting value and tax value of an asset or liability. Given that the temporary differences are actually differences between accounting value and tax value of an asset or a liability, there are two types of temporary differences: taxable temporary differences that will generate taxable sums in determining taxable profits of future years (when the carrying amount of an asset will be received or paid) and deductible temporary differences, which will generate deductible sums in determining taxable profits of future years (when the carrying amount of an asset will be received or paid).

There may be several situations, namely:
1) the facts recorded in the year N have been taken in the calculation of taxable income of the previous year (N-1);
2) Items included in the result of year N, but have been recorded in the prior year;
3) Items recorded in the current year, but which will be become taxable or deductible during a future year (N + 1);
4) Items included in the outcome of fiscal year N, but will be recorded later.

Regarded in relation with the matching principle, differences between the accounting and the fiscal result are divided into 2 categories:
- Differences that are irrelevant to future tax years;
- Differences that may change the taxes of a future year.
The first category includes permanent differences and temporary differences previously identified for which a deadline has been set (situation 1 and 2) and which does not raise problems on accounting and deductibility. [Morariu Ana et al., 2005]

Problems occur for the differences in the second category, which contradicts the accounting principle mentioned above. This is the case of temporary differences that have not yet been reabsorbed (cases 3 and 4) and deferred losses. The question is when the fiscal consequences associated with these types of differences should be taken into consideration: when differences occur or during the year when taxation is affected. To solve this problem two methods of allocating income tax expense were outlined:

1) **The Income Tax Payable**

The income tax payable is based on the idea that a tax expense of a year is equal to the actual tax sum which is payable for that period. The method characterizes a mandatory tax, using it. The method characterizes a mandatory tax, using it only the incidence of permanent differences on the accounting result in order to calculate the fiscal result. Therefore, temporary differences and reportable deficits are not included into the calculation of a provision. The possible implication of temporary differences is mentioned in the Annex to the accounting balance sheet. This method is generally used in countries where accounting is strongly connected to taxation. Thus, the tax on benefits determined by the laws varies from country to country and changes quite often. It is determined by taxable income, not by the accounting profit.

The income tax expense calculated using the tax payable is easier to understand for users and is much less expensive than the tax carry-forward method. The actually paid income taxes is the best basis for forecasting the cash-flow, as deferred taxes might not be paid for a long period of time, if paid at all. Using this method has a negative influence on the achievement of true and fair view, in the sense that income and expenditure might not be in connection one with each other, causing a short-term profit growth and a long-term decline.

2) **The Deferred Tax or The Tax Carry-Forward Method**

This method is also suggested by the International Accounting Standard IAS 12 “Income tax”

This method involves the allocation of tax expense to the profit, through the accounting recognition of temporary differences. This method is used in countries where accounting and taxation are independent of each other. Deferred tax liabilities and assets are in accordance with the definitions offered by the conceptual accounting framework, developed by both the IASB and FASB.

IASB considers income tax more as a business expense rather than as a distribution of results and it is considered a consequence of the principle of linking income to expenditure and of the matching principle. According to these two principles, it is necessary to charge the corresponding revenue and expenditure each year. Problems occur when the costs are valid for several years and the part of the expenses which led to obtaining the income of the current year has to be determined. The matured part of expenditure is “an expense”; the un-matured part is “an asset”; spending that cannot be connected to an income represent “a loss”. Therefore a tax expense related to a year includes taxes payable for that year as well as the incidence of temporary differences from previous years on future years. In other words, tax expense is the sum of the total current year tax and of the deferred tax included in the result. All expenses must follow the same
accounting principles, either accrued or deferred. Eventually, all temporary differences are reabsorbed, and their taxable effects should be accounted for in the same period when the transactions that caused these differences took place and when taxes are paid.

Not accounting for taxes according to the principle of tax carry-forward causes fluctuation of net income depending on temporary differences, which would cause a greater difficulty in forecasting profit and cash-flow.

In most countries, there are differences between accounting and tax rules regarding recognition and measurement of result. Some differences are permanent; others are temporary, being reabsorbed during a future year.

