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## **COMPARING THE EFFECT OF FUNDAMENTAL DIFFERENCES BETWEEN TAX LAWS AND IRANIAN ACCOUNTING STANDARDS ON THE DIFFERENCE BETWEEN DECLARATION AND DEFINITE TAXABLE INCOME**

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### **ABSTRACT**

The goal of this study is to identify "the causes of the differences between declaration and definite income tax identified by the tax organization and related entities." The population under study is the working companies in Mazandaran Province that have submitted tax declaration and have provided proper documentation and registries the during the related procedure and their definite income tax is specified by addressing the related documents and the definite and declaration taxable income of 238 eligible companies and the significance of the difference between definite and declaration taxable income is tested. The results of this study suggest that there are significant differences between definite and declaration taxable income and in creating this deference in satisfactory state of offices the most common expenses \_among the total expenses of the studied companies\_ rejected by the tax organization include: 17.79% difference arising from the failure to provide or lack of documentation and lack of factor to prove the expenses and 14.86% due to the lack of relationship between the expenses and the company income which indicate that incomplete accounting process in the financial activity cycle of the companies, forging expenses or denying the income by the companies as well as the difference between accounting standards and direct taxes code are among the main factors of creating difference between the declaration and definite income tax in satisfactory state of offices.

**Keywords:** *Declaration Taxable Income, Diagnosis Definite Taxable Income, Differences between Book Profit and Tax Income*

### **INTRODUCTION**

With the beginning of the era of industrialization and the emergence of companies and separation of ownership from management in established companies, the governments consider the corporate as the entities which are working to earn money and an important source of tax and one of the main sources of receiving income tax is the surplus capital and value due to the presence and activity of the companies. Since the companies and legal entities are the intersection of shareholders, investors, management, active forces and the society the effectiveness of tax systems about the legal entities is more complex that the tax systems regarding the individuals and may affect the interests of a wide range of individuals – entities (Bagheri *et al.*, 2008).

According to the above factors the differences between companies and tax organizations \_manifested in the declaration and definite taxable income determined by the tax organization\_ is very important. Here in Iran by enacting the tax law in 5 / 4 / 1930 until the enactment of direct taxes in 22/2/1988 and the Law amending the Law on Direct Taxes enacted in 6/2/2002 the determination and collection of the tax had some modifications which led to clarify the tax determination, self-report of the tax payers and increased compliance and reduced tax evasion. With regard to the government's policy is moving toward the privatization of government, the implementation of Article 44 of the constitution and greater reliance on government tax revenues, the reduced difference between declared and definite taxable income can lead to reduced collection costs, increased efficiency and productivity in the tax organization, the compliance of the tax payers, tax culture development, tax collection facilitation and increased government revenues, therefore it is essential to identify the causes of these differences, analyze the related reasons and provide

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solutions to resolve these differences and their origins and the research in hand is among the related studies (Delaware *et al.*, 2004).

### **The Importance of Research**

1) To identify strategies to reduce the cost and time of tax collection and increase the efficiency of the tax structure and increase the reliability and confidence in corporate accounting documents by identifying the effects of difference between tax laws and accounting standards on the difference between declaration and definite taxable income of the companies and increased tax revenues instead of oil revenues to government macroeconomic policies

### **The Target Population**

In this study the area under study base on the spatial dimension is the corporate group in Tax Affairs Department of Mazandaran Province who had the following conditions:

- During the years 2001-2006 had prepared their tax declaration based on legal offices.
- In accordance with Article 110 of Civil Code had submitted their tax declaration before the deadline to the tax-related administration and the definite tax is declared after the legal steps.

According to the to the latest amendments of the direct tax Code in 2001 and the accounting standards issued in 2002 to study the effects of changes in direct tax law and defining Accounting Standards on the differences between the declared and definite taxable income of the companies in Mazandaran the time period of 2001- 2006 is selected so that the effects during consecutive years would be studied and also due to following the legal formalities the income tax files have reached the definite state.

The reason of choosing definite taxable income is that the tax files issued by the tax administration may contain some errors and deficiencies or due to the cases of disagreements with tax organization regarding the compliance with laws be objected by the tax payers and by the measures taken in the judicial authorities, the errors are omitted and the definite file is issued and it is free from effective errors and in fact by the above selection the errors made by the tax officials are removed or their impact on the results is reduced.

### **The Sample and its Adequacy**

To select the sample with respect to the information available in 2001, 625 companies submitted their documents and all these companies have presented their tax declaration within 2001-2006 according to the conditions and based on Morgan sample volume calculation table, 238 companies in various cities of the province were randomly selected from the population and based on the time period 1428 companies in year \_\_ were analyzed and according to the collected data the related tests are performed and the results will be generalized to the entire target population.

