

The Relation between Accounting Result and Tax Result in the Case of the Profit Tax

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Abstract

Accounting and taxation are two connected domains in Romania. The proof that these are connected is the computation of the profit tax, for which the tax result is computed based on the accounting result. The scope of the paper is to present what is the relation between accounting result and tax result. There is a direct relation but also an indirect relation between the two results, taking into consideration the way of computing the tax result, but also the professional judgment, when the revenues and the expenses are recorded in the accounting register. The paper also analyzes which one of the two results influences the other result.

Key words: accounting result, tax result, relation, influence

J.E.L. Classification: H20, M41

1. Introduction

In Romania, accounting and taxation are two interdependent domains. At the beginning of the years '90, after the fall of the communism, Romania adopted the accounting systems with French influences because it was the most appropriate by the Romanian culture at that moment. The French system is characterized by the connection between accounting and taxation. Starting with the year 2000, Romania begun the process of harmonization with European Directives and International Accounting Standards and then adopted the International Accounting Standards for a part of its entities. These are influenced by the Anglo-Saxon system which is characterized by the disconnection between accounting and taxation. Even if it is trying the disconnection between the two domains, in Romania accounting and taxation are still connected.

As a proof that accounting and taxation are connected is the computation of the profit tax, because the tax result is computed based on the accounting result.

The aim of this paper is to present what is the relation between accounting result and tax result, which one of the two is influenced by the other and in what way is influenced.

The taxation regulations depend on the accounting regulations. The taxes are found by applying some rules over the accounting data. (Băcanu, 2015, p. 658)

It can be observed that there exists at least a provision in the fiscal legislation that relates to the accounting regulation. So, the fiscal result is determined taking into consideration the revenues and expenses recorded in accounting registers. Thus, the difference between the revenues and the expenses recorded in accounting registers is named the accounting result. The fiscal result is dependent on the accounting result. (Băcanu, 2016, p. 454)

The relationship between accounting and taxation is an evolving one and more complex than might at first appears. In general there are sound reasons for accounting principles to form the basis for calculating tax liability and there is evidence that in the UK there is a trend towards even greater reliance on commercial accounts for the purposes of taxation. (James, 2009, p. 20)

Without disconnection, companies could choose their taxable income. Differences between a company's tax base and its financial reporting lead to the accounting topic of deferred tax. (Nobes and Parker, 2008, p. 514)

The existence of a substantial "permanent" profit difference can create a significant variation in the customary relationship between income tax expense and pretax accounting income. (Comiskey and Hasselback, 1973, p. 60)

2. The accounting result and the tax result in Romania

According to the Order 1802/2014 approving accounting regulations on the annual individual financial statements and consolidated annual financial statements, in accounting, the profit or the loss is cumulatively determined from the beginning of the financial year. The result of the financial year is determined as the difference between the revenues and the expenses of the year. The final result of the financial year is established at the end of the financial year and represents the final balance of the profit and loss account.

Thus, the result of the financial year is influenced by the two elements: revenues and expenses. If the revenues are higher than the expenses the result is a profit and if the expenses are higher than the revenues the result is a loss.

According to the Law no. 227/2015 regarding the Fiscal Code, the tax result is computed as the difference between the incomes and expenses recorded according to the applicable accounting regulations, minus non-taxable income and tax deductions, plus non-deductible expenses. In determining the tax result, other elements similar to incomes and expenses are also taken into consideration, according to the methodological norms, as well as the fiscal losses that are recovered of taxable profits earned over the next seven consecutive years. The positive tax result is named taxable profit, and the negative tax result is named tax loss.

As opposed to the accounting result, the tax result is influenced by more elements: accounting result, non-taxable incomes, non-deductible expenses and other elements similar to incomes and expenses.

For determining the relation between the accounting result and the tax result we must take into consideration the direct relation but also the indirect relation.

The direct relation is linked by the mathematical calculation, where we can observe the evolution of the tax result taking into consideration the evolution of each element involved in calculation.

The indirect relation is linked by the professional judgment of the professionals, who are important elements in the determination of the accounting results and the tax result.

