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INTERACTION BETWEEN ACCOUNTING AND TAXATION – TEMPORAL AND SPATIAL MILESTONES

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Abstract:

The purpose of this research was to build a theoretical, methodological and empirical evaluation of the interaction between accounting and taxation on both micro and macro economical level (at European level and particularly on the Romanian system). The accomplished research focuses on the complexity of the relationship between these two domains and synthesizes the direction and intensity of the interaction manifested over time.

By carrying out these objectives we aimed to provide new solutions for improving accounting and taxation policies, in order to raise the level of adaptability to new conditions, raising the predictability level of the effects generated by the two types of policies and solutions for reducing the volatility of the financial flows which have impact on the economy.

Key words: accounting, taxation, the relationship between accounting and taxation, connection vs. disconnection, accounting law, tax law

JEL classification: M41, H30

INTRODUCTION

The premise for assessing the interaction between accounting and taxation is to understand all aspects of these domains, as well as the behavior of accounting and fiscal actors and the national specifics (respectively at EU level).

A synthesis of the major contributions in the research area regarding the link between accounting and taxation, and the opinions of specialist practitioners have allowed us to divide the research on two directions:

a) *temporal*, to reflect the direction and intensity variation of the interrelations between accounting and taxation; if in the past the dependencies were obvious and recognized, at present, there are three types of relations (Marchese, 2009): independence or slight dependency, the dependency of fiscality on accounting and the dependency of accounting on fiscality;

b) *spatial*, to reflect the link between accounting and taxation in various countries in the EU; countries that are EU members have been situated in different patterns:

- In Denmark and Holland the independency relation (the slight dependency) between accounting and taxation is pointed out; this is caused by the fact that the commercial accounting is separated from taxation; determining the tax base is done without being tied to financial results; the tax system is worked out regarding a number of rules. The slight dependency stems from the need to reconcile the results of trade and tax accounting;
- Austria, Belgium, France, Germany, Italy, Spain, Great Britain are part of the category in which taxation depends on accounting, because the tax system is worked out according to the financial result; there are positive and negative adjustments made to the financial result and they depend on a set of rules. This inverted dependency implies the constant preoccupation with risk reduction regarding "fiscal pollution" on the financial statements (Raileanu, 2009).
- Greece is the best example regarding the dependency of accounting on taxation.

Thus, on the issue of the relation between taxation and accounting, we can say that regarding the European Countries, we can speak of "diversity in unity".

1. THE INTERACTION BETWEEN ACCOUNTING AND TAXATION IN ROMANIA

There are regulations disparate on both domains (accounting and taxation). The International Financial Reporting Standards and the International Audit Standards aren't doubled by common fiscal standards because a fiscal consolidation on groups of countries in the EU doesn't exist (only a few partial models in Austria, Denmark and Italy). This created an incompatibility between IFRS and fiscal principles (that are not homogeneous on EU level). Recent preoccupation (Raileanu, 2009) tried to reconciliation between the IFRS and taxation in order to find solutions to the following aspects:

- *orientation:* getting close to investors vs. fiscal conformity;
- *result valuation:* real value vs. accounting value;
- *prevalence:* substance vs. shape

Two solutions were identified. The first one suggests determining a taxable income in accordance with IFRS (net profit would be determined in conformity with the financial statements for accounting purposes and adjusted according taxation rules).This solution created a few problems regarding: difficulty in administration (because of the adjustments); the risk of "fiscal pollution" on financial statements in conformity with IFRS; the necessity of a continuous and immediate actualization of adjustment rules because of IFRS modifications. The second solution proposes the full independence of the tax base from financial statements in accordance with IFRS. It proposes: calculating the gross difference between equity (in accordance with IFRS) and fiscal equity (based on the fiscal balance sheet); the deduction of postponed tax provisioning from these differences (net difference); balancing the income tax with the distributed sum (the distributed income will be taxed). This second solution is also conditioned by a (stable) set of rules about taxable base calculation and a separate set of recordings for assets and liabilities.

Specialists in the field (Ristea, 2009) said that the reconciliation of relationships between accounting and taxation in relation to IFRS is difficult because there is no a common fiscal standard and no a fiscal consolidation for groups at EU level.

