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# Accounting and Taxation of the Performance of Entities Under Ias 12 'Corporate Income Tax' - Application Particularities

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**Abstract:** Calculating and accounting only for current tax is not sufficient if, due to accounting policies or legal provisions, the tax value of assets and liabilities is different from their book value. Profits or losses are shown in the profit and loss account, while some gains or losses (other than those shown in the profit and loss account) are shown in reserves or retained earnings. To the extent that the taxation of certain profits or the deduction of certain tax losses is deferred to future periods, as well as in situations where some amounts shown in the reserve accounts or retained earnings are to be taxed in the future as a result of provisions in tax legislation, a deferred income tax liability must be recognized in the accounts. The transition to IFRS has led to the recognition of deferred taxes, receivable or payable, depending on the situation of each entity, in the profit and loss account, the retained earnings account or the reserve accounts.

**Keywords**: income tax; IAS 12; IFRS; deferred income tax; taxable temporary differences; performance; European directives

**JEL Classification**: M41

## 1. Introduction

The accounting-taxation relationship is a widely debated and analyzed topic in business and economic circles, both globally and at European and national level. Given that the Romanian economy is in full development process, investors will be particularly interested in taxation, but also in accounting, as the two areas are in an interconnected relationship.

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One of the criticisms levelled at the Romanian economy after 1990 was that the Romanian accounting system, which was undergoing a process of change, was oriented towards serving state institutions to collect taxes and duties and less to highlight the financial position and performance of economic entities. Over time, there have been important developments in the accounting and tax systems in Romania, so in the process of researching the relationship between the two systems we have benefited from a rich theoretical background consisting of literature, documentary studies, works of authors and legislation. At the same time, the major change that occurred with the transition to IFRS application by certain categories of entities facilitated access to a documentation base represented by IFRS published in Romanian, application guides and annual financial statements prepared with the application ofthese standards.

Concerns about the accounting-taxation relationship are increasingly evident at the global and European level, with the IASB and FASB working together to harmonize accounting concepts and standards, with the aim of applying similar rules for measuring income and expenses, and therefore also the profit reported by entities.

As far as the taxation of profits is concerned, one of the current concerns of states is to tax profits where they are made. The global interest in accounting and taxation is also present at EU level, with accounting directives and, more recently, a directive on corporate taxation.

From a theoretical point of view, the study aimed to highlight the extent to which taxation and accounting have influenced each other in certain periods. From the point of view of accounting and tax practices, the analysis of the annual financial statements prepared by entities has highlighted how the financial position and performance of an entity presented in the financial statements are influenced by the applicable accounting rules, i.e., the rules compliant with the European Directives or the accounting regulations compliant with IFRS. In this respect, particular attention has been paid to the presentation made by entities of current and deferred income tax, where applicable. With regard to the influence of taxation on accounting, only those aspects relating to the influence of financial accounting are covered. Starting from the national reality, the study on the analysis of the accounting- taxation relationship should be approached from two perspectives:

a normative perspective, which aims to analyze the relationship in which tax rules influence accounting rules by relating accounting treatments to tax treatments.

a practical perspective that addresses the behavior of accounting practitioners in relation to tax practices. This study has addressed the relationship between accounting and taxation by highlighting and understanding the different economic, legal and financial contexts that have existed over time and identifying the extent to which accounting, and taxation have been influenced by these factors.

## 2. Literature Review

Accounting and taxation of entities are areas of major interest at both global and EU level, with the effort of the bodies involved being embodied in accounting standards or European directives issued in the field of accounting or taxation.

Since 1989, there have been spectacular developments in the field of accounting, which in turn have led to changes and additions to tax legislation and the emergence of new professions with responsibilities in the preparation and auditing of accounting information or tax consultancy. The transition to accounting in accordance with European directives and subsequently to the application of IFRS-compliant rules has led to significant changes and additions to tax legislation. Although there has been a disconnection of the tax treatment from the accounting treatment of certain transactions, the accounting of entities has remained the starting point for determining certain taxes and duties. This disconnection process is more evident in the case of IFRS compliant entities, but also in the case of multinational entities adopting the business models of their parent entities in other countries. On the tax side, the measures set out in Directive 2016/1164/EU are topical.

