

ACCOUNTING PROFIT IN SPANISH LEGISLATION

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ABSTRACT

The main goal of this paper is to study the accounting profit in the spanish jurisdiction. For this purpose the accounting profit and its integration in accounting and tax legislation of Spain were analized. In accounting terms the study focus on the Commerce Code and Accounting law. On the one hand, the assumption of accounting profit in corporate income tax law and the significance of its economic periodization were investigated. The results show that the spanish Commerce Code recognizes a relevent role to accounting profit. It also recognizes that it is very important for the companies to give financial information about their economic lives. It establishes specific issues, such as the elements of the annual accounts, and how the net profit should be determined. On the other hand, an effort was made to understand and analyse the relevance of the periodization of the corporations' economic life. It happens having as underlying the accrual basis' accounting principle. This may occur due to several economic, financial and legal reasons. Concerning the economic reasons it is necessary to define economic periods for management evaluation and the distribution of the results to the company's owners. Financially, the company has to assure all the financial needs to maintain its activity. In legal terms, it is important to determine tax periods that can establish the tax due by the entity's economic performance. The analysis of article 10 of the spanish corporate income tax law allows us to conclude that the spanish tax legislator recognizes the tax direct valuation method to determine the taxable profit. It means that the net profit determined under accounting rules is used to calculate the taxable basis that will be subjected to pay income tax by the national economic entities.

Keywords: *accounting profit, corporate income tax, economic periodization, Spain, taxable profit*

1. INTRODUCTION

Depending on the area, there are several definitions of result. According to Hicks (1974) it is the maximum value that one person or entity can consume during a week, and maintaining the same financial situation that it had in the beginning of the week. This idea, in the economic area, relates the result to the concept of utility. For García Fernández (2000) the utility obtained with the development of an economic ativity depends on two situations. First, the satisfaction obtained with the consumption of certain goods and services; and second, maintaining the capacity to regenerate wealth in the future. Vidal Hernández-Mora (2003) presents a financial concept of what should be considered the result, stating that in his opinion the result is a magnitude freely used in the business sphere to determine if the business management is correct or not. However, its determination and goal can differ depending on the finality. This way, it is possible to distinguish three kinds of results: economic result, accounting result and tax result. In economic terms the result can be understood as the resources that can be extracted from the entity's patrimony without diminishing its wealth or economic capital (Hicks, 1974). In other words, it is the amount of the company's property that can withdrawn or spent without reducing the invested capital. It is also supposed to mantain the capacity of service of the economic unit, as well as to preserve the purchasing power of own financing (García Moreno, 1997). As explained by L. A. M. Pascual and Zamora (1998) the economic result shall be determined by

deducting from the income generated the amount expended to generate that income, including among them the opportunity cost of capital. This means that the result is the part of the sales income that remains after having paid all the factors that intervene in the production. Economic activity depends not only on the satisfaction of consumption of certain goods or services, but also on the sustainability of the company's capacity to generate such wealth in the future (Menéndez Menéndez, 2011). Thus, to determine the result it is necessary to take appropriate measures for the conservation or sustainability of the capital. It is essential to include all the expenses in order to not overestimate the result. The surplus can be distributed by the owners of the capital. So it is important that the result reflects the true and fair image of the company (Flood, 2019). Otherwise, the company may enter into a process of undercapitalization, resulting in a decrease in financial liquidity that may lead the company to lose its ability to act (Vidal Hernández-Mora, 2003). Accordingly, García Moreno (1997) considers that this concept is next to the concept of residual benefit.

