CONNECTIONS BETWEEN TAXATION & ACCOUNTING IN VIETNAM

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Abstract

This paper is about the connections between taxation and accounting in Vietnam. Recognizing the degree of connection between taxation and accounting means an essential part not only in macro management but also in accounting practice and tax problems in enterprises. The analysis shows that there is a close connection between taxation and accounting. The results of this analysis would help all sides involved to operate well the instrument of taxation-accounting in management and operation.

1. Objectives of taxation and accounting

The tax system is a part of the system of distribution of national income. The first priority of taxation is to build up income for a nation. Moreover, the government uses the tax system to control the whole economy, achieve its social targets, and in some cases, encourage or limit a number of activities in the economy. Putting these objectives in balance is the interest of any tax systems, and this requires the tax system to attain a certain number of standards. A tax system must be fair, effective, consistent, trustworthy, comfortable, and economical (James and Nobes 1978). At different points of time, these objectives could contradict each other in the building of the tax system but, to a certain extent, the government could soon find out those contradictions when building the tax system.

The accounting system via standards and accounting mechanism aims at giving financial reports and information to the users to make decisions. In general, the objective of accounting is to give useful data to different groups of users such as government agencies, investors, lenders, creditors, and shareholders, and so on. To achieve this objective, some basic accounting concepts are put into use such as accrual basis, going-concern, cost, relevance, consistency, and prudence concepts. The objectives of accounting can be changed and they are influenced by the economic and social environment of accounting (Mueller 1967; Choi and Muller 1992). In the planned economy, accounting aims at supplying information for the task of planning and macro controlling of the economy (Nguyen 2008, p. 101), while accounting in the market economy aims at providing the government and other groups of users with useful data in order to evaluate the effectiveness and financial strength of enterprises (Nguyen 2008, p. 162).

As mentioned above, the accounting could aim at different objectives (for different groups of users) in different economic and social situations. Six main objectives are as follows:

- Giving evidence of arising economic and financial transactions
- Allowing control over business (distribution property, profit, basis for income tax assessment, supervision and regulation of operations carried out by enterprises)
- Supporting decision-making process (on a micro scale)
- Assessing the economic and financial posi-

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tions of enterprises

- Supplying data to the national statistics and accounting agencies (at the macro level)

- Creating trust and support for social evaluation

Thus, there are different objectives between taxation and accounting. It should be noted that the priority of financial accounting is to supply useful data to the decision-making process by government agencies, investors, lenders, and creditors. The main responsibility of accountants and auditors is how to keep accounting information correct so that it could not do harm to these groups of interest.

On the contrary, the top priority of the tax system is to generate fairly sources of revenue for the state budget and the main responsibility of the planner of taxation policies is to protect the interest of the tax agencies. Because of differences in such objectives between taxation and accounting, in some countries such as Britain, Canada and Australia, proposals to build up the balance between taxation and accounting are hardly approved.

Because of the differences in objectives, law and policy makers build up different concepts and principles reflecting different concepts and principles of the tax and accounting systems. These differences could be divided into two groups: permanent and temporary differences. Permanent differences arise from some incomes and costs involved in determining the accounting profit but they are not taken into consideration when calculating the taxable income according to tax regulations. Temporary differences arises from some incomes and costs that are allowed to be taken into consideration when calculating the profit in a period but is not allowed to use in another period.

2. Theory on the connection between taxation and financial accounting

a. Independence or interdependence between accounting and taxation:

In the world, there are two systems on the connection between taxation and financial accounting: one on the independence of taxation and accounting from each other, the other on the interdependence between taxation and accounting.

In the independent system, tax does not do anything with the accounting profit. In other words, the accounting profit is determined without any controls of the tax regulations. Tax exists without any dependence on accounting; tax regulations are only observed when determining the taxable income. Enterprises are free to choose different accounting policies for different accounting and tax objectives. However, this independence is only relative, that is, there is no complete independence between tax and financial accounting. Accounting regulations may influence the tax regulations and tax regulations can be observed voluntarily when preparing financial reports, especially in small and medium-size enterprises. The basic characteristic of this system reflects itself in different degrees of freedom of enterprises in carrying out different accounting policies for different tax and accounting objectives.

On the contrary, in the interdependent system, tax is considered as a factor to explain the true nature of an accounting system. In this system, tax has an important influence on way of measuring the accounting profit, or in other words, tax regulations are imposed on measurement of accounting profit or determination of the taxable income via the observation of accounting policies. As such, the accounting profit is not much different from the taxable income if the tax law of a country requires that expenses should be calculated in expense accounts relating to the Business Operation Report in accordance with the expenses with deductions on taxable income (a form of accounting that the state applies to manage taxes). In this system, enterprises tend to report low profits via principles of circumspection in order to minimize the tax payment. The basic characteristic of this system is that enterprises frequently apply the accounting policies for both tax and accounting objectives.

