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Accounting and taxation in Romania: from connection to disconnection?

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Abstract

***Research Question**:* What are the effects of the evolutions in tax and financial reporting regulations on the book-tax relationship in the case of Romanian listed companies; is the *de jure* trend towards a disconnection confirmed, and what findings can be made from a *de facto* analysis based on the effective tax rate (ETR)?

Motivation: Istrate (2011) applied the grid proposed by Lamb *et al.* (1998) and found that, in 2020, the *de jure* trend was clearly towards a book-tax disconnection. My intention is to replicate this analysis for 2021 and to add some other variables that could characterize the period, in order to assess the 2021 *de jure* and *de facto* (dis)connection.

Idea: Mandatory introduction of IFRS for some listed companies, adaptation of the Romanian accounting rules to the European directive 34/2013, modification of the tax rules, in particular as a result of European efforts to fight tax avoidance, unprecedented situations such as the covid-19 crisis were just as many reasons for companies to adapt their tax and financial reporting behaviours, which makes the more interesting the analysis of the book-tax relationship.

Data: For the application of the analysis grid proposed by Lamb et. al (1998) and developed later by other authors, I have analysed the accounting and financial reporting regulations, in parallel with the treatments provided by the Romanian tax law. For the *de facto* analysis attempt, I analysed more than 3,800 observations about the Romanian companies listed on Bucharest Stock Exchange for the period 2000-2021.

Tools: The assessment of the book-tax relationship was done by applying the Lamb *et al.* (1998) model, with the six possible cases: from total identity, to total disconnection. My analysis takes into account 40 key elements. In the case of *de facto* analysis, I calculated an ETR as the ratio between the current tax expense to profit before taxes.

Findings and contributions: The study proposes a *de jure* analysis that confirms the evolution towards almost total disconnection between accounting and tax rules, especially for companies applying IFRS. The *de facto* analysis allows us to observe that ETR

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significantly different from the statutory tax rates (STR) – which confirms the disconnection between accounting and taxation. So, for the Romania listed companies, in general, the book-tax disconnection explains and justifies the differences between the ETR and the STR; in this case, the ETR is not really the best proxy for the tax avoidance, as many studies in the literature proposed.

Keywords: book-tax relationship, Lamb *et al.* (1998) grid of analysis, disconnection, effective tax rate

JEL codes: H25, K34, M41

1. Introduction

The relationship between accounting and taxation is most often limited to the analyse of the corporate income tax (CIT). There are differences between accounting and taxation rules, therefore the accounting income is often different from the tax income and the current income tax is not equal to the amount obtained by applying the statutory tax rate to the pre-tax accounting income. Even if sometimes the accounting income is close to the taxable income, the intervention of exemptions and other forms of tax credit always removes the current tax from the theoretical value (the rate applied to the pre-tax income). The calculation of effective tax rates (ETR) allows us to compare what is reported and paid with what would have been reported and paid if the accounting income was equal to the taxable income. For many countries, corporate income taxes are an important source of budgetary revenue. The starting point for the calculation of this tax is always the accounting figure and the options about the accounting and/or fiscal recognition of revenues and charges are numerous, which explains the important place that this tax occupies in accounting and finance research, but also in other areas. The application of IFRS and other sophisticated financial reporting rules, which complicate the financial reporting system away from taxation, has contributed to an increase in researches on the subject.

It is useful to highlight the implications of changes in accounting standards, including the adoption of IFRS by some companies: how companies handle differences that may arise between accounting and taxation. It is also useful to broaden the research on how authorities adapt certain basic concepts of international standards in current accounting and financial presentation, with effects on corporate tax behaviour.

The evolution of the relationship between accounting and taxation in Romania, concerning the corporate income tax, has been analysed in a series of studies that mobilize various theoretical models and allow a measure of the connection/disconnection between the two. Păunescu (2015) warns us that the

relationship between financial accounting and taxation is narrow and justifies this assertion by the fact that the tax rules establish that the accounting income is the starting point in the calculation of the taxable income.

Continuing the studies on the (dis)connection between Romanian accounting and taxation, I apply the analysis grids (see Table 4) initially proposed by Lamb *et al.* (1998), later developed by Nobes and Schwencke (2006) and adapted on the case of Romania by Istrate (2011). The starting point of this study are the results proposed by Istrate (2011): it identifies a *de jure* disconnection between accounting and taxation in 2010, after an almost complete connection immediately after 1990. I consider that the replication of the methodology for the year 2021 and the comparison of the results with those of 2010 are justified by significant changes, both in accounting and financial reporting standards, and in tax rules. With regard to the accounting of Romanian companies, some important events occurred during this period:

- the introduction, from 2012, of the mandatory application of the IFRS in the individual financial statements of Romanian companies listed on the regulated market of the Bucharest Stock Exchange (BSE): Iordache (2020) notes that more than half of these companies would not have opted for IFRS, if applied voluntarily;
- adaptation in national legislation of European Directive 34/2013, which led to certain changes in Romanian accounting standards (RAS), applicable from 2015;
- introduction of the mandatory application of the IFRS by 17 large State-owned companies, starting with 2018.

As regards the corporate income tax (CIT), the developments followed the trend of the previous period, in the sense of an increasing disconnection between accounting and taxation. These important tax changes from 2010 to 2022 include:

- introduction of EU rules to fight against the tax avoidance in terms of intra-group transactions (interests, asset transfers);
- introduction of tax exemptions and aids following the Covid-19 pandemic;
- introduction of certain tax reductions in the case of positive and increased equity;
- introduction of additional tax deductions for research and development activities or for environmental protection.

After applying the analytical grid proposed by Lamb *et al.* (1998), I measured the differences between accounting and taxation using an effective tax rate (ETR). The objective of the study is therefore to identify the evolution of the differences between accounting and taxation during the period 2010-2021, to illustrate these evolutions on a sample of Romanian companies and to comment on these evolutions.

