

# THE ACCOUNTING PROFIT'S RELEVANCE IN COLLECTING TAX REVENUE OF SPAIN

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## ABSTRACT

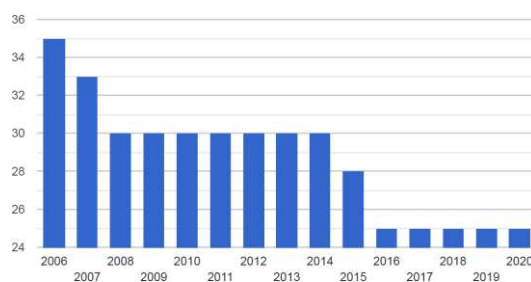
*The main goal of this research is to study the role of the accounting profit in the Spanish corporate tax collection. For this purpose, it analyses the legal dispositions of Spain, in particular, the Commerce Code - Código do Comercio (CC), the Accounting Law - Plan General de Contabilidad (PGC), and the Corporate Income Tax Law - Ley del Impuesto sobre Sociedades (LIS). The results show that the profit determined under the accounting standards' rules has a crucial role in the Spanish tax jurisdiction. It has express provision in several business legal norms, and it constitutes an essential element in the determination of business taxation. The accounting standards' discretion and the manipulation of accounting profit can be reasons for the reduced contribution to income corporate tax revenues by societies.*

**Keywords:** Spain, Accounting Profit, Corporate Income Tax, Taxable Income.

## INTRODUCTION

The phenomenon of economic globalisation has led to relevant changes in international taxation, including income tax. In recent years there has been a significant reduction in statutory taxes rates on societies' profits in most countries, which is often seen as a response to increasingly intense international tax competition. Tax competition phenomenon can be exercised through several forms and techniques (Devereux, Lockwood, & Redoano, 2008), and it can include all taxes, although it usually focuses on reducing direct taxation on companies or labour force (Santos, 2009). Fiscal competitiveness has thus become a concern of the different countries and a factor to be taken into account when attempting to reform the tax system (Martins, 2015). It is understood that tax competition is now considered to be harmful, at least from a certain level (Sharman, 2006). Thus, it is one of the problems of the most industrialised and developed countries and has led to a great deal of dialogue and positioning at the international level, especially in the OECD and the EU (Santos, 2015).

Spain has been following this tendency (Collier, 2017), nevertheless with less impact than other countries, as it is the case of Portugal (Delgado, Fernández-Rodríguez, Martínez-Arias, & Presno, 2019). Always the tax collection assumed an essential paper in nations life, due to it is the support to finance the public spendings.



**CHART 1**

## EVOLUTION OF CORPORATE TAX RATE OF SPAIN

Source: [https://www.theglobaleconomy.com/Spain/corporate\\_tax\\_rate/](https://www.theglobaleconomy.com/Spain/corporate_tax_rate/)

Through Chart 1, it is possible to understand the evolution of the corporate tax rate in Spain, that in just over ten years it has reduced by about ten per cent, and at this moment it is fixed at 25%.

<b>Table 1</b>													
<b>CORPORATE TAX REVENUE IN SPAIN ( EURO, MILLIONS )</b>													
Government													
Unit													
Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Tax													
<b>1200 Taxes on income, profits and capital gains of corporates</b>	42196	51642	32406	25777	21496	20490	23491	22203	21834	25989	25561	27076	30150
<b>1200 Taxes on income, profits and capital gains of corporates</b>	41194	49750	30682	23832	19369	18853	22098	21079	20695	24713	23836	25217	27929
<b>1200 Taxes on income, profits and capital gains of corporates</b>	1002	1892	1724	1945	2127	1637	1393	1124	1139	1276	1725	1859	2221

Source: <https://stats.oecd.org/Index.aspx?DataSetCode=REVESP>

Table 1 evidence that the decrease in rate implied a decrease of corporate tax revenue, along the time. In 2006 the tax rate was 35%, and the tax collection was 42 196 euro millions. In 2018 the tax rate was 25% and the tax revenues fixed at 30 150 euro millions. The level of tax collection is directly related to the determination of the tax base. In corporate income tax, Spanish jurisdiction assumes the direct estimation regime in the taxable income's calculation (Lapatza, Fernández, & Márquez, 2013); it means that the accounting profit assumes a relevant paper in that process (Nabais, 2019).

Currently, the companies' role in the contribution to public spendings has been evidenced, taking into consideration the economic sustainability matter, namely, in tax dimension (Cinzia, Edoardo & Andrea, 2019; Hendricks et al., 2015; Nerudová, Hampel, Janová, Dobranschi & Rozmahel, 2019; Previti, Palatnik & Seda, 2017). Thus, it is relevant to researching the relation between the accounting profit and tax collection in the corporate income tax. Although the recent studies, the matter it is still unexplored, and at the best of our knowledge, there is not research on Spanish case. The study approaches the following research question: What is the role of the accounting profit in the corporate income tax collection? The paper is composed for four sections: First, the introduction; second, it makes an accounting profit's framework; then, it analyses the result determined under the accounting standards as the corporate income tax measure; and finally, the conclusions.