Due to the interest of information users in tax issues, accounting is often perceived as subordinate to taxation. It is true that the two overlap, but it should be noted that modern accounting should be disconnected and independent from taxation and should take account of accepted accounting principles. In order to meet the needs of information users, accounting science has undergone a vast process of development of methods and techniques, both in terms of accounting for economic transactions and the way they are presented. As a result of joint efforts, various European Union Directives have been adopted over the last three decades to regulate accounting and financial reporting issues at European level.

The 4th Directive[1] was adopted in 1989 and included provisions on accounting principles, valuation rules and the format of annual financial statements published by entities. Directive VII[2] was adopted in 1983 and included information on the reporting principles and rules for groups of entities. Recently, these two directives have been replaced by Directive 34/2013[3].· This directive introduces an innovative

[1] Fourth Directive of the European Economic Communities 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, published in the Official Journal of the European Union No L 222 of 14 August 1978.

[2] Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, published in the Official Journal of the European Union No L 193 of 18 July 1983.

[3] Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council

approach to the information to be disclosed by entities in their annual financial statements, i.e., linking the complexity of reporting to the size of the economic and financial indicators. The Directive includes rules for the measurement of items in annual financial statements and the format of financial statements for micro-entities, small, medium-sized and large entities, as well as provisions on the preparation of consolidated financial statements. In the last decade, there has been a growing interest of users in non-financial information such as: environmental information, fighting corruption and bribery, fighting food waste. Directive 95/2014[1] was developed to meet this need for information.

For the information in the annual financial statements to be credible, it must, in some cases, be "confirmed" by independent persons, i.e., auditors. Statutory audit of annual/consolidated accounts is regulated at EU level by Directive 43/2006[2] and Regulation 537/2014/EU[3] .

Internationally there are two poles of accounting regulation, namely:

Fourth Directive of the European Economic Communities 78/660/EEC of 25 July 1978 on the annual accounts of certain types of companies, published in the Official Journal of the European Union No L 222 of 14 August 1978, as subsequently amended and supplemented.

Seventh Council Directive 83/349/EEC of 13 June 1983 on consolidated accounts, published in the Official Journal of the European Union No L 193 of 18 July 1983.

Directive 2013/34/EU of the European Parliament and of the Council on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing

Council Directives 78/660/EEC and 83/349/EEC, published in the Official Journal

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Directives 78/660/EEC and 83/349/EEC, published in the Official Journal of the European Union L 182 of 29 June 2013.

[1] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards the disclosure of financial and diversity information by certain undertakings and groups of undertakings, published in the Official Journal of the European Union L 330 of 15 November 2014.

[2] Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory auditing of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC Text with EEA relevance, published in the Official Journal of the European Union, L 157 of 9 June 2006.

[3] Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements concerning statutory audits of public-interest entities and repealing Commission Decision 2005/909/EC, published in the Official Journal of the European Union L 158 of 27 May 2014.

of the European Union L 182 of 29 June 2013.

Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards the disclosure of non-financial and diversity information by certain large undertakings and groups, published in the Official Journal of the European Union, L 330 of 15 November 2014.

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC Text with EEA relevance, published in the Official Journal of the European Union, L 157 of 9 June 2006.

Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements for the statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC, published in the Official Journal of the European Union L 158 of 27 May 2014.

IASB which is "committed to the development, in the public interest, of a single set of high-quality, global accounting standards that provide transparent and comparable information in general purpose financial statements."

FASB which is the national standard setter in the US.