The structure of this study includes a brief description of the Romanian context, a literature review, a section on methodology and data, the results of the analysis and the conclusions, followed by references.

2. Context

CIT is an important source of public revenues for the Romanian state budget; it is fourth in a tax hierarchy, far behind VAT, personal income tax and excises. According to the official data released by the Romanian authorities and by the Eurostat, CIT represents between 1.5% and 2% in the Romanian GDP (after 2010), while before 2010, the share of this tax in the GDP was between 2% and a maximum of 5%, in 1990. Despite this rather limited current contribution to public revenues, CIT is a very discussed topic because of the difficulties it generates in terms of accounting recognition of revenues/charges vs. the tax criteria, as well as the possibilities of avoiding the payment of this tax. An explanation of the place of CIT in public revenues comes from its statutory rate of 16%, valid since 2005, one of the lowest in the European Union. In addition to this reduced tax rate, many Romanian companies do not report profits at all: a Romanian National Bank report state that about 1/3 of Romanian companies have negative equity or equity below the regulated limit. The situation is persistent on the long term. The tax authorities do not have much to collect on the profits of these corporations, so they created a revenues tax, paid by the firms on the basis of reported revenues without taking into account the existence of any profit and without any special treatment of the charges. The introduction in 2001 of this tax on revenues for companies with revenues below 100,000 euro had unexpected effects: the State did not collect much money (an annual average of 0.14% of GDP, with a minimum of 0.07% in 2008 and a maximum of 0.26% in 2018, when the threshold was already 1,000,000 euros), but companies have seen a significant decrease in the administration costs of the tax burden, as well as the almost total elimination of an important source of difference between accounting and tax rules: the tax justification of charges. After a long period of application of the limit of 100,000 euros for this tax on revenues, we have an increase to 500,000 euros (in 2017), followed by another increase, in 2018, to 1,000,000 euros, so that, from 2018, the number of companies that are subject to the CIT decreases significantly. In the publications of the Romanian Tax Authority (ANAF), we could find that from 2018, about 12.5% of companies registered in Romania still pay CIT (about 115,000 companies, out of a total of about 900,000), compared to over 30% before the 2017 increase. There are even companies listed on the stock exchange which, due to revenues below 1,000,000 euros, have declared and paid the tax on revenues, without having to calculate the CIT.

We can expect that the close *de facto* relationship between accounting and taxation of most Romanian companies will be encouraged by the fact that the same public body (the Ministry of Public Finance) plays the role of accounting and tax standard setter. The Romanian Accounting Standard (RAS) are compatible in some respects with the basic definitions and concepts of IFRS. Despite this strong conceptual framework, when drafting the specific rules applicable to assets, liabilities, revenues and charges, the standard setter introduces many exceptions to the definitions it has

proposed in the conceptual section. Some of these exceptions reinforce the book-tax link between, concerning CIT, but also the value added tax (VAT).

Another area in which the Romanian standard setter demonstrates its authority is the presentation of financial and accounting information to the tax authorities. The mandatory balance sheets and income statements formats are prepared centrally by the Ministry of Public Finance for easier centralization. These models are imposed even on companies that apply IFRS which thus produce two sets of accounts: one for tax authorities and a second for other users - in particular investors. Some financial indicators (fixed assets, current assets, total assets, turnover/revenues, operating income) are often different in the two sets of financial statements because of the different algorithms applied: while the Ministry of Public Finance imposes the same algorithms on all entities, in the IFRS financial statements, each individual company applies the rules as closely as possible to the spirit of IFRS and its individual situation.

3. Literature review

The differences between the accounting income and the taxable income are mainly due to non-deductible expenses, non-taxable income and other tax deductions. However, after applying the tax rate to the taxable income, the resulting tax does not automatically become the tax payable, as there are tax credits involved (exemptions, reductions, external tax credit, sponsorship).

Differences between accounting and taxation (particularly in terms of accounting/tax income) are often justified by the fact that the two have different objectives (Nobes, 2004). Accounting aims to provide credible and relevant financial information, while taxation aims to provide resources needed to cover public expenditures (D'Ascenzo & England, 2005). On the other hand, in a context in which investors assess the management of companies by their reported performances, we could easily identify a possible conflict between, on the one hand, the desire to yield a higher profit, to satisfy the market and, on the other hand, the interest of avoiding the outflow of resources by paying taxes. In this context, we can expect that the accounting income will often differ considerably from the taxable income. Disconnection points between accounting and taxation have thus created legitimate differences between the two sets of standards (Tang, 2015), but there are also discretionary (abnormal) differences, resulting from managers' ability to manipulate both incomes. The disconnection between accounting and taxation is considered to have advantages, including a better relevance of the information provided in the financial statements. However, differences between accounting and taxation contribute to a significant increase in compliance costs, which, together with differences between tax systems in different States, lead to difficulties in comparing the performance of enterprises located in different States and in the possible allocation of profit tax between the

States in which the subsidiaries of certain groups are located. However, connecting accounting and taxation is not the only way to reduce tax compliance costs. Barrios *et al.* (2020) consider that the implementation of the European CCCTB project, even if limited to its first phase (CCTB) can have - precisely by reducing tax compliance costs - a significant effect on GDP and welfare in Member States.

Tennant and Tracey (2019) consider that accounting options are influenced by financial and tax considerations: sometimes these are in conflict. However, financial considerations often take priority over tax considerations, as managers prefer to maximize the value of shares and reduce taxes. Sikka (2017) in turn says that differences between accounting and taxation are influenced by economic, market and even political pressures.

Although tax standards try to establish precise rules for the tax recognition of charges and revenues, they cannot cover all situations because commercial transactions are complex and constantly evolving; hence some uncertainty in the application of tax and even accounting rules (Tang & Firth, 2011). Thus, the definitions and criteria for the recognition of revenues and charges established by accounting standards are constantly evolving; similarly, the tax criteria for the recognition of revenues and charges are also subject to a continuous updating process. In order to simplify the accounting and tax management activity, many companies, especially unlisted companies, opt, de facto, for accounting policies close to tax ones, to reduce tax compliance costs. This situation has been documented in Romania (Păunescu, 2015), but also in other states (Cercius *et al.*, 2016).