**Calculation and accounting for deferred tax**

Deferred taxes are attached to assets or liabilities, in temporary differences or tax carry-over, in which case the tax expense for the period contains:
- The amount of taxes payable;
- Incidence of temporary differences carried over from previous years or the years ahead;
  - Adjustment of deferred tax balances, if applicable (application of either fixed or variable carry-forward), which appearing in the balance sheet generates a change of tax rates or creates new taxes.

The concept of **global calculation** uses temporary differences, regardless of the date on which the tax will be payable or recoverable. It allows a rigorous combination of tax expenditure with the accounting result of the period, ensuring better compliance with the principle of linking expenditures to revenues.

The concept of **partial calculation** takes into account only temporary differences that will generate payments or tax reductions in the near future. According to this view, temporary differences representing a recurring phenomenon, namely those which are renewed annually (e.g., tax deductible expenses which occur systematically in their accounting next year) as well as temporary differences with long-term dead-line are excluded.

Although the global calculation is preferred, IASB authorizes the partial calculation too. IASB accepts to exclude from the calculation of deferred taxes temporary differences that will exist at least three years, provided that nothing indicates that these differences are likely to be reabsorbed after this period. In addition, the rule requires that these temporary differences related to the current year and previous years are listed in the annex. The total deferred taxes at the closure of a year come from compensating temporary differences of assets and liabilities. The accounting treatment differs depending on the significance of the balance achieved. If getting a credit balance, i.e. tax payment is higher than the potential tax credit; a provision for future expenses is created. The amount for which the provision is made is calculated as follows [Morariu Ana et al., 2005]:

\[
S = (\text{active temporary differences} - \text{passive temporary differences}) \times \text{tax rate}
\]

In the case of a balance of asset (debtor), the situation is more delicate because tax savings will not be effective unless the company achieves sufficient profits during the next years. However, the rule does not specify whether the compensation for temporary differences of assets and liabilities must be done annually or if it is possible to compensate for differences before being reabsorbed during different periods.
3. Performance taxation of the company under IAS 12

IAS 12 “Income taxes” aims at prescribing the accounting treatment for income taxes, operates with the recognition of deferred tax liabilities resulting from tax loses or unused tax credits as well as operating with the disclosure of income tax. The Standard requires applying professional reasoning for determining the deferred tax according to the balance sheet method, according to which the carrying amount of assets and liabilities from the balance sheet is compared to their tax base. The method takes into account all the changes of the deferred tax between the opening and the closing balance year, they are not subject to deferred tax, with no carryover in future periods. It is the case of tax deductions and reintegration in the case of tax method, such as non Differences between tax base and carrying value may be:

- **Permanent differences** – being items reintegrated in the tax result which appear within the financial deductible expenses (protocol expenses, interest and penalties for unpaid budgetary obligations) or non-fiscal income.

- **Temporary differences** – are differences between the carrying amount to which the assets and liabilities from the balance sheet of a company are registered in the financial statements and the fiscal (taxation) base. These differences will result in taxable or deductible amounts when the carrying amount of the asset or liability is recovered, i.e. extinguished.

The tax base of an asset or liability is the value attributed to the respective asset or liability for fiscal purposes. Temporary differences are based on the premise that registering in the balance sheet a certain value of an asset or liability means that the company expects to recover the asset or dispose of such debt at the declared value.

The source of temporary differences may be both the differences from the accounting result and taxable income and differences resulting from the adjustment of balance sheet items, which appear while restating as well as during the application, and they can occur in the following situations:

- The carrying amount of an asset or liability represents income or expenses belonging or not to the current year;
- The tax base of an asset or liability represents deductible or taxable sums, belonging or not to the current year.
- The moment of accounting recognition differs from the moment of fiscal recognition.

IAS 12 "Income Taxes" distinguishes between two types of temporary differences in tax impact:

a) **Taxable temporary differences**, which will generate taxable sums in determining taxable income in future years, when the carrying amount of the asset (liability) will be recovered (settled). These differences may occur when:

- carrying amount of an asset> tax base or
- carrying amount of debt < tax base.

b) **Deductible temporary differences**, which will generate deductible sums in determining taxable income in future years, when the carrying amount of the asset (liability) will be recovered (settled). These differences may occur when:

- carrying amount of an asset< tax base or
- carrying amount of debt > tax base.