## 3. Research Methodology

In addition to the literature review, the normative research method and the explanatory, descriptive and comparative research method were used as research techniques. The documentation focused on the study of the literature, without neglecting the documentation of national and international normative acts and of specialized articles or doctoral theses.

The database used in the study is the annual financial statements prepared using IFRS, published on the websites of the entities analyzed. The study did not include entities whose activity is regulated and supervised by the ASF and banking institutions, regulated and supervised by the NBR.

The study is dedicated to corporate income tax calculated under IFRS and corporate income tax under accounting regulations compliant with European directives. Situations are presented where deferred income tax needs to be shown considering tax legislation and the history in accounting practice (existence of revaluations not recognized for tax purposes or tax relief granted in certain periods). The study also includes aspects of deferred taxes presented in the first IFRS statements prepared by the entities surveyed.

## 4. Income Tax Deferred. Accounting and Tax Basis of Assets and Liabilities. Temporary Differences

In contrast to the accounting regulations in accordance with the European directives, which provide for the recognition in the accounts only of current income tax, i.e., that which is calculated and due for a fiscal year in accordance with tax rules, the accounting regulations in accordance with IFRS also provide for the calculation and recognition in the accounts of deferred income tax.

Deferred income tax is recognized when the accounting is disconnected from taxation and involves the recording of an income tax liability or receivable even if it is not due or cannot be recovered from the State budget according to tax rules in the year in question. Income tax within the meaning of IAS 12[1] includes all domestic and foreign taxes on taxable profits, including withholding taxes, which are payable by a subsidiary or associate. IAS 12 defines numerous specific terms as follows:

"- Tax expense (tax income) is the aggregate amount of current and deferred tax included in determining profit or loss for a period.

current tax is the amount of tax payable (recoverable) in relation to taxable profit (tax loss) for a period.

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

Deferred tax assets are the amounts of income tax recoverable in the future period in respect of:

deductible temporary differences.

carry forward of unused tax losses.

carry forward unused tax credits." (par.5)

Taxable or deductible temporary differences arise when the carrying amount of an asset or liability is different from the tax base.

Taxable temporary differences are those that lead in future periods to taxable amounts in determining taxable profit or tax loss when the carrying amount of the asset or liability is settled.

If the settlement or recovery of the carrying amount of an asset results in amounts that are deductible in computing future taxable profit or tax loss, the entity has deductible temporary differences. For assets, the tax base is the amount that will be

[1] CECCAR, 2015, International Financial Reporting Standards. Bucharest: CECCAR Publishing.

accepted as a deduction for tax purposes when the entity recovers the full value of the asset. For liabilities, the tax base is their carrying amount less amounts that will be deductible for tax purposes in future periods.

Deductible temporary differences generate deferred tax assets while taxable temporary differences generate deferred tax liabilities. IAS 12 requires prudence in the recognition of deferred tax assets and permits their recognition only if the entity expects to make sufficient profit in future periods to allow the deductible temporary difference to be utilized.

### 4.1. Accounting for Deferred Taxes.

Deferred income tax (liability or receivable) is recognized either in the profit or loss account or outside profitor loss. As a rule, deferred tax liabilities or receivables relate to income or expenses that are recognized in the income statement.

Separate accounts have been introduced in the Chart of Accounts in the accounting regulations approved by Order No. 2844/2016 for the accounting of deferred income tax, namely:

Account 692 ‘Deferred income tax expense’.

Account 792 ‘Deferred income tax revenue’.

account 4412 ‘Deferred income tax’.

IFRS compliant rules[1] require entities to calculate and record current income tax separately from deferred income tax. (Paragraph 133)

As regards the recognition of deferred income tax, IAS 12 states that it may affect the income statement but also other items that are recognized. To the extent that the deferred tax relates to transactions recognized in the income statement, the deferred tax shall be recognized in the income statement. Where the deferred tax relates to equity items (e.g., reserves) or retained earnings, the deferred tax shall be recognized on those items.