The analysis of changes in accounting and tax standards shows us, in recent decades, a fairly clear trend in the direction of disconnection between the two set of rules. However, in the literature, there are authors who suggest full accounting-tax compliance, while others argue that total disconnection is the right solution, in various geographical or institutional contexts (Atwood *et al.*, 2010).

Supporters of a close link between accounting and taxation argue that this option reduces administrative costs and, at the same time, limits the possibilities of tax optimization and, consequently, tax aggressiveness, as well as the earnings management. Desai (2005) considers that the separation between accounting and taxation offers to managers the opportunity to manipulate the profits reported to the financial market, as well as the incomes reported to the tax authorities, and this represents a deterioration in the quality of financial indicators. On the same line, Whitaker (2005) considers that reconciling tax accounting is the only way to limit tax optimization, which has become increasingly complex and harmful. A closer link between accounting and taxation can also generate a more prudent behavior, in the sense of applying accounting standards in order to take advantage of the possible asymmetry between the immediate recognition of charges - even they are only probable - and recognition of revenues only when they are certain; Watts (2003)

appreciates that this asymmetry allows managers to reduce the present value of taxes and increase the present value of the company. Blaylock *et al.* (2017) also argue that the costs of tax compliance have been reduced; moreover, a decrease in earnings management is estimated, by linking the taxes paid to the reported accounting income (reduced taxes would also mean that the income presented to investors are also reduced). In the United States, proposals were even made to increase the degree of connection; proposals came from the politicians, both from the Bush administration and the Obama administration, in their attempts at tax reforms. Tang (2015) found that, across a sample of companies in 32 countries, a high degree of accounting and tax compliance discourages earnings management and tax avoidance. By analyzing the situation of private (unlisted) companies in 12 European countries in which tax rate reductions have taken place, Sundvik (2017) finds evidence that greater compliance is associated, overall, with a lower level of earnings management, although, when this earnings management appears - for example, when the income tax rate is lowered – higher compliance is more strongly associated with lower manipulation of reported incomes. An example of costs that can be reduced by a closer link between accounting and taxation are audit fees: Kuo and Lee (2016) find a significant reduction in audit fees as a result of an increase in the connection between accounting and taxation.

On the other hand, it is considered that a close link between accounting and taxation undermines the relevance of financial information, as tax accounting is not intended to guarantee the needs of investors (Young & Guenther, 2003); the authors use a binary variable to measure accounting-tax compliance, considering that the connection is weak in: Australia, Canada, Denmark, Hong Kong, Ireland, Israel, the Netherlands, New Zealand, Norway, Singapore, South Africa, United Kingdom, United States and narrow in Belgium, Finland, France, Germany, Italy, Japan, Korea, Spain, Sweden and Switzerland. Yoon (2008) also finds confirmation of a better relevance of financial information in countries with a limited level of compliance between accounting and taxation. Atwood *et al.* (2010) notes that an increase in the level of compliance results in less persistent and less cash-flow-related accounting incomes. Hanlon (2005) finds that a greater distance between accounting and taxation leads to a lower persistence of company-reported incomes and that these differences attract the attention of investors, influencing their perception of company performance. Cuzdriorean *et al.* (2012) found that the close relationship between accounting and taxation can be a significant obstacle in harmonizing international accounting.

The distance between the accounting and the taxable incomes or the conformity between accounting and taxation appear in many studies. Evers *et al.* (2016) states that most studies that address book-tax differences have in common the fact that they use a proxy for the taxable income, in the absence of access to tax returns. Tang & Firth (2011) list the two possibilities for measuring differences between accounting and taxation in terms of CIT:

a) from the accounting income, from which the taxable income is deducted, we obtain the sum between permanent and temporary differences;
(b) by applying the CIT statutory rate to the pre-tax accounting income, followed by the deduction of the current CIT charge.

Atwood *et al.* (2010) propose a measure of the compliance between accounting income and taxable income, in an international context; based on CIT current expenses, including the change in relation to accounting profit, placed in a regression model, can measure the compliance between accounting and taxation. Hung (2000) uses an accounting-tax compliance index based on the following variables: the average consensus on accounting - taxation (60%), to which he adds the answers to the following questions: the form prevails over the substance? Is accelerated depreciation accepted? The duration of depreciation depends on the tax law? The classification of leasing contracts depends on the tax law? Xian *et al.* (2015) calculate the difference between accounting and taxation as a difference between pre-tax accounting income and taxable income; the latter is estimated as a ratio between the current charge of CIT and the legal rate of CIT.

According to the accrual model, some authors break down the differences between accounting and taxable incomes into two categories: normal and abnormal (discretionary) differences; we find such a classification in Tang (2015), but also in Tang & Firth (2011). Xian *et al.* (2015) point out that the discretionary differences between the two incomes represent an indirect indicator of tax planning.

In some situations, in order to avoid attracting the attention of tax authorities, companies may use earnings management techniques to reduce the magnitude of differences between accounting and tax income (Xian *et al.*, 2015).

In the case of Romania, Cuzdriorean *et al.* (2010), analyzing data on Romanian companies listed on both segments of the BSE financial market, found that there is an influence of taxation on accounting, but this influence is not decisive as it is presented in other studies on the situation of Romanian firms. The trend towards such a situation in which the influence of taxation on accounting has decreased is also confirmed by Deaconu and Cuzdriorean (2016), in particular following the emergence of new users of accounting information and the amendment of standards in this regard.

4. Methodology and data

This study is a continuation and a development of Istrate (2011) analysis, so I used the model originally proposed by Lamb *et al.* (1998) and developed by Nobes and Schwencke (2006). They calculated a score that measures the distance between accounting and taxation. The list of items analyzed by Lamb *et al.* (1998) includes

15 elements (with some subdivisions), to which Oliveras and Puig (2005) add an additional item (financial assets), while Nobes and Schwencke (2006) arrive at 17 items, after adding the asset depreciation. For the situation in Romania, Istrate (2011) provides a list of 18 elements, adding also some subdivisions to the list found in the literature (Table 2).