Hoogendoorn gives a summary of the connection between tax and financial accounting in Europe as follows (Hoogendoorn 1966):

Table 1: The degree of connection between tax and financial accounting

Relative independence	Inter dependence
Czech Republic	Belgium
Denmark	Finland
Ireland	France
Netherlands	Germany
Norway	Italy
Poland	Sweden
United Kingdom	

b. Ways of connecting between taxation and financial accounting:

The connections between taxation and financial accounting could be found in the following ways: (1) setting up the principles of this system appropriate to principles of the other system, (2) the degree of connection, and (3) the similarity between the two systems. As a result, the setting up and development of the principles of each system could be arranged as follows: the accounting principles are in accordance with the tax principles, the tax principles are in accordance with the accounting principles, and building up new principles for the two existing systems. An ideal approach is to set up principles in a way that the two systems would use the same system of measuring the aggregate value of income, that is, the tax payers need to know how much to spend in a year and what the aggregate value would be by the end of each year (Simons, 1938). Of course, this requires changes in both systems, and when that happens, the measured profits of the two systems are equal. This means that there is complete proportion between the two systems by means of setting up a system of common principles. Unluckily, this approach is not practical because the setting up of a system of common principles requires great changes in both existing systems. The Accounting System Department (or Committee for Accounting System and Standard) should narrow their plans of setting up an accounting system aimed at achieving proposed objectives.

The degrees of connection are measured by a scale that varies from “no connection” to “complete connection.” As already mentioned above, in Britain and the USA, there exist a few adaptable degrees between tax principles and accounting principles while in some European countries (France and Germany), the adaptability degree is very high. This is explained by the objectives of the two systems (same or different) in these countries.

The similarity between the two systems could be created by imposing one system on the other or it is simply a coincidental similarity. It is necessary to distinguish imposition from coincidental similarity between tax principles and accounting principles. Ray and Richter (1975) maintain that coincidental similarity is not the necessary subject in studying the connection between tax and financial accounting. According to Lamb et al. (1998), there are various forms of connection between taxation and financial accounting.

Table 2: Forms of connection between taxation and accounting

Forms of connection	Interpretation
Case 1: Disconnection	Tax (or taxation) regulations are different from accounting principles. This connection shows tax does not influence the decision to use accounting to write financial report.
Case 2: Identity	Tax and accounting rules are equal or similar. Tax has much influence on decision on accounting methods used for making financial report.
Case 3: Accounting leads	Accounting principle is detailed and there is no tax principle. In case tax principle exists, it is very little detailed. Hence, tax imposition should be based on accounting regulations. This connection shows the influence of accounting on tax.
Case 4: Tax leads	Tax principle is detailed and there is no accounting principle. If the accounting principle does exist, it is very little detailed. Hence, accounting should be based on tax regulations. This connection shows the influence of tax on accounting.
Case 5: Tax dominates	Though tax and accounting principles exist in parallel, tax principle is always used for transactions and for accountants to write financial report. This connection shows great influence of tax on accounting.

Table 3: Connection between tax and accounting in Vietnam

Content	Connection
1. Evaluation of price of fixed assets	Case 2 (Identity): Both tax and accounting apply the base cost concept to record fixed assets, including prices after initial records.
2. Classification of property leasing	Case 3 (Accounting leads): Classification of property leasing in accounting is regulated by Standard 6-Property leasing. Classification of property leasing in tax is also based on this regulation.
3. Depreciation of fixed assets	Case 5 (Tax dominates): Principles of depreciation of fixed assets exist in both tax and accounting. However, in practice, depreciation of fixed assets of enterprises is often under the rule used for calculating expenses on corporate income tax (decision on depreciation by the Ministry of Finance)
4. Provision	Case 5 (Tax dominates): The setting up of provision funds as regulated by related circular issued by the Ministry of Finance is used for calculating expenses on corporate income tax. Though accounting could set up funds based on other rules, in practice, the establishment of provision funds in companies is always based on the related circular for taxation purpose.
5. Research and development costs	Case 3 (Accounting leads): Record of R&D costs in accounting (being capitalized or included in costs) is based on future revenue from the costs. There is no tax regulation on these costs, so it is based on accounting rules.
6. Evaluation of price of goods in stock	Case 2 (Identity): Ways of recording the buying price of goods in stock and cost of goods sold by tax and accounting systems are identical.
7. Cost of loan interest	Case 2 (Identity): Capitalization of cost of loan interest is the same in tax and accounting
7.1. Capitalization	Case 1 (Relative disconnection): In accounting, cost of loan interest for production and trading is included in financial costs in the period. In tax, cost of loan interest is included in production cost in a "reasonable" manner. For example, when enterprises get loans with real interest rate over regulated rate, the expenses arising from the difference in the two rates are not included in costs for tax purpose.
7.2. Production and trading costs	
8. Transaction in foreign currency	Case 2 (Identity): changes in exchange rate arising in the period is included in the turnover or in financial cost in accounting system; and in pre-tax turnover, and in tax return in tax system.
8.1. Changes arising in the period	Case 2 (Identity): Both tax and accounting system offer identical ways of settlement. According to the current rules (set by Circular 201/2009/TT-BTC), the difference in exchange rate at the year end for cash, short-term receivables and payables temporarily is recorded in the owner's capital (TK413) to make financial report. At the beginning of the following year, theses differences are returned from the owner's capital. As for long-term receivables and payables, the differences are added to the turnover and costs in both tax and accounting systems.