The term "deductible temporary differences" means that the entity will have to enrich the current outcome with sums that represent income tax recoverable in the future.
The Standard thus recognizes both the effect of taxable temporary differences, recorded as deferred tax debt (liability) and of the deductible temporary differences, in terms of recognition of deferred tax liabilities (asset) for the latter, provided that in future years sufficient taxable profits will be achieved in order to allow the recovery of deferred taxes.

Deferred tax liabilities are the amounts of income tax payable in future periods in what concerns taxable temporary differences.

Deferred tax assets, are the amounts of income taxes recoverable in future periods, given the existence of deductible temporary differences, carry forward of unused tax losses or credits.

The Standard divides income tax in two categories: the current tax and deferred tax.

Current tax is the amount of income taxes payable / recoverable in relation to taxable income / tax loss over a period.

Income taxes taken into account in determining and recording accounting net profit / net loss of a year should encompass both current tax and deferred tax.

Deferred tax method is characterized by the fact that income tax expense differs from the amount of taxes payable as a result of taking into account the temporary differences.

Switching from the accounting result to the fiscal result is presented in the following formula:

Fiscal result = Accounting result ± Permanent differences ± Temporary differences

Deferred tax assets and liabilities should be measured at the tax rates expected to apply to the period when the asset will be realized or the liability will be settled based on tax rates (and tax provisions) that were regulated or estimated to be regulated by the balance sheet date.

As forms of expression, temporary differences may include:

• Differences between accounting and taxable income results, which include:
  - Revenues recognized from an accounting perspective in years previous to the fiscal recognition, such as the result related to construction contracts which, in accounting, is recognized while the work is in progress, and fiscally at work completion. income from investments in associated companies are accounted for by the equity method, but fiscally the cost method is used (since dividends are recognized as they are received).
  - Revenues fiscally acknowledged in years previous to the accounting acknowledgement, such as revenues fiscally acknowledged in previous years such as the recognition accounting fees received in advance, which are taxed in the year of receipt, but are acknowledged in the profit and loss account in the years following.
  - Expenses acknowledged fiscally during years previous to the accounting acknowledgement. Examples in this regard are the recognition of the fiscally and linear digressive depreciation, from an accounting perspective; rent paid in advance are acknowledged in the year of fiscal payment, and from an accounting perspective, during the year corresponding with the rent.
  - The expenses acknowledged from an accounting point of view during years previous to fiscal recognition. Examples are provisions for deferred tax assets acknowledged from an accounting point of view during the year when their recovery becomes uncertain, but fiscally deductible during the year when the court has declared the customer’s bankruptcy. Fixed assets are amortized from the accounting point of view over a shorter period than the one when they are fiscally acknowledged.
Differences resulting from the adjustment of balance sheet items

This can include identifiable assets and liabilities, for a purchase of companies, which are assessed for tax purposes the historical book value, the revaluation of assets if there are no similar adjustments from the tax point of view, correct the inflation if from fiscal point of view there are no similar adjustments.

The question of accounting method adopted by a company: to take into account only the tax payable or to taken into account the effect of price differences. In all advanced accounting systems income tax accounting is assigned two objectives:

1. Acknowledging the company’s obligation towards the state during the current year.

Thus, accounting taxation appears obvious, taking into account the tax effects of temporary differences.

A second issue arising is that of acknowledging the tax effects of temporary differences based on a partial or global approach. Partial approach only requires recognition of temporary differences that will resolve in near future. Global approach requires recognition of all temporary differences, regardless of their date of re-absorption. Revisions to tax accounting rules, carried out in recent years in advanced accounting reference, supported the global approach.

Temporary differences can be:
- taxable: generate taxable amounts in determining taxable profits of future years, when carrying amount of the asset (liability) will be recovered.
- deductible, which will generate deductible amounts in determining taxable profits of future years, when carrying amount of the asset (liability) will be recovered (settled).