In applying the grid, only accounting and tax rules are taken into account, without reference to accounting practice. The actual application of these standards may or may not confirm the findings of the *de jure* analysis. In order to have an idea of how, in some representative Romanian companies, this *de jure* situation is reflected in the actual accounting options, I analyzed some representative data from the financial statements of Romanian companies listed in the two BSE segments: the regulated market, with data from 2000 to 2021, and the AeRo alternative market, with data from 2010 to 2021. According to the literature, ETR was calculated by dividing the current charge of CIT to the pre-tax accounting income.

Table 1. Structure of the population analysed

Year	Observations			Statutory CIT rate
	Total, from which	Regulated market	AeRo market	
2021	216	69	147	16%
2020	223	67	156	16%
2019	236	70	166	16%
2018	229	69	160	16%
2017	252	70	182	16%
2016	274	70	204	16%
2015	270	65	205	16%
2014	272	65	207	16%
2013	270	67	203	16%
2012	275	65	210	16%
2011	284	68	216	16%
2010	376	88	288	16%
2009	90	90	-	16%
2008	78	78	-	16%
2007	84	84	-	16%
2006	77	77	-	16%
2005	73	73	-	16%
2004	74	74	-	25%
2003	63	63	-	25%
2002	46	46	-	25%

Year	Observations			Statutory CIT rate
	Total, from which	Regulated market	AeRo market	
2001	40	40	-	25%
2000	39	39	-	25%
Total	**3,841**	**1,497**	**2,344**	**-**

Source: BSE and listed companies' websites

For this part of the study, the initial total number of observations for both segments of the BVB was greater than 5,300, but some were eliminated as follows:
- observations with taxes other than CIT (302 cases with tax on revenues or other specific tax);
- observations with a negative pre-tax income and without current CIT (1,208 observations).

The total of the observations with a negative pre-tax income was greater than 1,500: I did not eliminate the situations with negative pre-tax income, but with a current positive CIT: for these observations, I reduced the ETR to the level of the 99th percentile. In over 550 cases, the current CIT was negative (8 observations) or zero: in these cases, the ETR was reduced to 0. In Table 1, I presented the structure of the population analyzed in the calculation of ETR. The number of observations is different on the two segments of the BVB and the analysis period is also different. For the regulated market, the period before 2012 is characterized by the application of Romanian accounting standards (RAS), while 2012 was the first year of application of IFRS; in the AeRo market, I start with 2010 and the accounting standards applied are the national standards (RAS) for all the period.

As a result of the application of the grid proposed by Lamb *et al.* (1998), by Istrate (2011), I expect the evolution of accounting and tax standards towards a more pronounced *de jure* disconnection, which should lead to an increase *de facto* disconnection. This may be even more evident after the application of IFRS: Sikka (2017) shows that applying these standards reduces the usefulness of accounting figures for tax purposes.

5. Results

The descriptive analyses I propose in this study are reflected, first, in Table 2, in which we have added two columns for 2021, one for companies applying RAS, the other for IFRS. After that, I calculated the indexes proposed by Nobes and Schwenke (2006) to measure the distance between accounting and tax rules. Finally, I calculated ETR as a proxy for the *de facto* book-tax (dis)connection.

5.1 Analysis of the items that can characterize the accounting-taxation relationship: comparison 2010 - 2021

In Table 2, I have kept the last of the 6 columns proposed by Istrate (2011). In order to be able to compare the scores calculated according to the formula proposed by Nobes and Schwenke (2006), I have added to the score proposed by Istrate (2011) 10 new elements, for a better description of the accounting-tax relationship in 2021. Thus, the total number of items analyzed is 40, compared to the 30 proposed in Istrate (2011). The application of IFRS in the individual accounting of certain Romanian companies requires to propose two columns concerning the accounting-tax relationship: one for RAS, the other for IFRS.

Table 2. Measure of the accounting-taxation relationship in Romania, 11 years apart

Item	2010	2021	
		RAS	IFRS
1. Fixed assets recognition and valuation			
a) cost			
b) revaluation	II and I	II and I	I
c) subsequent costs	II	III’	I
d) disposal of an asset in an intra-group	I and II	I and II	I and II
operation	II and I	I	I
e) fixed assets obtained as a result of restructuring operations (mergers, separation, contribution, transfer of activity)	II	I	I
2. Impairment of tangible assets	I	I	I
3. Leases			
a) lease classification	II	III’	I
b) lease-back	I	III’	I
4. Depreciation			
(a) normal	I	I	I
(b) accelerated	III’, I	III’	I
5. Provisions	I and V	I and V	I
6. Grants and subsidies	III	III	III
7. Research and development costs	II	I	I
8. Inventory valuation:			
(a) cost measurement	II	II	II
(b) flow assumption	II	II	II
(c) other areas (e.g. impairment)	I	I	I
9. Long-term contracts	III’	III’	I
10. 1) Interest, independent companies			
(a) capitalization	II	II	II
(b) other			
- bank loans and similar	II	II	II
- other credits	I	II	II
2) Borrowing costs for companies belonging to groups	II and I	I	I

Item	2010	2021	
		RAS	IFRS
11. Financial assets:			
- long term financial assets;	I	I	I
- short-term financial assets	III	III	I
- impairment of receivables	III’	III’	I
12. Foreign currency			
(a) operating activities	II	II	II
(b) financing activities	II and I	II	II
13. a) Goodwill (non-consolidation)	I	I	I
b) Goodwill (consolidation)	I	I	I
14.Pensions			
(a) mandatory contributions	II	II	II
(b) voluntary contributions	I	III’	I
15. Policy changes and fundamental errors	III and V	III	III
16. Scope of the group	I	I	I
17. Fines, charitable donations, entertaining expenses	I	I and III’	I
18. Others			
a) advertising costs	II	II	II
b) instalment sales	II	II	II
c) travel costs	II	II and I	II and I
d) assets exchanged	IV	II	I
e) special activities (bars et night clubs, casinos, discos)	I	I	I
f) biological assets	II	II	I
g) investment property	II	II	I

1) Fixed assets are important by their weight in the balance sheets of Romanian firms. The data specific to Romanian companies listed on the two segments of the BSE allow us to calculate the figures that appear in Table 3. In addition to the weight of fixed assets in total assets, I presented, in the same Table 3, the proportion of tangible and intangible fixed assets - likely to generate deductible depreciation expenses - and also information regarding the option to reevaluate some fixed assets.