3. The direct relation between accounting result and the tax result

The direct relation between accounting result and the tax result can be analyzed from the mathematical calculation: $\text{accounting result} + \text{non-deductible expenses} - \text{non-taxable incomes} + \text{other elements similar to incomes} - \text{other elements similar to expenses} = \text{tax result}$

To determine how each element from the formula influences the tax result we will analyze the evolution of the tax result depending on the evolution of each element, taking into consideration that the other elements remain constant.

To simplify the analysis it will be considered that other elements similar to incomes will evolve the same as the total revenues, and the other elements similar to expenses will evolve the same as the total expenses. So in this paper we will analyze the accounting result, the non-deductible expenses and the non-taxable revenues.

As it can be observed from the accounting legislation, the accounting result is determined as the difference between the total revenues and the total expenses.

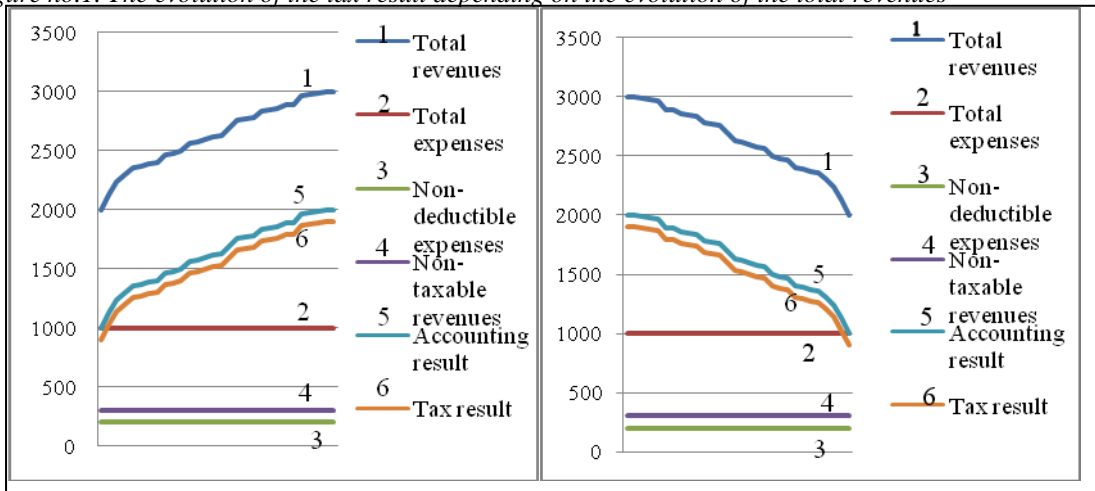
First, it will be analyzed how the evolution of the total revenues influences the tax result and then how the evolution of the total expenses influences the tax result, determining in this way the relation between the accounting result and the tax result.

The analysis is made on mathematical data, to point out the way in which the tax result evolves.

If the total revenues increase in a determined period of time and the other elements remain constant, the accounting result will increase and the tax result will also increase. If the total revenues decrease in a determined period of time and the other elements remain constant, the accounting result will decrease and the tax result will also decrease. So, the total revenues and the

accounting result are directly proportional, as it can be seen from the figure no. 1. The total revenues and the tax result are directly proportional. The accounting result and the tax result are also directly proportional.

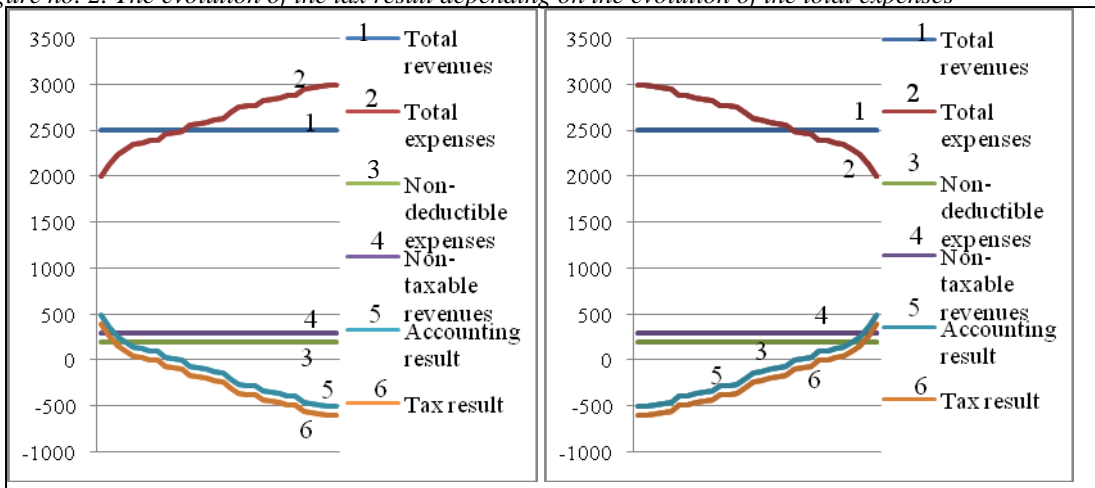
Figure no.1. The evolution of the tax result depending on the evolution of the total revenues