Regarding the five facets of relationships between accounting and taxation (disconnection, identity, accounting leads, taxation leads, taxation dominates), identified by Lamb, Nobes and Roberts (1998), judging through national rules, Romania was integrated in the „taxation dominates" category because, before IFRS becoming mandatory for some entities, the researchers' general opinion was that fiscality rules have had higher priority than accounting principles. The most important argument for this, is that the state is the biggest user of financial information, although the accounting offers information to other users, such as: investors, banks, clients and providers.

Analyzing the perceptual evolution of the relationship between accounting and taxation after 1990, Istrate C. (2011) has shown that a big part of Romanian entities base their choices mainly on the terms of taxation, in order to make their life easier and cheaper (in order to do less paperwork and bookkeeping).

From an organizational point of view, accounting is considered a component of fiscal management, offering information that assures efficient, correct and secure taxation function. Accounting, on its own terms, takes different shapes (financial, bookkeeping, operational and fiscal). Because of the differences that exist between accounting and taxation rules and principles, we can say that between financial and fiscal accounting there exists a disconnection.

Regarding all of the above, we agree with our predecessors' opinion and state that in Romania, the interaction between accounting and taxation remains tense.

To surmount this problem, an intervention is necessary, at regulators level, in the domain of fiscal legislation, with the purpose of adapting to the basic needs of the entities; the most tense area is the taxation of income for which is necessary a much clearer delineation of incomes measurement methodology and methodology of identifying the moment of their recognition.

Under the regulatory aspect, because in Romania accounting and fiscal rules are created by the Public Finance Ministry, we can appreciate that the interdependence between accounting and taxation is very tight, inducing in the interaction between the two, a dominant position for taxation over accounting.

Even though the regulations of the two domains (tax law and accounting law) have different final purposes (determine the rules of taxable income calculation and the rules that allow adaptability to accounting functions), the accounting and taxation meet up in the same reality, that of the entity that creates wealth and that of participant at its distribution.

Synchronization between accounting and taxation, on the basis of the development of economical-financial reports and commercial trade growth, requires a standard methodology that must eliminate accounting representation errors, in which equity of financial-accounting relationships need to prevail.

This fact is imposed even more because is an obvious desire in EU funds absorption growth, that generates the obligation of respect the rules of the Fiscal Governance Treaty, adopted in the EU. Without having the claim of a perfect prevision, we can estimate that accounting and fiscal evolution is conditioned primarily by economic and political variables.

In this one-to-one relationship, the influences of accounting over taxation are explained through the fact that, in order to measure taxable matter, the taxation authorities had to find the rules of valuation, of delimitation in time, of amortization etc. The creation of new rules would have proven superfluous, because accounting already had consecrated procedures.

Furthermore, in Romania, accounting is subject to law framework (Law no. 82/1991, published) and to accounting regulations (Order no. 1802/2014 of the Minister of Public Finance) regarding individual annual financial statements and consolidated annual financial statements, the new regulatory being imposed by adequacy the European regulatory frame, through adoption new directives (Directive 2013/34/UE, that applies to entities that cannot make transactions on a regulated market) and repeal others (Directive IV 78/660/CEE and Directive VII 83/349/CEE).

All these regulations describe the limits of conformity in accounting, stating: the format and contents of annual financial statements, accounting principles and knowledge, valuation, removal from bookkeeping and presentation of elements in the individual annual financial statements, general account plan as well as content and function of accounts.

The final purpose of adaptation in regulations plan is that of assuring a good representation of the results, considering the quality traits of accounting information, such as: intelligibility, relevance, credibility, neutrality and comparability.

To help the taxpayer, the legal frame offers him some liberties to how the real situation is described (explanatory notes of financial statements); the contributor can also choose: the cost model in valuing non-current assets and the model of revaluation; stocks valuation methods at bookkeeping exit point; valuation methods for assets that come from own production (production cost and full cost); interest appreciation (capitalization or recognizing it as expense); evaluation and acknowledgement of provisions; estimation of bad debts; the tax treatment of the revaluation reserve; recognition events after the balance sheet; amortization period etc.