Table 3. Data on the fixed assets of the Romanian listed companies

Items	Regulated market of BSE	AeRo market
Total available observations	1,609	3,569
Financial reporting standard applied	RAS, 2000-2011 (839 observations) et IFRS, starting with 2012	RAS, for the entire period
Period	2000-2021	2010-2021
Fixed asset, in total assets, on average (%)	56.52	62.95
- with a minimum of	51.69 (in 2001)	58.31 (in 2020)
- and a maximum of	60.99 (in 2020)	66.01 (in 2017)

Items	Regulated market of BSE	AeRo market
Tangible plus intangible assets, in total assets, on average (%)	49.12	57.33
- with a minimum of	43.12 (in 2021)	51.03 (in 2021)
- and a maximum of	53.10 (in 2009)	60.82 (in 2016)
Number of observations with revaluation reserve reported in the equity	1,224 (76.07%)	3,154 (88.37%)
Revaluation reserve in total assets, on average (%)	23.92	40.93
- with a minimum of	20.37 (in 2014)	32.82% (2010)
- and a maximum of	53.05 (in 2001)	94.06% (2019)

Source: financial statements of the Romanian listed companies

In the case of tangible fixed assets, the evolution of the accounting-taxation relationship between 2020 and 2021 is significant only for IFRS, where we reach a *de jure* disconnection that leads to differences from the tax rules, much more rigid in definition, recognition, valuation and revaluation or depreciation/impairment. In the case of the initial cost measurement, for example, the introduction of provisions for decommissioning into the cost of the asset is not recognized for tax purposes. The same is true for assets acquired as a result of reorganizations (mergers, separations, contributions in assets): from an accounting point of view, the transfer is made at fair value, whereas the tax value for the acquirer must be equal to the tax value that the asset had prior to the transaction.

The positive revaluation is, at present, completely neutral from the point of view of CIT, the potential depreciation allowance increases, but this increase is offset by the systematic imposition of the revaluation reserve. This rule has been valid since 2010 and has limited the appetite of Romanian companies to reevaluate certain categories of fixed assets, other than buildings and land. They were revaluated for reasons not related to CIT, but rather to the tax on building. This tax was calculated until 2015 by applying an increase in the tax rate of up to 20% per year, in the case of non-revaluation in the last 3 years and even up to 40% per year, in the case of non-revaluation in the last 5 years. Thus, the tax authorities create the premises for some companies to completely abandon the revaluation and the RAS has been explicitly modified in this respect. However, despite these incentives to forgo revaluation, few companies have made such a change in accounting policy, showing once again that the persistence of accounting options is very important.

The adoption in Romania of the ATAD Directive has introduced into the Tax Code the rules according to which the taxation of the gains resulted from transactions relating to fixed assets within the group, in particular when one of the parties involved is based in another State, must follow tax procedures to avoid profit shifting.

An important connection point from accounting to the taxation of fixed assets is the minimum entry value above which an asset is recognized as a tangible asset: the accounting standard does not establish such a general limit (neither in RAS nor in IFRS), sending to a threshold of significance that individual enterprises must establish themselves. However, most companies applying the RAS apply the tax threshold of 2,500 lei, or about 500 euros (this threshold is valid from 1.07.2013, when it was about 600 euros). The same thing happens with depreciation periods, so often you can find companies that use fully amortized assets.

Fixed assets become, *de jure*, one of the most important sources of differences between accounting and taxation, that is to say an element that can frequently lead to the case of disconnection I. This situation is not only specific to Romania: Evers *et al.* (2016) found a similar situation for Germany in 2010, and Cernius *et al.* (2016) confirmed a similar result for Lithuanian companies.

2) The conditions imposed by the tax law for the tax recognition **of impairment of fixed assets** are very difficult to fulfil, so that these expenses are practically not deductible. The tax depreciation retains initial cost as a depreciating value, with very little possibility of changing it. In the practice of Romanian companies, especially those applying RAS and, in a more nuanced way, in the case of the IFRS application, there is always a significant persistence of the accounting-tax connection. This connection is almost complete for businesses that are not required to have their financial statements audited. Audited companies - because of their public interest status or size - do not often feel compelled to depreciate their fixed assets. Istrate *et al.* (2020) find that the impairment of fixed assets is the third most common justification for modified opinions expressed by auditors of Romanian companies listed on the regulated market (the revaluation of fixed assets is the first explanation for this type of opinion).

3) Leases have been separated into operating leases and finance leases since 1999. Initially, accounting rules were accepted for tax purposes, but at one point the Tax Code introduced slightly different criteria for the separation of the two types of contracts. These differences did not affect the accounting and taxation of leasing contracts too much. In 2010, there was a complete accounting-tax disconnection for leaseback contracts. This is no longer the case: the tax rule has evolved to accept the accounting method of recognition of this type of transaction. In order to avoid overly complicating the way these contracts are handled, the companies that apply RAS opt for the accounting solution, because it is easier to manage from a tax point of view. However, in IFRS, the application of the new rules on leasing contracts, given that tax standards have not changed, leads to a complete disconnection between accounting and taxation, both from the point of view of contract classification and from the point of view of establishing values specific to leasing contracts.