Source: Chart elaborated by the author

If the total expenses increase in a determined period of time and the other elements remain constant, as it can be seen from the figure no. 2, the accounting result will decrease and the tax result will also decrease. If the total expenses decrease in a determined period of time and the other elements remain constant, as it can be seen from the figure no. 2, the accounting result will increase and the tax result will also increase. So, the total expenses and the accounting result are inversely proportional, the total expenses and the tax result are inversely proportional, but the accounting result and the tax result are directly proportional.

Figure no. 2. The evolution of the tax result depending on the evolution of the total expenses



Source: Chart elaborated by the author

Thus, the evolution of the profit tax is directly influenced by the evolution of the accounting result, if all other elements remain constant.

Second, it will be analyzed how the evolution of the non-taxable incomes influences the tax result and then how the evolution of the non-deductible expenses influences the tax result.

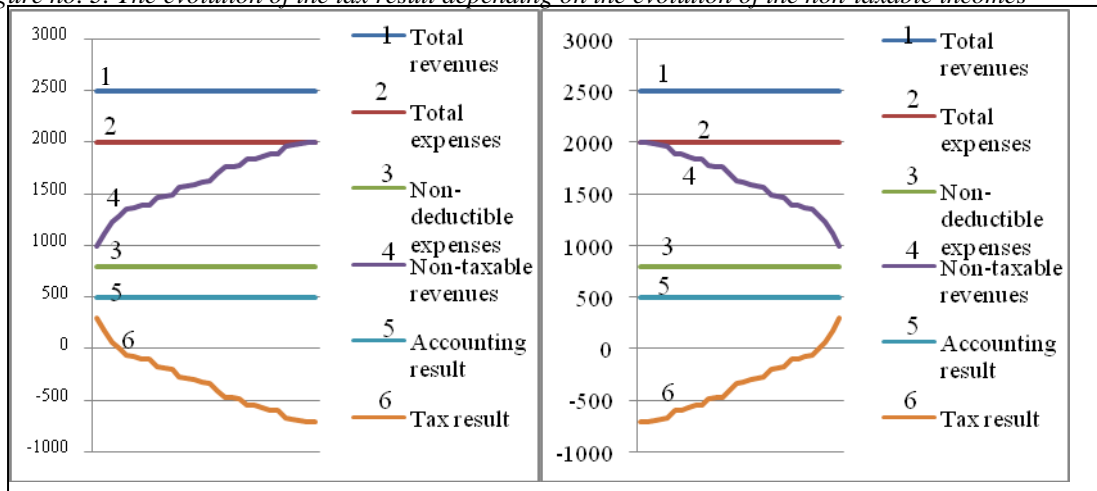
Non-taxable incomes and non-deductible expenses are fiscal elements that modify the accounting result in order to obtain the tax result.

A company obtains revenues from the activity it performs and for obtaining these revenues it performs various expenses. From the total of revenues, some of them might be non-taxable incomes according to the Law no. 227/2015 regarding the Fiscal Code, and from the total of expenses some of them might be non-deductible expenses according to the same Law.

Thus, the non-taxable incomes cannot be higher than the total revenues, and the non-deductible expenses cannot be higher than the total expenses.