2. ACCOUNTING RESULT

As it was said already, the concept of result is susceptible of several definitions, depending on the perspective. We briefly address the concept of economic result which, although not being our specific object of study, is related to the concept of accounting result or accounting profit. In these terms, the result is the difference between the income and the expenses produced by the entity during the economic year, adding or withdrawing to that difference the positive or negative variation of the final stocks with respect to the initial ones, and it is calculated from the income statement (Chico de la Cámara, 2006). This statement is composed by the income and the expense items, so the operating profit is accurate in this document (LLP, 2018). The operating result comes from the exploration activity of the entity, it should be distinguished from others that do not have the same qualification. Regarding the expenses, they are all the costs of the economic year that were incurred to obtain the income. They can be the consumption of goods, raw materials and other consumable goods, external expenses, expenses with personnel, taxes (including the entity's income tax) and all operating expenses that meet that general definition. Other accounting items can be recognized as expenses, such as amortizations, depreciation and provisions, which are designed to recognize the loss of value of the asset or right (Juan Martín Queralt, López, & Galiardo, 2013). The operating incomes are the positive operating result's component, in other words, they are entity's sales and services. They also recognize the variation in inventories and the work done for the company itself. After determining the operating result, other incomes and expenses that do not relate with the ordinary company's activity are added, such as the financial ones (Nabais, 2018). The legal obligation to prepare the corporate's annual accounts and the inherent determination of the net profit are established in the Spanish Commerce Code (Codigo de Comercio). This legal disposition imposes the obligation to present the financial statements at the end of the economic period. (Lapatza, Fernández, & Márquez, 2013). It also determines what kind of financial documents it is necessary to present and that the manager is the person responsible for their formulation. Thus, according to article 34, it is recognized as essential to prepare the statement of financial position, financial performance, cash flows, changes in equity, and the balance sheet annex. This imposition has as underlying the consideration of the assumptions made by the international accounting organizations, such as IASB (Flood, 2019). This entity establishes in its conceptual framework the objectives of the financial reporting, which go in the same direction that the Spanish law determines (LLP, 2018). So, IASB conceptual framework considers that the financial reports should provide information about the entity's financial position, financial performance, cash flows and changes in the financial position which are not caused by financial performance (e.g. share issues) (Freitas, 2007; Melville, 2015). J.M. Queralt, Serrano, López, and Ollero (2019) consider that this juridic determination represents the importance of the

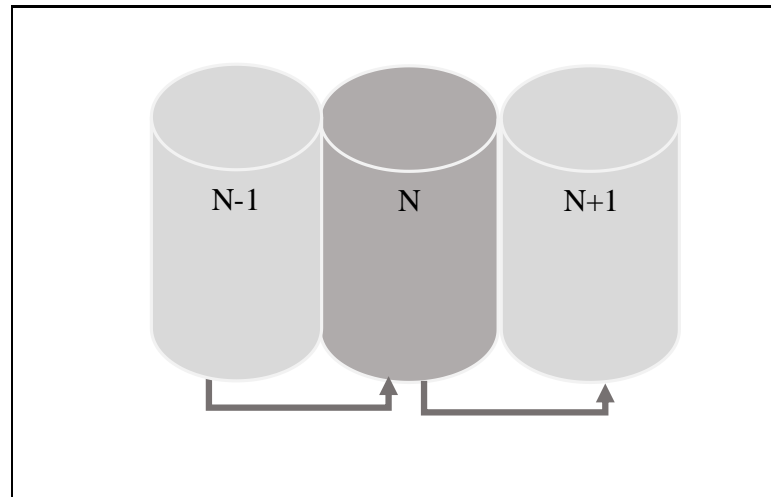
annual accounts as an informative overview of all the accounting process made by the corporation during the economic year. These set of accounting elements form a unit that must be analysed and interpreted as a whole since they are the basis to prepare other complementary financial documents (Ortega, 2015). The Spanish Commerce Code, in article 35.2, also makes considerations about how the accounting profit is obtained. It explains that the net profit is calculated having as underlying the incomes and the expenses taking into consideration the accounting standards. The statement of financial performance has the specific goal of finding out the company's positive and negative returns. The accounting profit is very useful for tax purposes (Lal, 2012). Corporate income tax law resorts to the direct estimation regime to sustain the determination of the corporate income's tax (J.M. Queralt et al., 2019). Accounting profit is taken as the starting point for the determination of the fiscal result and this requirement is of central importance for fiscal purposes (Gadea, 2008). Article 10 of the LIS, establishes that the taxable base will be constituted by the amount of income in the tax period, reduced by the offsetting of negative tax bases of previous tax periods. According to the same disposition it will be calculated, correcting the accounting profit under the determinations requested by the code. So, the result determined according to the accounting standards will be considered as a starting point to determine the taxable result (L. M. Pascual, Gálvez, Gómez, & Pino, 2013). This disposition expressly determines that the accounting profit is calculated considering: 1) the Commerce Code's norms; 2) other laws relating to the mentioned determination and, finally, 3) the dispositions that are dictated in the development of the mentioned norms. For the second condition the Capital Companies Law will be considered. Concerning the third requirement must be considered, essentially, the Spanish General Accounting Plan and General Accounting Plan for Small and Medium-sized Enterprises and specific accounting criteria for micro-enterprises (Lapatza, 2007). The application of the accounting standards is mandatory, even if they have regulatory character, this condition has as main goal the uniformization and standardization of the accounting information (Lapatza et al., 2013). The accounting standards do not define the net income, however they establish the rules set for its determination. The correct determination requires all the incomes and all the expenses to be reflected in the results account (Lal, 1981). If this is not observed, the accounting profit is not correct and the financial position statement does not represent the company's real patrimonial situation (Gadea, 1998). Thus, the obligation to apply the accounting principles and the valuation rules accrue from the Spanish General Accounting Plan. To L. A. M. Pascual and Zamora (1998) the accounting profit presents a relative magnitude and a temporal one as well. Having a relative magnitude means that only at the end of a company's life it is possible to determine the result in absolute terms, because only in that moment the entity ceases its activity and does not need to maintain the productive capacity. On the other hand, the temporal magnitude represents the need for the company's life to be fractioned into time intervals, usually in annual periods. According to Amat, Aguilá, and Marín (2018) this period of time is called economic exercise and it allows each period to be isolated from the previous and the following economic periods. This fractionation allows business leaders to have continuous and relevant information to make economic-financial decisions and to remunerate the investors, otherwise this would not be possible.

