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Financial reporting based on IFRS and tax based reporting

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Abstract:

Reporting for tax purposes for a long time had an impact on financial reporting, due to the importance of the field of taxation to fill the state budget. The implementation of the International Financial Reporting Standards has not affected only the financial reporting, it has also impact on taxation systems. The implementation of IFRS will result in an increase of the degree of alignment between tax and financial reporting. The usage of financial reporting based on IFRS as a bases for the computation of the corporate tax would lead to an increase comparability of tax reporting and to a decrease in the tax compliance costs for companies. But, usage of financial reporting based on IFRS as a starting point for the identification of the corporate tax base would have different effects depending on the country and the industry to which a company belongs.

In this paper we analysed the potential tax effects of usage of IFRS as a base for corporate taxation in Kosovo. Our results suggest that usage of financial report based on IFRS for tax calculation will simplify reporting process and minimize compliance cost. In general, is unreasonable reporting based on two or more sets of financial reports, one based on accounting standards and the other based on the requirements of the tax laws. Findings of this paper suggest that is reasonable to be alignment between the financial reporting and tax reporting, with purpose to decrease the burden of entities for two or more reporting systems.

Key words: Corporate income tax, International Financial Reporting Standards **(**IFRS), IFRS implementation, Tax accounting

1. INTRODUCTION

Financial reporting based on IFRS will play a role in harmonising of the financial accounting and reporting rules and provide more transparency and comparability among the countries. The financial reporting based on IFRS could provide a starting point for a tax base, which will help to reduce the compliance costs from different tax rules.

The impact of financial reporting based on IFRS on tax reporting and the need for harmonization of these reports has been reviewed by many researchers. Eberhartinger and Klostermann (2007), concluded that only in a few cases essential differences with the current tax rules would arise, and hence no dramatic change in the tax base would be expected if IFRS were used for fiscal purposes.

Countries with tighter link between tax and financial reporting have often represented a limit to a full IFRS adoption. Eberhartinger and Klostermann (2007) think that IFRS principles have several drawbacks if used for fiscal purposes and, therefore, countries with a more strict link between tax and financial reporting have generally preferred to limit IFRS adoption to consolidated accounts. On the other side, countries in which tax reporting historically relies less on financial reporting generally opted for a more extensive implementation of IFRS.

Italy is one of the European countries with a closer linkage between financial and tax accounting and where there are relevant conceptual differences between the domestic accounting framework and the IFRS framework. As a consequence, the choice of extending IFRS to the annual accounts of certain types of companies has immediately implied a problem of mismatch between the new set of accounting standards and tax rules (Gavana et al, 2010).

In the UK, UK tax authority allows UK corporation to use authorized accounting standard as a starting point for calculating the UK tax liability. The UK tax authority have then introduced regulation with the intention that corporation's taxable income will be the same whatever the profit before tax starting point is (Collins, 2011).

Some countries, in process of IFRS implementation, still are indecisive whether they will use financial report based on IFRS or national financial report as a starting point for calculating tax income. In some other countries, tax authorities still require from entities to prepare financial reports based on national rules for taxation purpose. We believe that the implementation of IFRS by countries will result in an increase of the degree of compliance between tax and financial reporting.

2. LITERATURE REVIEW

The impact of financial reporting based on IFRS on tax reporting and the need for harmonization of these reports has been reviewed by many researchers, with purpose to reduce the differences between the various reports and reducing the burden on economic entities for drafting more sets of reports.

The use of IAS/IFRS broadens the tax base in every country, a reduction of the nominal tax rate could be expected in the future. Indeed, the nominal tax rate could be reduced without having an impact on the overall effective tax burden (Spengel, 2003).

Lungu et al. (2007), concluded that major uses of SME financial statements by the tax authorities include: to determine gross profit, assess directors' fees, look at tax provisions, ensure that expenses are reasonable and check for a clean audit report.

Strouhal (2012), summarizing the results of his study, highlights following issues: (1) professional accountants hope that the major benefit of the IFRS for SMEs adoption will be elimination of duplicate accounting, unification of the accounting system within international groups and the higher comparability of accounting data, (2) elimination of the linkage of national accounting system to tax system or preparation of such improvements of tax legislation that will make IFRS for SMEs capable to apply as a reporting framework.