If the non-taxable incomes increase in a determined period of time and the other elements remain constant, the tax result will decrease. If the non-taxable incomes decrease in a determined period of time and the other elements remain constant, the tax result will increase. As the non-taxable incomes are fiscal elements, they will not influence the accounting result. So, the accounting result will remain constant. The non-taxable incomes and the tax result are inversely proportional.

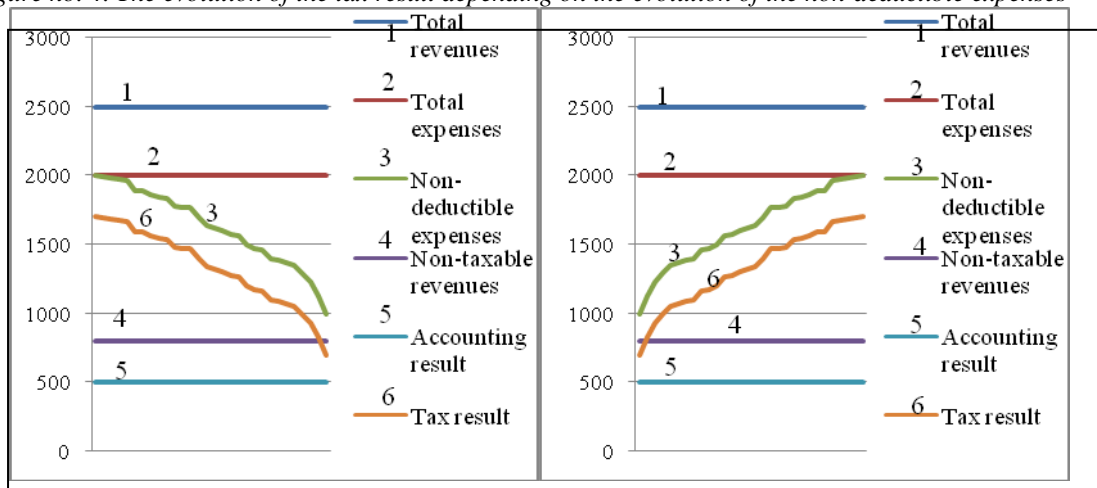
Figure no. 3. The evolution of the tax result depending on the evolution of the non-taxable incomes



Source: Chart elaborated by the author

If the non-deductible expenses increase in a determined period of time and the other elements remain constant, the tax result will also increase. If the non-deductible expenses decrease in a determined period of time and the other elements remain constant, the tax result will also decrease. As in the case of the non-taxable incomes, the non-deductible expenses are fiscal elements and they will not influence the accounting result, so it will remain constant in this case also. It is analyzed only the relation between the fiscal elements and the tax result. So, the non-deductible expenses and the tax result are directly proportional.

Figure no. 4. The evolution of the tax result depending on the evolution of the non-deductible expenses

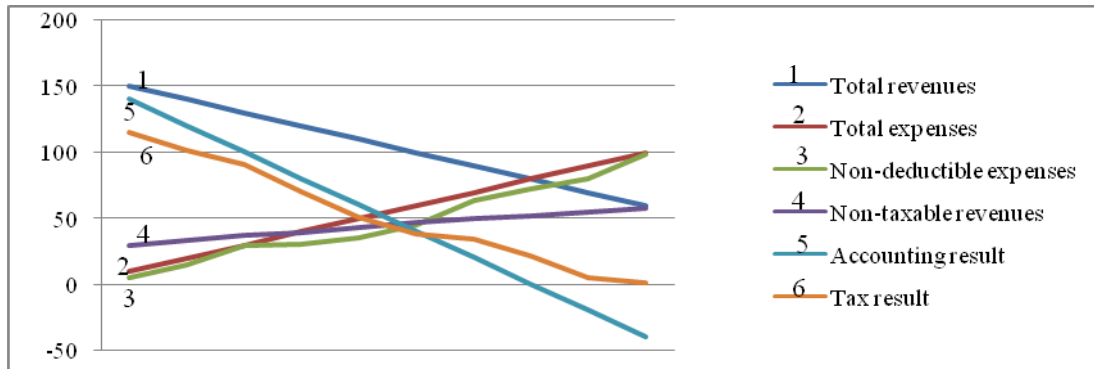


Source: Chart elaborated by the author

Further, we will analyze if these relations will remain the same if the accounting result will not remain constant and which will be the relation between the accounting result and the tax result.