Fiscal regulations reflect for contributors the imperative obligation to conform at the fiscal norm; fiscal authorities are empowered to monitor compliance with tax laws and ensure full and timely collection of source revenues owed to the State.

Recent organization adaptations of the fiscal system (involving the creation of structures anti-fraud) is no longer limited to monitoring tax compliance, participating actively in tracking, identifying and punishing tax evasion, taking precautionary measures and recovering damages, as well as the forming a conscience civic tax, with direct effects on voluntary compliance.

Beyond the lawmakers intention to facilitate fiscal conformation, in Romania can still notice a tendency to exacerbation of limits of compliance and freedom of action on the part of taxpayers. Causes are (Robu, 2014): low knowledge (generated by the high volume of fiscal reglementation, frequent law modifications, the existence of numerous laws that are interpretable and can generate abuse and corruption) and dishonesty (corruption and tax evasion).

2. EUROPEAN CONCERNS REGARDING THE INTERACTION BETWEEN ACCOUNTING AND TAXATION

To accelerate decision making regarding harmonization of corporation tax bases, since 2001, the European Committee took the initiative to consult countries that are members regarding the subject of corporations' taxation. Due to the independence of national fiscal policy, the corporations' taxation rate remained the decision of Member States. In exchange in order to avoid different treatment at a European level, the Committee has taken responsibility in creating a unique methodology for determining the tax base and allocating it on fiscal residences of the states in which Trans-European entities does business. As a result, four alternatives were proposed: a) mutual acknowledgement principle; b) common tax base; c) introducing a federal European tax; d) creating a unitary and mandatory corporate tax base determining system that must replace current national systems.

Romanian specialists (Tomi, 2011) appreciates that, from the Romanian realities perspective and from national fiscal interests, Romania has opted for the principle of common consolidated basis (according to which, each entity that belongs to a trans-European company can determine its own tax base and profit taxable using same accounting rules, even though it operates in different countries. The basis thus determined is aggregated to the parent company and shall be allocated to each tax jurisdiction according to the entity's operations in that jurisdiction; each State will apply own tax rate to the basis which rebounded to the entity from its jurisdiction.

The arguments that fundament this option were: a) the taxation criteria refers to the place in which the incomes are made, that which stimulates the creation and production activity detrimental “fiscal engineers”; b) it generates low adaptation costs; c) it avoids double tax; d) the tax rate of profit (income) remains the only fiscal competition element; e) the states are interested in consolidating own tax bases through the creation of public goods that can stimulate the attraction and can maintain more efficient economic activities; f) it stimulates fusion and trans-European concentration, that become advantageous for medium and small enterprises, offering more opportunities, which is convenient for a country that is still developing, such as Romania.

We uphold the idea which states that adopting IAS/IFRS standards for EU companies was a necessary step towards financial market integration at an international level (Hlaciuc et al., 2010). European Directives (4 and 7) have contributed to the harmonization of basic accounting information regarding joint stock companies thus creating a general improvement to the quality of the European accounting regulations and helping the activity of international companies.

The official adoption of IAS, in the name of CE, has been accompanied by an official acknowledgement from other influential international organizations, like International Organization of Securities Commissions (IOSCO). On the 2nd of September 2002, IASB (International Accounting Standards Board) and FASB (Financial Accounting Standards Board) signed a treaty through which they agreed to promote convergence of accounting standards referred. The result obtained at the end of 2007 was also important, through IASB and FASB cooperation – which means the give up the obligation of reconciliation between the annual accounts elaborated by European entities based on IAS/IFRS, with those of the US GAAP system. With this occasion, SEC (Securities and Exchange Commission) underlined that this issue must not be viewed as the end of cooperation between IASB and FASB, but as an important step towards creating a unique set of standards, applied at a global scale; the convergence process between IAS/IFRS and US GAAP continues.

3. OWN REFLECTIONS ABOUT THE INTERACTION BETWEEN TAXATION AND ACCOUNTING

Researching the nature of the interrelations between accounting and taxation has allowed us to identify a complexity of situations that we will tackle as follows.