4) Depreciation of fixed assets is an important element through its effects on accounting and taxable incomes. Romanian tax standards have established, *de jure*, that tax deductions for depreciation are independent of accounting depreciation. However, the RAS allows accelerated depreciation – accepted for tax purposes – even if it explicitly recognizes that this depreciation does not reflect the irreversible loss in value of fixed assets. Thus, the option for accelerated depreciation - very rare - falls in case III', for RAS. In IFRS, *de jure* disconnection is total, especially since the definition of the estimates required for depreciation is very different from what is accepted by the tax standard. However, if we had concrete data from a sufficiently large sample of Romanian companies, we would probably find that the accounting depreciation is calculated - in many cases - by applying the specific tax rules, even if the company is subject to IFRS.

5) The list of deductible provisions is short and, in addition, there are very restrictive deductibility conditions. Thus, apart from the provisions for guarantees given to customers, the others are limited for tax purposes or tax recognition sometimes seems to be done in a completely different way from the recognition of such provisions. In general, companies applying RAS and not having the obligation to audit their financial statements only recognize tax provisions (Dănescu *et al.* 2011); for the rest, the disconnection is almost complete.

6) In general, the tax treatment of **subsidies** is identical to the accounting system, that is to say that they are transferred to taxable revenues at the same time as in the accounting system. In the case of IFRSs, a difference may occur for grants in respect of assets, where companies choose to present them as a deduction from the book value of the assets so financed, but this difference only has an effect on the fact that the tax value differs from the book value, without affecting the net deductible depreciation expense.

7) The difference between the two dates (2021 compared to 2010) for **development expenses** is due to additional tax deductions, as well as tax exemptions for businesses with majority activities of this type. The tax rule establishes as a starting point the accounting rule in the initial recognition of research and development expenditures, but there is an additional 50% tax deduction.

8) In the case of valuation and recognition of **inventories**, the 2021 accounting rules are identical to the 2010 rules. Thus, taxation is aligned with accounting, except for negative quantitative differences found in the inventory.

9) Long-term contracts generating revenues over several periods have been and are recorded according to accounting rules for which there is no tax equivalent and, in most cases, accounting documents are prepared in such a way that they correspond to tax requirements. For IFRSs, the amendments made by IFRS 15, to the extent that

they are strictly applied, may result in significant differences between accounting and taxation.

10) The borrowing costs is considered in accounting by applying tax-recognized rules. It should be noted that RAS require, as of 2015, the capitalization of some of these costs, almost as in IFRS. For the rest, from 2018 onwards, and pursuant to the ATAD Directive, significant differences may occur in the borrowing costs for group-owned companies, which completely disconnects the accounting recognition (whether capitalization or not) of tax deductibility.

11) For financial assets, long-term securities are subject to accounting rules that can be completely disconnected by tax rules. With respect to short-term financial assets, the tax rules are rather aligned with the accounting rules, in the case of companies applying RAS. On the contrary, the application of IFRS, with the diversity of situations for financial instruments, creates the conditions for a complete disconnection of accounting and taxation. If we look at the most common financial assets – trade receivables – we see that the tax standard sets rules to limit the deductibility of their impairment and, often, companies applying RAS prefer to limit themselves to accounting for this tax impairment (the situation is similar to that described by Poli - 2015 - for unlisted Italian companies).

12) For Romanian companies paying CIT, the accounting **foreign exchange differences** are recognized for tax purposes. Differences may occur in the case of conversion reserves, but they are specific to the consolidated financial statements, so they are not the subject of our analysis.

13) The goodwill, whether it appears in the individual accounts (due to mergers, contributions in assets, acquisitions of groups of assets) or consolidation, is not recognized for tax purposes. Thus, according to the RAS, the goodwill is depreciated and the depreciation expense is not deductible, while in IFRS, any impairment expense is also non-deductible.

14) There are two types of **employers' social contributions**: those that are mandatory – fully and immediately recognized in accounting and taxation – and those that are optional, for which there are tax recognition limits. Romanian companies that engage in such optional contributions are generally limited to tax-recognized levels, so the classification in case III is justified. For companies applying IFRS, the rules of IAS 19 are far from those accepted by the tax rules: we can therefore assess that there is a disconnection.

15) The Fiscal Code does not provide rules for **changes in accounting policies** - the only specification being that accounting methods for valuing inventories are recognized for tax purposes. Under these conditions and in the absence of any explicit tax restrictions on changes in accounting policies, we can assess that the tax

treatment is aligned with that of the accounting (case III). In the case of the correction of material errors resulting from previous years and with an impact on the tax result, the tax rule imposes a CIT rectified return, without introducing any special restrictions in this regard.

16) In 2010, **business groups** had no tax recognition, in terms of CIT. The total disconnection relationship is maintained in 2021, even if a tax integration regime was introduced by Romanian law. The definition of the tax group at the CIT has nothing to do with the consolidation accounting criteria, so the disconnection relationship between accounting and taxation remains valid.

17) In the case of **fines and representation charges**, the tax rules did not change significantly in 2021 compared to 2010, i.e. the disconnection relationship is valid. However, companies applying RAS tend to limit accounting charges according to tax thresholds, so that case III is identified. **Sponsorship** fees remain entirely non-deductible, with the possibility of recognizing them as a tax credit.

18) Here I have added four new elements, taking into account the changes in accounting and tax regulations between 2010 and 2021. For asset exchanges, until 2014, there was no explicit accounting rule, so firms followed the tax rule. The change in the accounting standard from 2015 onwards has led to a complete alignment with the existing tax standard: this is case II, a full connection for companies applying RAS. At the same time, RAS is beginning to recognize the concepts of investment properties and biological assets, but without any valuation/depreciation features that would differentiate them from the structures in which they were previously located: the connection is complete. On the contrary, companies that apply IFRS and that have transactions involving exchanges of assets, investment properties or biological assets apply accounting rules entirely different from tax rules - case I, disconnection.