With IFRS implementation, a new accounting standard will be impacted to the taxation. This impact will be more obvious for multinational corporation as they will face tax impact of IFRS implementation in more than one taxation jurisdiction. Implementation of IFRS will create an increase of ETR (effective tax rates) or more volatile ETR. IFRS implementation will also create an opportunity to decrease foreign tax (Mulyadi et al. 2012).

Several countries have issued reconciliation regulations for transformation of accounting profit (determined with reference to IFRSs) to tax base. In Slovakia, the Act on Income Taxes requires that companies, which are legally preparing their statutory separate finance statements in accordance with IFRSs, need to determine their tax profit by adjusting the very IFRS profit (Tumpach & Stanková, 2014).

Usage of IFRS-financial report for tax calculation will simplify reporting process and minimize compliance cost (Eberhartinger and Klostermann 2007).

Haverals (2007) found that the use of IAS/IFRS in Belgium will broaden the tax burdens of companies by 3.8–14.6% depending on their sector. This is mainly attributable to the rejection of the favourable declining-balance depreciation rules. The shift to an IAS/IFRS-based tax accounting could therefore have a dissuasive effect on investments.

The adoption of IFRS as a starting point for the identification of the tax base would lead to an increased cross-country comparability of tax reporting and to a decrease in the tax compliance costs for companies operating in different countries (Guggiola, 2010).

Analyzing the contributions of the literature on this issue, we can conclude that the usage of financial reporting based on IFRS as a the tax base would lead to an increase of the degree of compliance between financial and tax reporting and to a decrease in the tax compliance costs for companies operating in different countries.

3. METHODOLOGY

The main objective of this article is to find out the perception of the practitioners of Kosovo accounting profession about the suitability of financial reporting based on IFRS to offer sufficient information for tax-based accounting. For this purpose there have been interviewed the practitioners of accounting profession, accountants of companies, because they are professionals in the field of financial and tax-based reporting. Another objective of this article was to identify whether the implementation of IFRS as a bases for tax-based accounting would reduce the burden of companies in the field of financial and tax reporting.

Previous findings from the review of relevant literature in this field, have served as a basis for the design of the research questionnaire.

The hypothesis of this study is based on the findings of previous studies in this area as well as our experience in the field of study. This hypothesis is as follows:

H1 = Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting.

Based on this hypothesis is designed the research questionnaire, which was sent to the accountants of entities in the period January-February 2014. The questionnaires were sent to 180 businesses, and 52 questionnaires were received and were judged useful for the study. For classification purposes, in the questionnaire is included a section to collect demographic informations of the accounting professionals.

4. ANALYSIS, DATA EXPLANATIONS

To test this hypothesis, we have analyzed the responses in our questionnaire regarding suitability of financial reporting based on IFRS for sufficient information for tax-based accounting. Results are presented in the following table:

Table 1 "Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting?"

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	no	13	25,0	25,0	25,0
	n/a	2	3,8	3,8	28,8
	yes	37	71,2	71,2	100,0
	Total	52	100,0	100,0	

Details regarding the perception of the accounting representatives show that 71.2 % of respondents answered that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting. Only 13 from 52 , or 25.0 % of respondents declared that financial reporting based on IFRS is not suitable for sufficient information for tax-besed accounting.

Analysis of the Data According to the Profession of Respondents

Table 2 Profession * Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting? Crosstabulation

Count

	Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting?			
	no	n/a	yes	Total

Profession	audit	4	0	3	7
	certif. account	3	2	19	24
	techn. account	3	0	6	9
	other	3	0	9	12
Total		13	2	37	52

Data analysis related with suitability of reporting based on IFRS to offer sufficient information for tax-based accounting, according to the profession groups shows that from the group of auditors, 3 from 7 of them evaluate that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting. Meanwhile, from profession groups of certified accountants, 19 from 24 of them evaluate as suitable financial reporting based on IFRS for sufficient information for tax-based accounting. From the group of accounting technician 6 from 9 of them responded with “yes” in this question. While, the group the others, 9 from 12 of them answered that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting.