1. The comparative analysis of domain researches results allowed us to consider that debates have been focused on the reconciliation between accounting and taxation, more exact on finding solutions that allow:

- getting close to investors (in terms of tax and accounting) simultaneously with tax compliance
- approximation of real value to accounting value;
- creating a generally applicable principle through which business / transactions can be treated from the point of view of economic substance, and from the point of view of legal

2. From the organizational point of view, accounting is considered a component of fiscal management, providing information to ensure the effective, safe and correct taxation. At a micro-economic level, the influence that taxation has over accounting is shown through: amortization, provisions, value loss, fixed asset revaluation, stocks valuation (entry and exit level), expense treatment (donations, sponsorships, protocol, interest, research and development, pensions), policy changes and correcting the accounting errors.

3. The most relevant approaches for the relation between taxation and accounting are: regulatory approach and practical approach (small and medium entities follow fiscal rules rather than accounting rules; on the other side, there are big entities in which accounting rules are the most important). To allow the correct entity image to be created (through annual financial statements), accounting must be conducted on its own principles, without being influenced by exceptional value adjustments due to taxation. To achieve this goal, the accounting must be disconnected from taxation in the sense that the fiscal acknowledgement of size of certain expense should not be conditioned by their reflection in accounting; disconnection is formally accepted (at normative level).

4. In Romania, the relationship between accounting and taxation can be defined as tight (from a normative point of view), but tense (from a practical point of view). Solving this problem belongs to the tax regulatory authorities in order to adapt to the specific needs of Romanian companies; the tense area is taxation, which we appreciate that it requires a much clearer delineation of incomes measurement methodology and methodology of identifying the moment of their recognition.

In the European context, Romania has adopted the principle of common consolidated basis (according to which, each entity that belongs to a trans-European company can determine its own tax base and profit taxable using same accounting rules, even though it operates in different countries. The arguments for this decision were: a) the taxation criteria refers to the place in which the incomes are made, stimulating productive activities; b) it generates low adaptation costs; c) it avoids double tax; d) the tax rate of profit (income) remains the only fiscal competition element; e) the state is interested to consolidate own tax basis, by making investments in public goods of national importance, which lead to the development of more efficient business; f) it stimulates fusion and trans-European concentration, that become advantageous for medium and small enterprises.

5. The direction of accounting and taxation evolution is conditioned, firstly, by economic and political variables. They are few chances to be immediate progress on the convergence of tax and accounting, especially considering that globalization facilitates the exploitation of existing discrepancies and gaps both in terms of capital interests and the economic and social interests of the states.

6. EU level preoccupations (in the context of assuring the four liberties – free movement of goods; free movement of people/workers; free movement of services; free movement of capital) sustain the reconciliation between accounting and taxation.

7. The new trend of creative accounting that permits the beautification of the entities image, through annual financial statements, respectively sizing expenses and revenues with the objective of minimizing the fiscal obligation further creates tension between accounting and taxation.

8. Taxation must not intervene from an accounting point of view; any conflict between the accounting policy adopted by the entity and taxation must be solution outside of bookkeeping.

CONCLUSIONS

Summarizing the profile debates and passing the research findings through own reasoning we consider that the interaction between accounting and taxation must be interpreted on three levels:

– *normative (regulatory)*, context in which emerges a prevalence of disconnection; only under conditions of adequate regulation, the accounting and taxation converge towards a common goal;

– *practice*, context in which emerges a dichotomous situation (the accounting and taxation manifesting each hegemonic valence;

– *opinions of specialists*, context in which there is a lack of consensus;

To positively develop the interaction between accounting and taxation, we consider that the following measures should be taken:

– *from a fiscal point of view*, is appropriate to establish rules / clear principles (compatible with accounting principles), simplify the legal and consistency in the procedures of tax administration, reducing tax obligations and changing attitude of the tax authorities (which should become more cooperative, transparent and to respond promptly to requests taxpayers);

– *from an accounting point of view*, is necessary that harmonization through correlation, making compatible and standardization to continue, regarding the accounting components, to reduce differences between accounting practices that are applied at a global level, thus making compatibility and comparability pertinent;

– *from a common point of view (fiscal and accounting)*, it requires further concerns for improving the dichotomy between; a) closeness to the investor, respectively, tax compliance; b) fair value or book value; c) substance, respectively, form.

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