Example: a company paid in 2010 a sum of 5,000 MU, representing the financial interest related to a loan for financing a depreciable property during the linear years 2011-2015. The company included this interest in the cost of the intangible asset, but tax rules provide that such expenses are deductible in the year of their payment. We see therefore that the interest paid is a temporary difference for 2013 because it is an expense that will be displayed during the coming years, but that was deducted in full from fiscal year 2010 results.

This difference will be absorbed for one fifth of its value (1,000MU) during each year from 2011-2015.
- Interest: 5,000MU
- Intangible asset cost: 10,000MU
- Total acquisition cost: 15,000 MU

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The temporary difference arises between the asset’s accounting value in 2011 (15000-3000 = 12.000 MU) and the asset’s tax base in 2011 (15000-7000 = 8.000 MU).

The second category of temporary differences occur when the tax law creates a different basis for financial and tax reporting.

An example would be the donation of a depreciable asset by a partner, so its tax basis is zero, while its accounting value is given by the fair value.

Another example would be the revaluations, when an asset is revalued and you don’t have an equivalent adjustment for tax purposes. The gain from the increasing value of the asset is taxable only at the asset’s sell.

In many countries, accounting for deferred taxes is not required at the level of individual accounts, the results and financial position of a company may be very different, as the latent fiscal situation is or not taken into account.


1. The taxable amount of an asset

The taxable amount of an asset is the amount that could be deducted from taxable economic benefits when the net carrying amount of an asset is recovered, given that the economic benefits are not taxable, the tax base of an asset will be equal with its net accounting value and there will be no temporary differences.[Morariu Ana et al., 2005]

Example: The carrying amount of a machine is 1,000MU, duration of use five years. From an accounting perspective the equipment shall be amortized linearly and in terms of tax, the equipment is depreciated digressively (without the influence of obsolescence). Revenues from the operation or disposal of equipment will be taxable.

- Accounting depreciation = 1.000 x SLDR = 1.000 x 20% = 200 MU
- Fiscal depreciation = 1.000 x DDR = 1.000 x 30% = 300 MU
- Straight-line depreciation rate (SLDR) = 100% / 5 = 20%
- Digressive depreciation rate (DDR) = SLDR x 1.5 = 20% x 1.5 = 30%

Net accounting carrying amount = accounting carrying amount - accounting depreciation = 1,000 - 200 = 800 MU

The taxable amount is the amount that can be deducted from taxable economic benefit when the net carrying amount of an asset will be recoverable.

In the next four years, the company will gain from the operation of the equipment taxable profits of 800 MU. In the first year of functioning, 300 MU tax depreciation were deducted from economic benefits. Only 700 MU (1,000 - 300) will be deducted from taxable economic benefits of the next four years. There fore the asset tax base is 700 MU.

At the end of the first year of use:
- Net carrying amount of assets = 800 MU
- tax asset base = 700 MU

Net carrying amount of the asset is greater than the asset tax base which has resulted in a taxable temporary difference of 100 MU (800 MU - 700 MU) which leads at a deferred tax liability of 16 MU (16% x 100)

First year of use of property, the company has paid tax to 16 MU lower than would be normal in terms of accounting, because of the economic benefit in order to determine taxable income minus tax depreciation in the amount of 300 MU and not 200 MU representing the accounting depreciation.
This reduction of profit tax in the first year of functioning will be balanced over the next four years, when the company will make payments higher by 16 MU on income taxes because the tax consequences of the accounting net asset value recovery. That is why the company is creating, after the first year of using the equipment, a deferred tax liability amounting 16 MU.

Example: Dividend receivable at a subsidiary have a carrying value of CU100. Dividends are not taxable. Net carrying amount of debt receivable dividend is 100 MU (value of the claim is recorded in the balance sheet). The taxable amount of interest charged on debt is equal to its carrying value for the sum of 100 MU. To determine the taxable amount for interest receivable there are two arguments:

The first: The taxable amount of interest charged on debt is equal to its carrying value for 100 MU. There are two judgments to determine the taxable amount for interest receivable: “The tax base of an asset is the amount that will be deductible for tax purposes, the economic benefits that the company obtained in the future, when it recovers the carrying amount of the asset. If such economic benefits are not taxed, the tax base will be equal to its carrying amount.”