In view of the legal provisions on the tax treatment of retained earnings, entities that have changed over to IFRS and have recorded amounts in accounts 1175 “Retained earnings representing realized surplus from revaluation reserves”, 1177 “Retained earnings arising from the transition to IFRS, less IAS 29”, 1178 “Retained earnings arising from the use, at the date of transition to IFRS, of fair value as deemed cost”, have recognized deferred income tax on the deferred income accounts line item:

[1] CECCAR, 2015, International Financial Reporting Standards. Bucharest: CECCAR Publishing.

| | | |
|---|---|---|
| % | = | 4412 “Deferred income tax” |
| 1177 “Retained earnings arising from the transition to IFRSs less IAS29” | | |
| 1175 “Retained earnings representing realized surplus on revaluation reserves” | | |

In accordance with the treatments set out in many IFRSs and Order No 2844/2016[1], certain gains or losses on the valuation of assets or liabilities are recognized in equity accounts (paragraphs 168 and 169 of Order No 2844/2016).

The increase in value of fixed assets in the event of revaluation is also shown in equity. IAS 12 states that if the conditions for recognizing deferred income tax on items recognized in equity are met, then the related income tax should also be recognized in (debited to) equity accounts.

A separate account (1034 Current income tax and deferred income tax recognized on equity) has been established by Order No 2844/2016 to record deferred tax on legal reserves and other reserves provided for in the Tax Code.

This account replaces the reserve accounts for which current tax and deferred tax are recorded, the purpose being to keep the reserves recorded at the values at the date of their creation. In these circumstances, the entry of a deferred tax liability is made under the accounting item:

| | | |
|---|---|---|
| 1034 “Current income tax and deferred income tax recognized on equity” | = | 4412 “Deferred income tax” |

The creation of a separate account 1034 “Current income tax and deferred income tax recognized on equity”

for the accounting of deferred income tax relating to reserves was prompted by the fact that there are provisions in the tax legislation that impose restrictive conditions on entities for the use of reserves (e.g., tax relief reserves, in theevent of a decrease they are considered to have been used, resulting in current taxation).

### 4.2. Application Particularities for Deferred Taxes in the Accounting of Entities that have Made the Transition to IFRS

The study focused on the analysis of information in financial statements prepared by entities that have changed over to IFRS. The database used for the analysis

[1] Accounting regulations in accordance with International Financial Reporting Standards, approved by Order of the Minister of Public Finance No 2844/2014, as amended and supplemented, published in the Official Gazette of Romania, Part I, No 1020bis/19 December 2016.

consisted of financial statements prepared under IFRS in which deferred income tax reported by entities is presented. Numerous entities did not provide information on deferred income tax and others provided summary information.

The accounting regulations in line with the European Directives do not provide for the recognition of deferred taxes, but only for a tax provision for certain identified situations. The transition to IFRS has required entities to apply IAS 12 and to recognize deferred taxes, receivable or payable, depending on the situation of each entity.

Entities that have recognized significant amounts of deferred tax on transition to IFRS include:

Alfa S.A. highlighted:

Deferred tax debt: 100,342,752 lei due to the fact that:

the tax value of intangible fixed assets does not include the increase due to inflation.

assets belonging to the public domain of the State are not depreciable assets from a tax point of view, regardless of how they are recorded in the accounts (the company has recorded under intangible assets the right to use the fixed assets under concession belonging to the public domain of the State).

deferred tax receivable to be recovered in the amount of 9,970,209 lei, following the revision of a provision for employee benefits.

Beta S.A. presented an analytical statement of deferred income tax and a reconciliation of accounting profit to tax profit.

The company has recognized both an income tax liability and a receivable for tangible and intangible fixed assets, which it has offset for presentation purposes in the annual financial statements as they were related to the same tax authority.

The company recorded receivables for deferred taxes and for other items such as inventories, provisions for pensions, compensatory payments and other provisions, with total receivables amounting to RON 1,263,220,000 and total payables amounting to RON 357,720,000.