### **Sampling Method and the Reason of Selection**

Since the objective of this study was to investigate the effects of differences between the tax laws and accounting standards on the difference between declared and definite taxable income and all population being surveyed have the same chance so after randomization of the samples that represent the whole population, it is possible to generalize the results to the whole population. Accordingly the probability sampling should be applied. Sampling methods are various the most popular of which is simple random sampling “without replacement”. Hence the applied method for sampling in this study is simple random sampling “without replacement”. The reason for choosing this method of sampling is the distribution of the statistical population within the province, availability, simplicity and low cost of it.

### **Methods of Data Collection**

The data required for the study are gathered in the stage of collecting and setting the research literature on the theoretical research based on the library method and through referring to the libraries, magazines, specialized publications and Internet sites, etc. In the field method (Document Study) the information in the tax files and the company’s staffing office and the Tax affairs office of Mazandaran province were used to gather the data required for the study.

### **Data Collection Tools**

1. **Scripts:** used to record the literature.
2. **Table:** To collect and summarize data on the variables of the study

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3. **Form:** To exchange information and opinions in the tax reports and the votes of the tax authorities. In this research the Excel and Spss software were used to summarize and the data processing.

## **MATERIALS AND METHODS**

### **Methods of Data Analysis**

#### *Statistical Techniques*

##### *A - Descriptive Methods*

It includes frequency tables, graphs, measures or statistical parameters (mean  $\pm$  SD) and the calculation of the correlation coefficient.

Statistical significance means that the estimated correlations are different than zero within a specific range. If the calculated correlation coefficient is not significantly different from zero, must be assumed that the variables are not correlated or the sample size was not large enough to show this correlation. The level of statistical significance depends on the subjects for which the correlation coefficient was calculated. When the calculated correlation coefficient is statistically significant, it means that logically we can make sure that there was a real correlation between the variables and the sample size was large enough (Delaware, 2004).

In this study the significance test of the correlation between two variables at 95 per cent (5% error level) is performed.

##### *B - Analytical Methods*

To test the research hypotheses the U test (Man- Whitney), paired sample test (Wilcoxon) and H (Kruskal - Wallis) were used.

### **Hypotheses**

#### *The Main Hypothesis*

The difference between direct tax law and accounting standards affects the difference between declaration and definite taxable income diagnosis of the tax organization.

#### *Secondary Hypotheses*

The difference between direct tax law and accounting standards and different interpretations of the companies and organizations affects the difference between declaration and definite taxable income diagnosis of the tax organization.

#### *Research Variables*

Variables in this study are divided into two groups of dependant and independent variables which are as follows:

##### *Independent Variables*

Total unacceptable costs in terms of the contradiction between tax law and accounting standards

##### *Dependent Variables*

The declaration and definite taxable income diagnosis of the tax organization and the difference between them

#### *Determination of Normal Data*

Considering that in selecting the statistical methods the parametric and nonparametric tests to test the research hypothesis require awareness about the normal data, using the Kolmogorov - Smirnov (K - S), we examined the data normality.

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Null hypothesis. Each of the variables examined in this study are normally distributed.

### The Main Hypothesis

**Table 1: Declaration and definite taxable income mean comparison test for the total legal entities**

Index	Mean	Standard deviation	t value	Degree of freedom df	P_value	z	The result
Declaration Taxable income	385.8789	7732.43543	-5.549	1427	0.000	-31.183	There were no significant differences
Definite taxable income	112 8.1373	7526.04994					

Based on the paired sample test (Wilcoxon)  $p < 0.05$  it can be concluded that there is a significant difference between declaration and definite taxable income and since the value of mean definite taxable income is higher than the mean declaration taxable income so it can be concluded that the definite taxable income is higher than the declaration taxable income.

### The Main Difference between Declaration and Diagnosed Definite Taxable Income

**Table 2: Declaration and diagnosed taxable income mean comparison test for the total legal entities**

Index	Mean	Standard deviation	t value	Degree of freedom df	P_value	z	The result
Declaration Taxable income	385.8789	7732.43543	-5.833	1427	0.000	-31.291	There were no significant differences
Diagnosed taxable income	1205.7115	7747.96444					

According to the results of paired-sample test (Wilcoxon)  $p < 0.05$  it can be concluded that there is a significant difference between declaration and diagnosed taxable income and since the value of mean diagnosed taxable income is higher than the mean declaration taxable income so it can be concluded that the diagnosed taxable income is higher than the declaration taxable income.

Comparison test of declaration taxable income and total costs that comply with accounting standards but they do not comply with tax laws and declaration taxable income is for the companies with acceptable offices.