8.2. Settlement at the end of the period	
9. Goodwill (from merging)	does not influence corporate income tax of the merged entity.
10. Change in accounting policy and key error	Case 3 (Accounting leads): Accounting specifies in detail the settlement of accounting when changes and key errors in accounting occur. Tax does not have detailed guidance.
11. Scope of accounting entity and tax payer	Case 1 (Disconnection): According to the tax law, individuals and organizations trading in profitable goods and services should pay tax. According to the accounting law, accounting department is an independent entity that provides genuine information via financial report. For example, a branch of a company may be a tax- payer but it is not an accounting entity. In view of writing merged financial report, the parent company is a merging entity (accounting entity) while all of its subsidiaries and partners are all tax- payers.
12. Penalty, compensation, and support	Case 1 (Disconnection): This independence arises from the difference between “accounting cost” and “reasonable” cost in tax.
13. Record of sales	
13.1. Ordinary sale	Case 2 (Identity)
13.2. Installment and deferred payment sale	Case 3 (Accounting leads): Sales and profit per period are specified in detail in accounting. Tax does not have detailed guidance.
	Case 1 (Disconnection): In accounting, turnover is defined and recorded via two methods: by rate of progress according to the plan and by rate of progress according to the workload completed. The record of turnover by rate of progress according to the plan does not need the definition of the volume of customer and does not need to bill. In tax, taxable revenue is recorded when volume of sale is billed.
13.3. Turnover by rate of progress	Case 5 (Tax dominates): In accounting, record of commissioned goods is strongly controlled by regulation on value added tax (declaration unit, tax-paying unit).
13.4. Turnover by commissioned and assigned goods	
13.5. Pre-extracted cost and allocated cost	Case 4 (Tax leads): In accounting, pre-extracted cost and allocated cost are based on the principle of relevance. However, details about the level of appropriate allocation (or expired time of allocation) or the level of pre-extracted cost are not specified in accounting. On the contrary, tax system provides detailed rules in order to specify the tax-deducted cost in the period.

3. Connection between tax and financial accounting in Vietnam

Based on the above theory on the connection between tax and accounting, we would like to identify and systemize forms of connections between tax and accounting in Vietnam for some subjects and transactions as follows:

The analysis of 20 subjects and transactions in tax and accounting in Table 3 shows that:

- Case 1 accounts for 25% (5/20)
- Case 2 accounts for 30% (6/20)
- Case 3 accounts for 20% (4/20)
- Case 4 accounts for 5% (1/20)
- Case 5 accounts for 15% (3/20)

Case 1 reflects the independence between tax and accounting; and the other cases reflect the interdependence between tax and accounting. As a result, the analysis shows that the interdependence between tax and accounting in Vietnam is very high (accounting for 75%). This is reasonable in a country where accounting (and tax) is considered as the macro management instrument of the state. In reality, accounting in enterprises, especially small and medium-size ones, has long been and is now being controlled strongly by the tax system.

4. Conclusion

Recognizing the connection between tax and accounting is very meaningful not only for policy planners and executing agencies but also for those in charge of tax and accounting in enterprises. This paper tries to set up a theoretical framework on the connection between tax and accounting in our country these days. The results of the theoretical analysis show that there is a close connection between tax and accounting. Such the close connection would help reduce operational costs of the tax payers. It is true that setting up a system of books for both tax and accounting would also help reduce the operational costs of the tax payers. There is no need for complicated regulations to regulate the accounting profit in taxable income and thus, would facilitate the operation of enterprises. Moreover, the close connection between tax and accounting would help reduce the management cost for tax agencies because tax should be in conformity with accounting to verify taxes. However, when tax is closely connected to accounting, the activity of accounting is limited and accounting is then controlled by tax. So accounting is considered as a supporting instrument for tax management rather than an instrument for managing enterprises. Finally, this paper only aims at giving a theoretical analysis. Any further research would require a study of the factual connection between tax and financial accounting■

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