Dividends income is not taxable when determining the fiscal result therefore tax base the receivables related to income from dividends is equal to the carrying value of deferred tax assets related to income from dividends.

The second argument: Dividend income is not taxable; therefore the tax base of deferred tax assets is 0 MU, there is a taxable temporary difference between carrying amount of 100 um and the 0 tax base. Dividend income will not be taxable in the moment of registration, or later, upon receipt. It means that the tax rate applied to taxable temporary difference of 100 um is 0%, and therefore does not give rise to a deferred tax liability.

2. The tax base of a debt

The tax base of a liability is its carrying value, except any sum that will be deducted for tax purposes in future periods in respect to that debt.

Example: Current liabilities include accrued expenses at a carrying amount of 100 MU. Expenditure related will be deducted for tax purposes after cash accounting, expenditure had already been deducted for tax purposes. In accounting, at end of year N, in order to respect the matching principle, interest charges related to a business loan will be recorded, even if interest will be paid next year.

Case I: The carrying amount of interest debt (the value which appears in the balance sheet) is 100 MU. The tax base of the interest debt is 0 (interest expense is not deductible in the year N, but the following year when payment will be done). The following year, the interest debt will have a tax base equal to 100 MU. In year N the tax base of interest debt is zero, and represents its carrying value of 100 MU, but not the 100 MU deducted for tax purposes in future periods in respect of that debt.

The carrying amount of interest debts is higher than the tax base of the interest debt which leads to a deductible temporary difference of 100 MU which gives rise at a deferred tax asset of 16 MU (16% x 100). In year N, interest expense was not deductible, it was added to the accounting profit in order to determine taxable income and the company paid 16 MU more for the taxes. The following year, interest expense will be deductible in determining taxable profit, and the company will pay with 16 MU less than would be normal from an accounting point of view if this transaction wouldn’t have had fiscal consequences. That is why there is a deferred tax asset of 16 MU.

Case II: The carrying amount of interest debt is 100 MU. The tax base of interest debt is 100 MU. Interest expense in year N is deductible in calculating taxable income,
therefore the tax base of interest debt in N is 100 MU and in the following year would be 0 MU. This means that the tax base of interest debt of 100 MU is equal to its carrying amount of 100 MU, without the amount to be deducted for tax purposes in future periods in respect of that 0 MU debt.

The carrying amount of interest debt is equal to the tax base of interest debt, therefore there are no temporary differences.

**Example:** Current liabilities include fines and penalties with a carrying amount of 100 MU. Fines and penalties are not deductible for tax purposes.

*The carrying amount of the debt on fines and penalties is 100 MU (The value of the debt recorded in the balance sheet).*

The tax base for fines and penalties is 100 MU (is equal to its carrying amount of 100 MU without the amount less the amount to be deducted for tax purposes in respect of that liability in future periods of 0 MU).

*The carrying amount of fines and penalties debt is equal to the tax base for fines and penalties debt, therefore there are no temporary differences.*

**The acknowledgement of tax assets and liabilities payable**

The acknowledgement of tax assets and liabilities payable of the current and previous years should be accounted for as a liability, to the extent that it is not paid. If the amount already paid on behalf of the current year and previous years exceeds the amount due for those years, the excess must be recorded as an asset. Because a tax loss can be accounted for as belonging to previous years this advantage must be counted as an asset.

IASB states that the benefit obtained from the use of tax loss must be accounted for as an asset during the year in which tax loss occurs because the company’s benefit is likely and can be measured reliably, meeting the requirements of an asset.

**Acknowledging deferred tax assets and liabilities**

In all cases when there are taxable temporary differences deferred tax liability should be accounted for, unless:

- Goodwill for which depreciation is not deductible;
- Initial accounting of an asset or liability resulting from a transaction that is not a business combination and affects neither the accounting result, nor the one taxable at the transaction date.