### ACCOUNTING PROFIT

The profit's concept is susceptible to several definitions, depending on the perspective. In the economic domain, the it is the difference between income and expenses produced by the entity during the economic year, adding or withdrawing to that difference the positive or negative variation of the final stocks concerning the initial ones, and it is calculated from the

income statement (Chico de la Cámara, 2006). The income and expenses compose the positive and negative comprehensive income statement's items, thus the operating profit is accurate in this financial document (LLP, 2018). The operating result comes from the entity's exploration activity; it should be distinguished from others that do not have the same qualification (ICAEW, 2020). Regarding to the expenses, they are all the costs of the economic year that were incurred to obtain the income. They can be the consumption of goods, raw materials and other consumable goods, external expenses, employees' expenses, taxes (including the entity's income tax) and all activity expenses that meet that general definition (Melville, 2019). Other accounting items can be recognised as expenses, such as amortisations, depreciations, and provisions, which are designed to recognise the asset's value loss (Juan Martín Queralt, López & Galiardo, 2013). The operating incomes are the positive operating result's component; in other words, they are the entity's sales and services. They also recognise the variation in inventories and the work done for the company itself. After determining the operating result, other incomes and expenses that do not relate with the ordinary company's activity are added, such as the financial ones (Nabais, 2018).

The legal obligation to prepare the corporate's annual accounts and the inherent determination of the net profit is established in the Spanish Commerce Code (Codigo de Comercio). This legal disposition imposes the obligation to present the financial statements at the end of the economic period (Lapatza et al., 2013). It also determines what kind of financial documents it is necessary to present and that the manager is the person responsible for their formulation. Thus, according to article 34, it is recognised as essential to prepare the financial position's statement, financial performance, cash flows, changes in equity, and the balance sheet annexe (Guiza, 2021). This imposition has as underlying the consideration of the assumptions made by international accounting organisations, such as IASB (Flood, 2019). This international entity establishes, in the conceptual framework, the objectives of the financial reporting, which go in the same direction that the Spanish law determines. So, IASB conceptual framework considers that the financial reports should provide information about the entity's financial position, financial performance, cash flows and changes in the financial position which are not caused by financial performance (Freitas, 2007). Queralt, Serrano, López & Ollero (2019) consider that this juridic determination represents the importance of the annual accounts as an informative overview of all the accounting process made by the corporation during the economic year. These set of accounting elements form a unit that must be analysed and interpreted as a whole since they are the basis to prepare other complementary financial documents (Ortega, 2015). The Spanish Commerce Code, in article 35.2, also makes considerations about how the accounting profit is obtained. It explains that the net profit is calculated having as underlying the incomes and the expenses, taking into consideration the accounting standards. This aspect implies companies prepare two profits, the income prepared under the accounting guidelines, and the fiscal income prepared under the corporate income tax law, due to the differences between accounting and tax domain (Wahab & Holland, 2015). The academic literature calls it as the book-tax differences (BTD) (Guenther, Maydew & Nutter, 1997; Ling & Wahab, 2019; Moore & Xu, 2018). The accounting profit is handy for tax purposes (Lal, 2012).

Corporate income tax law resorts to the direct estimation regime to sustain the determination of the corporate income's tax (Pereira, 1990; Queralt et al., 2019). Accounting profit is taken as the starting point for the determination of the fiscal result, and this requirement is of central importance for fiscal purposes (Gadea, 2008). Article 10 of the LIS, establishes that the taxable base will be constituted by the amount of income in the tax period, reduced by the offsetting of negative tax bases of previous tax periods. According to the same disposition, it will be calculated, correcting the accounting profit under the determinations requested by the code. Thus, the result determined according to the accounting standards will be considered as a starting point to determine the taxable result (Pascual, Gálvez, Gómez & Pino, 2013). This disposition expressly determines that the accounting profit is calculated considering: 1) the Commerce Code's norms; 2) other laws relating to the mentioned

determination and, finally, 3) the dispositions that are dictated in the development of the mentioned norms. For the second condition, the Capital Companies Law will be considered. Concerning the third requirement must be considered, essentially, the Spanish General Accounting Plan and General Accounting Plan for Small and Medium-sized Enterprises and specific accounting criteria for micro-enterprises (Lapatza, 2007).

The application of the accounting standards is mandatory, even if they have regulatory character, this condition has as main goal the uniformisation and standardisation of the accounting information (Lapatza et al., 2013). The accounting standards do not define the net income; however, they establish the rules set for its determination (Kieso, Weygandt & Warfield, 2020). The correct determination requires all the incomes and all the expenses to be reflected in the results account (Lal, 1981). If this is not observed, the accounting profit is not correct, and the financial position statement does not represent the company's real patrimonial situation (Gadea, 1998). Thus, the obligation to apply the accounting principles and the valuation rules accrue from the Spanish General Accounting Plan. To L. A. M. Pascual and Zamora (1998) the accounting profit presents a relative magnitude and a temporal one as well. Having a relative magnitude means that only at the end of a company's life it is possible to determine the result in absolute terms because only at that moment the entity ceases its activity and does not need to maintain the productive capacity. On the other hand, the temporal magnitude represents the need for the company's life to be fractioned into time intervals, usually in annual periods. According to Amat, Aguilá & Marín (2018), this period of time is called economic exercise, and it allows each period to be isolated from the previous and the following economic periods. This fractionation allows business leaders to have continuous and relevant information to make economic-financial decisions and to remunerate the investors; otherwise, this would not be possible.