According to the results of paired-sample test (Wilcoxon)  $p < 0.05$  it can be concluded that there is a significant difference between declaration taxable income and the total costs that comply with accounting standards but in contrast with tax laws in companies with acceptable offices and since the value of mean total costs that comply with accounting standards but in contrast with tax laws plus the declaration taxable income is higher than mean declaration taxable income so it can be concluded that the total costs that comply with accounting standards but in contrast with tax laws plus the declaration taxable income is higher than declaration taxable income.

According to the information of the tables the frequency of total rejected costs due to the disagreement between accounting standards and tax law and the sum of the ratio of total rejected costs due to the disagreement between accounting standards and tax law to declaration taxable income it can be concluded

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that between all analyzed companies the highest cost which complies with accounting standards but rejected by direct tax law is related to the cost of the payable profit to the entities other than banks which is associated with financing sources and according to the next tables we find that most of the cost of the company that does not conflict with the Accounting Standards but rejected by direct tax law is related to the fees paid to employees beyond article 148 that the companies may pay such expenses to increase productivity or cope with lack of manpower in their system (Kouhi *et al.*, 2005).

**Table 3: Hypothesis Testing**

Index	Mean	Standard deviation	t value	Degree of freedom df	P_value	z	The result
declaration taxable income	484.5161	9160.43515	5.520-	995	0.000	-21.452	There were no significant differences
total costs that comply with accounting standards but in contrast with tax laws plus the declaration taxable income	745.8213	9430.93283					

Based on the information of the tabled the frequency of total rejected costs and the ratio of the sum of total rejected costs to the declaration taxable income it can be concluded that among all companies being studied the highest costs which is the source of conflict between companies, Managers and accountants , tax organization and tax authorities are the costs that are not based on documents as well as the costs not related to the income and activity of the company which indicates the lack of transparency in the financial and corporate activities (Shamsi *et al.*, 2009).

## RESULTS AND DISCUSSION

### Summary of Methods and Findings

In this study we sought to investigate the difference between declaration and definite taxable income based on the differences cause by the differences between direct tax law and Accounting Standards. In this study regarding the lack of normality of the research variables based on the Kolmogorov - Smirnov (K - S) test and after collecting the data and calculating the main variables the results of research hypotheses were analyzed using the SPSS software, U test (Man- Whitney), paired sample test (Wilcoxon) and H (Kruskal - Wallis).

### Conclusion

The difference between direct tax law and accounting standards and different interpretations of companies and tax organizations affect the difference between declaration and definite diagnosed taxable income. The research findings suggest that the disagreement between accounting standards and the direct tax law significantly causes difference between declaration and definite taxable income. It should be noted that among all companied under investigation the highest cost that complies with accounting standards but rejected by the tax law is related to the profit paid to entities other than the banks which is related to the



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financing sources and the fees paid to employees beyond article 148 that the companies may pay such expenses to increase productivity or cope with lack of manpower in their system.

The results of analyzing unacceptable cost in terms of accounting standards and the direct tax law indicate that the highest costs which is the source of conflict between companies, Managers and accountants, tax organization and tax authorities are the costs that are not based on documents as well as the costs not related to the income and activity of the company which indicates the lack of transparency in the financial and corporate activities.

### **Final Conclusion**

Considering the main reason for the difference between declaration and definite taxable income it can be concluded that in order to solve the difference between direct tax law and accounting standards it is necessary that to change the economic situations and providing accounting services, using financial software, the direct tax and business laws must be modified. Also by the increase productivity and efficiency of the companies and the optimal use of resources and long term management of the resourced and the debts, it is possible to reduce the incentive to conceal income and decrease the difference between declaration and diagnosed taxable income.

### **Recommendations**

Recommendations from this study are presented in two parts as follows:

#### **Research Proposals**

1. Full implementation of VAT law and administrative infrastructure which requires a comprehensive system and requiring taxpayers to use the factors with printed serial number, the economical code of the other party which removes any possibility of concealment of income or expense forgery and leads to transparency and confidence-building of the financial information of the companies for the shareholders, investors and related organizations such as the tax organization.
2. With regard to the effectiveness of the Regulations subject to Clause 2 of Article 95 of Civil Code and other regulations relating to direct taxes, in creating the difference between the declaration and definite taxable income it is better to teach the regulations to the students in Accounting System, and Tax Accounting course because in current tax accounting the rule is taught out and the regulations that are printed of the book of the law are ignored.
3. Regarding Depreciation regulation subjected of Article 152 of Civil Code although it leads to iformity and comparability of financial statements but its amendment is necessary based on the pattern of economic benefits, the useful life of the assets and Accounting standards and requires urgent and detailed review of the experts.
4. The modification and update of the direct tax laws, business law and regulations of writing books considering the economic conditions and the financial activities modifications seems necessary.

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