Accounting for all deferred tax assets can be explained by the fact that the carrying amount of an asset is recovered as the future economic benefits for company, and if the carrying amount is greater than the tax base, then the size of the economic benefits will be greater than the deductible amount in terms of taxation, and the difference between the two is a taxable temporary difference.

In regard to goodwill, it is known that it is the excess of purchase price in relation to the fair value of net assets acquired. Many countries do not authorize Goodwill depreciation deduction, therefore it has a null tax base, which implies a taxable temporary difference.

If goodwill is the residual, and the accounting of deferred tax liabilities would increase its carrying amount, this would explain the refusal to account for a deferred tax liability. Initial accounting for an asset or liability can give rise to temporary difference, for example, where the cost of an asset is not fiscally deductible where the asset transaction is a business combination, any deferred tax asset or liability will be accounted for, which will change the size or bad will or goodwill. The same works for any other type of transaction if it affects the tax or accounting result. In cases where the transaction is not a business
combination and affects neither accounting nor on the tax result, IAS 12 does not authorize
the account for a debt or a deferred tax asset.

In all cases when there are deductible temporary differences a deferred tax asset
should be accounted for, as long as it is probable that tax benefit could be available, on
which these differences can be imputed, except:
- Bad will treated with deferred income in accordance with IAS 22 "clusters"
- initial accounting for an asset or liability resulting from a transaction that is not
a cluster and affects neither the accounting result, nor the result taxable at the transaction
date.

Accounting for all deferred tax assets is explained by the fact that the carrying
amount of debt will be deduced during future years through an outflow, which attracts a
debt accounting.

If this resource which outflows from the company is deductible during a year
following the one when the accounting has been made, then deferred tax asset is generated
on behalf of the income tax that will be recoverable during future years over the same
manner, if the carrying amount of an asset is lower than its tax base, the difference gives
rise to deferred tax asset that will be recoverable during future years, on behalf of income
taxes.

In regard to bad will, this rule does not allow accounting for deferred tax asset
derived from the temporary differences associated with it, which is treated as deferred
income in accordance with IAS 22 standard, because bad will is a rest, and accounting for
defered tax asset would increase its carrying amount.

Initial accounting for an asset or liability is the case of public a grant linked to a
tax-free asset, which is not allowed to be deducted from the tax base of the asset. The
carrying amount of the asset is lower than its tax base, which implies deductible temporary
difference, which is not allowed in accounting for deferred tax assets.

5. Conclusions

Once an appeal to the accounting of deferred taxes, balancing their previous years
is adjusted annually to take into account the tax rates or creating new taxes. For a company
that wishes to increase its results or net assets, it appears clearly that this method is
profitable in case of an increase of taxes. Companies will choose their financial strategy
depending on fiscal changes. Any change of method which is not required by the
regulation development may, therefore be interpreted as an attempt to manipulate the
results (creative accounting).

Income that will never be taxable do not generate temporary differences, however,
income that is not taxable during a certain year, but become taxable in later years, generate
taxable temporary differences.

Those expenses that will never be deductible do not generate temporary
differences but expenses not deductible in any given year, but which become deductible in
year after, generate deductible temporary differences. A company recognizes an asset (a
liability), to the value that is expected to be recovered in a future period. There are
situations when recovery (liquidation) of the carrying amount of an asset (liability)
involves future payments larger (smaller) than would be normal from an accounting
perspective as a result of compliance with the rules imposed by fiscality. The company will
have to acknowledge, with some exceptions, a deferred tax liability or asset whenever
recovery (liquidation) of the carrying amount of an asset (liability) determines tax
payments larger (smaller) than their value if such recovery (liquidation) would not have tax consequences. There are countries where fiscal authorities charge different tax rates depending on how an asset or liability will be recovered or settled.

**Upon completion of this scientific approach, we can say that the performance of the company in all its aspects is influenced by both accounting and taxation, and by the intensity of the relationship between these two components which are inextricably linked to the activity of the company.**

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