### **ACCOUNTING PROFIT AS CORPORATE INCOME TAX MEASURE**

In Spanish Supreme Law, article 31.1 predicts the principle of ability to pay, and this essential criterion underpins to accomplish the duty to public spending contribution. Nevertheless, Spanish doctrine and the constitutional court's case-law draw attention to the non-exclusive character of this principle as a criterion of tax justice, and it allows looking for the richness where it is (Perogordo & Roch, 2007). The global economic power of each person, individual or legal, measures the level of contribution in the repartition of national costs, it justifies the need for different taxes and not a single and global tax. A single chargeable event does not evidence this economic capacity but in several. Thus, taxable events are the economic ability to pay's indexes (Moschetti, 1980). In the case of the corporate income tax, the measure to evaluate the company's ability to pay is the accounting profit, with this prediction the legislator assumes the result determined under accounting standards, as an essential element for determination of the measure of the ability to pay. This aspect is similar to what happens in most European Union's member states.

Article 10.3 of LIS explains that for the taxable income determination, it should assume the accounting profit and correct it according to the tax law's dispositions. This legal instruction leads to the dependence on accounting, being the result determined under the accounting rules the basis for the determination to companies' taxable income. It means that the corporate tax lawmaker considers that the accounting statements represent the company's fair economic reality. Doctrine arguments that although accounting pieces shows the entity's economic reality, it does not represent the full ability to pay of taxpayer (Basto, 2001). In the opinion of Chico de la Cámara (2006), the Generally Accepted Accounting Principles (GAAP) regulates the accounting standards, and this can lead to the unreal capacity for tax payment.

The accounting standards incorporate the high discretion level due to the financial measurement that is relevant to obtain the true and fair view. This particularity is adverse to the equality's tax principle, due to it allows to manipulate the accounting profit (Aguar, 2013). To consider the income effectively obtained, similar to the income determined through elements of accounting content may prove to be misleading. The fact that taxation is based on accounting elements does not mean that the income determined through them corresponds to the income that was obtained effectively.

Nevertheless, the level of discretion in accounting norms, other factors can lead to the accounting profit does not represent the faithful ability to pay of taxpayer. It is the case of the non-record sales and services, the consideration of the unreal expenses, record of personal expenses of company's owners, and others situations that can reduce the accounting profit and for inference to reduce the corporate tax income. This particularity can justify, in part, the contribution of the Spanish companies to the total income tax collection as a whole, it means, personal and legal persons are taxpayers in the income tax.

Government Unit	Total												
	Euro, Millions												
Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Tax													
<b>1000 Taxes on income, profits and capital gains</b>	112577	132909	111177	98414	97241	98844	102448	100546	101236	104662	105908	113417	123011
<b>1100 Taxes on income, profits and capital gains of individuals</b>	70381	81267	78771	72637	75745	78354	78957	78343	79402	78673	80347	86341	92861
<b>1200 Taxes on income, profits and capital gains of corporates</b>	42196	51642	32406	25777	21496	20490	23491	22203	21834	25989	25561	27076	30150

Source: <https://stats.oecd.org/Index.aspx?DataSetCode=REVESP>

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
<b>Contribution of corporation tax to income tax according to table 2</b>	37%	39%	29%	26%	22%	21%	23%	22%	22%	25%	24%	24%	25%

According to table 2 and 3, in the year 2018, personal taxpayer supported 75% of the total income tax revenues; corporate entities were responsible for 25%. This trend has been

observed for some years, with a more significant difference in the years between 2010 and 2014. The accounting profit's discretion, the manipulation of the result and the several companies' tax exemptions lead to a lower contribution of legal entities to the income tax collection, and inherently to a deficient contribution to public spending.

## CONCLUSION

The principal goal of this paper is to understand the role of the accounting profit in the collection of tax revenues in Spain. The results show that the accounting profit assumes relevance in the collection of tax revenues since it is the base of corporate tax income. Nevertheless, it has significant responsibility for the low contribution of the company's corporate tax collection. This situation occurs due to the discretion's high level on accounting result's determination and the fact that the company can manipulate the result through the unrecord sales and the unreal costs' recording. Although the tax legislator imposes tax corrections to avoid some abuses, the basis is always the accounting profit.

This research evidences the crucial role of the accounting profit in compliance with the civic duty of Spanish companies to pay tax. The fact that it only studies Spain's case study constitutes a limitation; thus, it could be interested in to understand if the tendency maintains in others tax jurisdiction.

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