Data analysis for testing the interconnection of variables “Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting“ and “Profession”:

Ho: Suitability of financial reporting based on IFRS for sufficient information for tax-based accounting and profession are independent

Ha: Suitability of financial reporting based on IFRS for sufficient information for tax-based accounting and profession are not independent.

Table 3 Chi-Square Tests - Profession* Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting

Count	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	8,031[a]	6	,236
Likelihood Ratio	8,452	6	,207
N of Valid Cases	52		

Variable testing addiction from the table above, made through Chi-Square test, shows that variable "Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting" is not affected from "profession" of interviewees and from this we can conclude that it hasn't dependency between two variables, because the value of $p = 0.236 > 0.05$, and in this case is confirmed the initial hypothesis on the independence of variables. Thereby we come to the conclusion that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting, something that is evaluated like that, from most groups of respondents despite of their profession.

Analysis of the data according to the education level of respondents

Table 4 "Education level" * "Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting"? Crosstabulation

Count

		Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting?			
		no	n/a	yes	Total
Education level	Bachelor (plus)	10	2	28	40
	Bachelor	3	0	9	12
Total		13	2	37	52

Data analysis related with suitability of financial reporting based on IFRS to offer sufficient information for tax-based accounting, according to the education level groups shows that from the group bachelor plus, 28 from 40 of them evaluate that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting. Meanwhile, from group bachelor, 9 from 12 of them evaluate as suitable financial reporting based on IFRS for sufficient information for tax-based accounting.

Data analysis for testing the interconnection of variables “Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting “and “Education level”:

Ho: Suitability of financial reporting based on IFRS for sufficient information for tax-based accounting and education level are independent

Ha: Suitability of financial reporting based on IFRS for sufficient information for tax-based accounting and education level are not independent.

Tabela 5 Chi - Square Tests – “Education level” * “Is financial reporting based on IFRS suitable for sufficient information for tax-besed accounting”?

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	,632[a]	2	,729
Likelihood Ratio	1,081	2	,582
N of Valid Cases	52		

Variable testing addiction from the table above, made through Chi-Square test, shows that variable “Financial reporting based on IFRS is suitable for sufficient information for tax-based accounting” is not affected from “education level” of interviewees and from this we can conclude that it hasn’t dependency between two variables, because the value of p =

0.729 > 0.05, and in this case is confirmed the initial hypothesis on the independence of variables. Thereby, we can conclude that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting, something that is evaluated like that, from groups of respondents despite of their education level.

As we said above we can come to the conclusion that the hypothesis H1 is confirmed related with suitability of financial reporting based on IFRS to offer sufficient information for tax-based accounting, because 71.2 % of respondents claimed the reasonability of hypothesis.

5. CONCLUSIONS / RECOMMENDATIONS

Results of this study show that financial reporting based on IFRS is suitable for sufficient information for tax-based accounting. The usage of financial reporting based on IFRS as a basis for the computation of corporate tax would lead to an increase comparability of tax reporting and to a decrease in the tax compliance costs for companies. The findings of this article suggest that the implementation of IFRS as a basis for tax-based accounting would reduce the burden of companies in the field of financial and tax reporting. Our findings regarding the suitability of financial reporting based on IFRS to offer sufficient information for tax-based accounting are in accordance with previous studies in this area. Usage of IFRS-financial report for tax calculation will simplify reporting process and minimize compliance cost (Eberhartinger and Klostermann 2007). The adoption of IFRS as a starting point for the identification of the tax base would lead to an increased cross-country comparability of tax reporting and to a decrease in the tax compliance costs for companies operating in different countries (Guggiola, 2010).

Based on the findings of this study, we recommend that the tax reporting should be aligned with reporting standards. Entities should not prepare two or more reports that have significant differences between them. Entities do not need to prepare the financial statements on the basis of tax rules, but reports in order to present a true and fair view of company activities.

The usage of IFRS for tax purposes will create a favorable tax regime in attracting foreign companies to tax their sources of income in Kosovo, and on the other hand to decrease the motives of Kosovo companies to transfer profits abroad.

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