5.2 Indexes measuring the book-tax differences

In the continuation of the partial replication of the results of Istrate (2011), I recalculate the indexes of the measurement of the influence of taxation on accounting proposed by Nobes and Schwencke (2006). The calculation of these indexes is based on the premise that in cases II and III accounting and tax practices coincide; differences arise when we deal with cases I (complete disconnection of accounting and taxation), III (accounting imposes the rule, but taking into account the tax interest), IV (the tax rule is preferred) and V (taxation dominates).

Table 4. Longitudinal comparison of the accounting relationship – taxation in Romania

The case	2010	2022	
	RAS	RAS	IFRS
Case I – Disconnection	15,5	14,5	27,0
Case II – Identity (Total connection)	17,0	14,0	11,0
Case III – Accounting leads	2,5	3,0	2,0
Case III' – Accounting leads, but with reverse effect	3,0	7,5	0,0
Case IV – Taxation leads	1,0	0,0	0,0
Case V – Taxation dominates	1,0	0,5	0,0
Total	40,0	40,0	40,0
Minimum index (case IV/V – case I)	-13,5	-14,0	-27,0
Maximum index (case III'/IV/V – case I)	-10,5	-6,5	-27,0

Source: Istrate, 2011 and table 2, above

The new elements introduced compared to Istrate (2011) modify the 2010 scores as follows: the minimum index goes from -11.5 to -13.5 and the maximum index goes from -10.0 to -10.5. The 2021 - 2010 comparison does not give us spectacular results for companies applying RAS. On the contrary, as expected, the *de jure* accounting - tax separation is extremely clear with respect to IFRS. This confirms the conclusion proposed by Albu *et al.* (2014) that an analysis of a country's accounting cannot be based on the assumption that it is a monolith and that all categories of enterprises behave in the same way. The *de facto* confirmation of this disconnection has yet to be demonstrated: being part of multinational groups and having recourse to exigent financial auditors can ensure such a disconnection in the effective application of accounting and tax rules. I can estimate, similar to Păunescu (2015), that for locally owned companies, the persistence of accounting policies and the history of accounting-taxation compliance has not yet led to a very visible *de facto* separation between accounting and taxation. The results reported in Table 4 can be considered a rather subjective measure of the relationship between accounting and taxation.

5.3 Book-tax differences as measured by the effective tax rate

The results presented in Table 4 allow us to assess that *de jure* disconnection is fairly clear, both in 2010 and 2021, especially for companies applying IFRS. It follows that the differences between accounting and the taxation of earnings can be significant. Nevertheless, Fekete *et al.* (2014) find a strong link between SME accounting and taxation in Romania. For the period 2011-2020, Vâlcu (2022) calculates ETR of Romanian companies listed on the regulated market and finds that ETR (current income tax/pre-tax income) are on average close to the legal tax rate.

For the companies analyzed in this study, the results seem to confirm a disconnection between accounting and taxation, as the average ETR over the period analyzed is over 26% for a legal rate of 16% and over 27% for a legal rate of 25%. Even if the observations for which the legal rate was 25% are very few (the period 2000-2004

only brings 262 observations out of 3,841, or 6.82%), I find that on average, the decrease of the in the ETR after the 9-point drop in the legal rate was significant only in the first three or four years after the change. For all years, the average ETR is significantly higher than the legal rate (confirmed by the T-test, both for the total, and for each segment of the financial market), indicating a tax burden that seems significant, as well as tax rules that may be interpreted as significantly different from accounting rules, at least for listed companies, in terms of tax recognition and accounting recognition of revenues and expenses, but also for other differences between accounting and taxation. Comparing the two segments of the BSE, the differences in effective rates between them are not significant, according to the T-test.

The highest levels of ETR were calculated for 2009 and 2010, exactly in the two years following the global financial crisis, when the sharp drop in revenue from the Romanian state budget led to the introduction of a minimum corporate tax: the legal rate remained at 16%, but the amount paid could not be less than a minimum level, valid between April 2009 and September 2010.

Table 5. Effective tax rates for the Romanian listed companies

Year	ETR for total observations (%)	ETR by market segment (%)		ETR by accounting rules (%)		ETR by auditor category (%)		
		regulated market	AeRo market	IFRS	RAS	B4	nB4i	nB4L
2021	18.11	15.94	19.13	16.02	19.08	16.58	20.66	17.20
2020	21.55	22.04	21.35	22.57	21.15	19.56	25.55	21.69
2019	19.94	17.82	20.83	17.88	20.79	17.61	17.66	21.39
2018	24.11	20.61	25.62	20.70	25.52	16.42	19.87	27.42
2017	24.70	25.84	24.27	26.07	24.20	17.85	23.10	27.44
2016	26.03	19.58	28.24	19.67	28.13	17.43	25.80	28.81
2015	22.85	20.66	23.55	20.77	23.47	17.53	27.78	22.87
2014	24.34	21.01	25.39	21.18	25.26	21.76	18.78	25.05
2013	27.19	22.34	28.79	23.19	28.36	29.43	18.52	24.92
2012	26.30	23.81	27.08	23.00	27.15	32.58	14.77	25.18
2011	23.66	20.83	24.55		23.74	17.36	18.39	24.93
2010	46.10	41.94	47.37		46.37	39.61	53.10	44.92
2009	35.34	35.34			35.34	33.06	33.75	36.04
2008	21.49	21.49			21.49	13.20	25.54	24.63
2007	18.35	18.35			18.35	16.97	13.60	17.80
2006	19.39	19.39			19.39	16.43	12.14	20.82
2005	20.79	20.79			20.79	13.11	12.86	25.73