From the figure no. 5, we can observe that if the total revenues decrease and the total expenses increase, the accounting result decreases. The non-deductible expenses and the non-taxable revenues are increasing, but they cannot be higher than the total revenues and the total expenses, so they will increase in the limits of the total revenues and the total expenses. We can observe that the tax result will decrease, being directly proportional with the accounting result. Thus, from all the elements the accounting result influences the most the tax result.

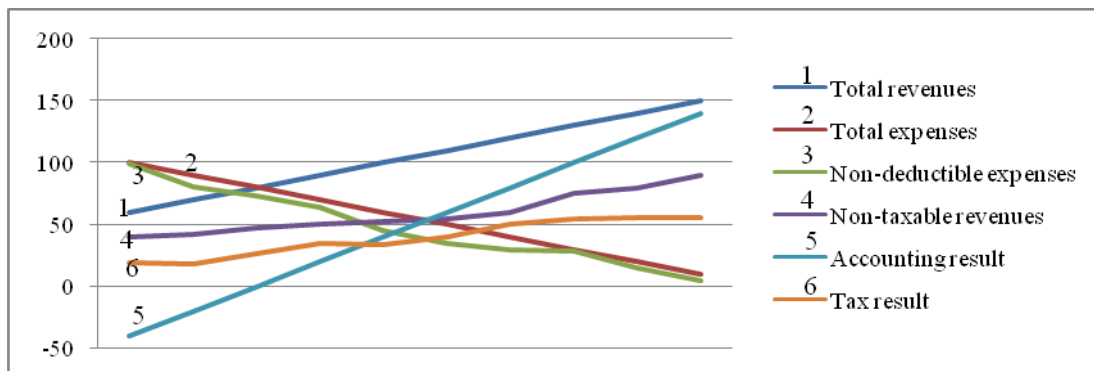
Figure no. 5. The evolution of the tax result when the accounting result decreases and all elements vary



Source: Chart elaborated by the author

On the other hand, if the total revenues increase and the total expenses decrease, the accounting result will increase. If the non-deductible expenses decrease and the non-taxable revenues increase also in the limits imposed by the total revenues and the total expenses, the tax result will increase. In this way there exists a directly proportional relation between it and the accounting result.

Figure no. 6. The evolution of the tax result when the accounting result increases and all elements vary



Source: Chart elaborated by the author

As we could observe from the above analysis, the relation between the non-deductible expenses and the tax result and the non-taxable revenues and the tax result in the case where the accounting result was constant does not remain the same when the accounting result varies. The tax result remains directly proportional with the accounting result even if the fiscal elements vary. Thus the accounting result highly influences the tax result.

4. The indirect relation between accounting result and the tax result

This high influence of the accounting result in the mathematical calculation of the tax result can be viewed as a double influence. First, the obviously direct relation between accounting result and tax result analyzed in the previous chapter. Second the indirect relation between tax result and the accounting result, because, the highly influence of the last one, can be a bad influence for the

accounting result because it can be distorted by the companies to obtain a smaller tax result. Thus the tax result indirectly influences the accounting result.

Also, the professional judgment of the professionals can be affected by the connection of the two domains, and they can apply the accounting legislation and adopt the accounting policies taking into consideration the best choice from the fiscal point of view.

This will influence the annual financial statements, implicit the profit and loss account and also the accounting result.

The professionals must apply the accounting legislation without being influenced in their judgment by the fiscal legislation, because they must present a true and fair view of a company for the users of the annual financial statements.

5. Conclusions

Accounting and taxation are still connected in Romania, because the tax result is computed based on the accounting result.

Analyzing the relation between them we can see that the tax result is directly proportional with the accounting result.

Even if the non-deductible expenses and the non-taxable expenses vary, the directly proportional relation between the accounting result and the tax result still remains. This means that the accounting result has a high influence on the tax result.

This high influence of the accounting result means an indirect influence of the tax result on the accounting result this is way the accounting professionals should apply the professional judgment in a manner that is not influenced by the fiscal legislation.

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