In the annual financial statements, deferred taxes have been presented net under receivables (905,500,000 lei). The company does not mention whether the recognition of these taxes was made on the deferred result account in connection with the application of IFRS as the accounting basis or on other items (profit and loss account and reserve accounts).

Gama S.A. presents a statement of deferred taxes recognized in the deferred income statement on transition to IFRS for periods prior to 2012 and in the income statement for 2012.

Delta S.A. recorded a deferred income tax liability of 722,787 lei for amounts recorded in the revaluation reserve for revaluations made after 31 December 2003.

Omega S.A. recorded a deferred tax liability of 146,415,260 lei on equity for adjustments made in accordance with IAS 29.

Sigma S.A. presented in 2012 and 2011 explanations of deferred tax but also a reconciliation between tax expense and book profit multiplied by the tax rate applied.

Deferred income tax receivables amounted to 20,397,086 lei and were set up for various provisions, while the liability amounted to 46,991,586 lei and was related to differences between the accounting basis and the tax basis of fixed assets.

Analysis of the tax information in the annual financial statements revealed the following:

not all entities complied with the disclosure requirements for deferred tax and reconciliation of tax expense to accounting profit and tax rate.

deferred taxes were usually determined by: - differences between the tax base and the accounting base of tangible and intangible assets as a result of the revaluation of discounting to inflation under IAS 29 or fair value measurement as deemed cost; - provisions made for various current liabilities at the balance sheet date; - unrecovered tax losses.

through the accounting treatment, deferred taxes can influence the result of the year (profit or loss).

Thus, in the case of recognition of deferred tax receivables for items in the profit and loss account, income is recorded in account 792 “Deferred income tax income”, while liabilities are recorded as expenses in account 692 “Deferred income tax expense”). According to the Tax Code, deferred income tax expense is non-deductible, and income is non-taxable.

## 5. Conclusions

When referring to corporate tax, we must bear in mind at least two aspects:

the first aspect concerns the accounting rules that the entity under review applies,

and the second aspect, which derives from the first, concerns the chargeability of corporation tax.

In all cases, irrespective of the accounting rules applied, entities owe current income tax which is shown under current liabilities in the balance sheet/statement of financial position.

Current income tax is calculated according to methodologies laid down in tax rules that provide for uniform tax rules.

Entities applying accounting regulations in accordance with European directives may present under the tax provision heading some amounts for which payment is uncertain due to challenges by auditors or legislative uncertainties. In contrast to these entities, those applying IFRS recognize in the accounts both current taxes due at the balance sheet date and the amounts of income tax payable or recoverable in future periods.

Deferred tax information is relevant for users as most entities should be reporting such tax. For example, entities have repeatedly revalued property, plant and equipment, resulting in carrying amounts that differ from tax values, which usually results in taxable temporary differences. Under tax law, entities with tax losses are entitled to recover them in future periods. To the extent that these entities record book profits, they will be able to deduct these tax losses from their taxable income.

At the balance sheet date, entities assess the possibility of future profits from which to recover tax losses and recognize a deferred tax asset where appropriate. The recognition of deferred tax liabilities is mandatory and is related to the provisions of tax legislation, while the recognition of deferred tax assets should be done with caution as the recovery of some taxes depends on the ability of the entity to make sufficient profits in the future.

IAS 12 states that income tax is recognized either in the income statement or in the capital accounts, depending on the items giving rise to it. In order to ensure a uniform application of the accounting rule, accounts have been provided for the recognition of both current and deferred tax.

The study of entities that have made the transition to IFRS revealed the recognition of significant deferred taxassets or liabilities in relation to the entities' total assets or liabilities. For example, Beta S.A. recognized receivables of 1,263,220,000 lei and payables of 357,720,000 lei, while Alfa S.A. recognized payables of 100,342,752 lei and receivables of 9,970,209 lei.

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