Year	ETR for total observations (%)	ETR by market segment (%)		ETR by accounting rules (%)		ETR by auditor category (%)		
		regulated market	AeRo market	IFRS	RAS	B4	nB4i	nB4L
2004	26.68	26.68			26.68	26.17	18.95	28.34
2003	26.30	26.30			26.30	26.04	25.32	28.74
2002	29.86	29.86			29.86	32.01	20.49	32.89
2001	29.58	29.58			29.58	38.07	20.35	27.35
2000	25.77	25.77			25.77	n.a.	n.a	n.a.
Total	**26.12**	**23.97**	**27.49**	**20.97**	**27.17**	**21.99**	**22.63**	**26.89**
Total 16%	**26.02**	**23.24**	**27.49**	**20.97**	**27.14**	**21.53**	**22.71**	**26.77**
Total 25%	**27.45**	**27.45**	**n.a**	**n.a**	**27.45**	**29.41**	**21.39**	**29.29**

After the elimination of the minimum tax - which were very badly perceived by the business community - the ETR falls significantly, but remains very high compared to the legal rate - between 20% and 25% - until 2018. The financial year 2019 is accompanied by a significant decrease in the average ETR, overall and by segment. This is probably due to the influence of information on the pandemic crisis. These appeared in February 2020, when all Romanian listed companies have their closing date as of December 31 and we know that the presentation of the financial statements is, as a rule, somewhere between March and April, while the regularization of the CIT for 2019 was done before March 25, 2020. Under these circumstances, we can assume that the pandemic and the resulting state of emergency - as post-closure events - led to the accounting recognition of the corresponding risks. 2020 and 2021 were fiscal years with tax breaks generated by the pandemic but also by other tax decisions, such as the reduction of up to 15% of the tax payable, in case of positive and increasing equity.

As regards the rules applied, for the period in with IFRS data could be compared with RAS data (2012-2021), the ETRs of firms applying IFRS is lower than the ETRs of companies applying RAS and significantly different from it (according to the T-test), both well above the statutory rate of 16%. These results could suggest that the application of IFRS leads to a better reconciliation of accounting and taxation! Or rather, that companies that apply IFRS have more resources in terms of reducing the tax burden.

The auditors of Romanian companies can be divided into three categories: Big 4 (B4), non-Big 4 affiliated to international networks (nonB4i) and local auditors (Nb4L). In calculating the average ETRs, we observe in Table 5 that internationally affiliated auditors (whether B4 or not) work for companies whose ETRs are lower than those established for companies with local auditors. In all cases, however, the ETRs are well above the legal rate.

6. Conclusions

The book-tax link, as regards to corporate income tax, is very present in the literature. In the case of Romania, studies have found that this link has evolved towards an increasingly visible *de jure* disconnection. Applying the analytical grid proposed by Lamb *et al.* (1998) and developed by Nobes and Schwenke (2006) and continuing the study of Istrate (2011), I have analyzed a number of elements in which the difference between accounting and taxation rules may be directly identified. In Istrate (2011), the last year analyzed is 2010; I have kept this date and added 2021, in two columns, taking into account that, since 2012, a number of Romanian companies apply IFRS in their individual accounting. The analysis only concerns the individual financial statements of companies, as the calculation of CIT is done at the level of each legal entity; it is only in 2018 that the possibility of tax integration was introduced at the level of certain groups, whose tax definition is very far from the criteria used in the accounting consolidation. To the initial 30 items in the 2010 column published in Istrate (2011), I have added 10 new items, for which tax rules may differ from accounting rules and are the result of changes in accounting and tax rules.

After adapting the 40 items to the 6 cases proposed by Lamb *et al.* (1998), I calculated scores, following the model of Nobes and Schwenke (2006) and found that accounting and taxation are quite *de jure* disconnected, but that the evolution of this disconnection between 2010 and 2021 is not significant for companies applying RAS. On the contrary, for companies applying IFRS in their individual accounting, the distance between accounting and tax rules has become increasingly important, which may allow us to estimate that there would be an almost total disconnection of accounting and taxation. This latter conclusion is consistent with the literature, which presents international rules as being independent from tax rules. It also confirms the assumption that the application of IFRS creates at least two categories of companies, as regards the manner in which accounting and tax reporting is carried out.

In an attempt to find empirical confirmation of the *de jure* book-tax disconnection in Romania, I have taken as an indicator the effective tax rate (ETR), calculated by dividing the current income tax to pre-tax accounting income. I did not take into account deferred taxes to ensure comparability of data on the period used (2000-2021 for companies listed on the regulated market and 2010-2021 for those listed on the alternative market). After eliminating the observations with missing data, those with a negative pre-tax income (except where there is a positive current tax charge), and those in which some companies have incurred taxes other than CIT, I arrive at a total of 3,841 observations, including 1,497 for the regulated market (648 IFRS). Unlike Vâlcu (2022), I find that the average ETR is much higher than the statutory tax rates, especially for the 16% period. The change in the legal rate from 25% to 16% only led to a decrease in ETR for about four years, after which it rose to high levels.

The significant differences between the ETR and the statutory rates can confirm the *de jure* disconnection between accounting and taxation identified on the basis of Lamb *et al.* (1998). The general figures show significant differences, but if we look at IFRS data compared to RAS data, we find lower ETR under IFRS, which is somewhat different from the result reported in Table 4. Another difference that I find in the analysis of these average ETRs is that the ETRs of companies audited by auditors affiliated to international networks are lower than the ETRs calculated for companies audited by local auditors.

The main limitations of the research are its descriptive nature, the taking into account of a very small number of companies - notably due to the limited size of the Romanian financial market - and the lack of an econometric model to analyze the differences between accounting and taxation in relation to corporate governance indicators or other types of indicators.

The limitations could represent future directions for research. It would also be very useful to compare the Romanian data with those of other European countries, especially Central and Eastern Europe. In addition, the results of the study can also be interpreted in the sense that the differences between ETR and STR can be explained, at least partially, by the important *de jure* book-tax disconnect. In these circumstances, the use of ETR as a proxy for tax avoidance does not necessarily seem to be a very appropriate one, or at least it is necessary to separate, as far as possible, the part of the difference generated by the *de jure* disconnection on the part generated by the eventual fiscal aggressiveness of the companies. Future researches in this regard can lead to useful and relevant results.

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