3. THE PERIODIZATION PROCESS

The process called accounting periodization must be carried out before determining the result in accounting (García Novoa, 1998). This procedure has the purpose of delimiting the expenses and the income that correspond to the period for which the result is to be calculated, regardless of the payment of expenses or the collection of revenue (Amat et al., 2018). This process will lead to adjustments, which have materialized in a series of accounting corrections (Constans, 2012).

The objective is the aduated allocation of expenses and income in the period in which the specialization does not coincide with the payment dates or corresponding receipt (Deegan, 2016). Periodization is a consequence of the application of accounting principles, in particular the principles of accrual, correlation of income and expenses, as well as the prudence in valuation and registration.

Figure 1: Representation of the accounting periodization process



Source: Author

Thus, Article 38 d) of the Commerce Code confirms the value of this underlying assumption because it expressly provides that the income and the expenses shall be charged to the financial year to which the annual accounts relate, independently of the payment date or collection. This assumption is recognized in the IASB's Conceptual Framework, that considers the accrual basis as an essential underlying assumption (Walther, 2017). The same relevance is given by the spanish accounting standard, in paragraph 3 of its theoretical framework. It is consensual that the result, from an economic point of view, has a single magnitude and can only be measured exactly at the end of the company's economic life. The determination of the periodic result is an unavoidable necessity as a consequence of several factors of both economic and legal nature. They are: 1) need to determine the result of the period for mercantile and fiscal effects; 2) management of the activity and control of the management itself; 3) financing of the activity; 4) return to the capital owners who invested in the company. The division into financial years is only possible through the periodization process, which is strictly related to the specialization or independence of the exercises (L. A. M. Pascual & Zamora, 1998).

Table following on the next page

Table 1: hypothetical cases

Economic operation	Period	Payment/ receipt moment	Value	Accounting records (adjustments)			Observations
				N-1	N	N+1	
Insurance cost	June/N until may/N+1	June/N	100		1) Payment 2) 50 of Cost	3) 50 of cost	Corresponding cost imputation at each period, although the payment occurred in N.
Payment of interest in advance	January/N	December /N-1	20	1) Payment	2) 20 of cost		Although the payment occurred in N-1 the interest refer to N. moment they have to be recognized.
Electricity cost	March/N	April/N	25		1) Cost and Payment		The payment and cost happened in the same economic period.
Receipt of interest	January/N +1	January until December /N	5		1) 5 of Income	2) Receipt	Although the receipt occurred in N the Interests refer to N-1, moment they have to be recognized.

Source: Author

4. CONCLUSION

The spanish Commerce Code acknowledges the relevant role of the annual presentation of accounts done by the companies. Therefore it gives particular instructions about this process, determining the obligation to prepare financial statements, determining who is responsible for this procedure, what kind of financial information needs to be given and how the accounting profit is determined. This legal disposition does not differ from the international accounting harmonization, following the essential of IASB's conceptual framework. The relevant role of accounting is recognized by the spanish corporate income tax law. It assumes accounting profit as a starting point to find out the taxable base. It does not mean that all the accounting rules are considered valid from the point of view of taxes, and so some of them may be subjected to tax adjustments. For a correct determination of accounting profit it is essential that all the period's incomes and expenses are recorded. For this purpose it is important to determine particular rules about this recognition, which means to know in which period the positive and negative components must be acknowledge. The accounting periodization process supports this procedure and it has as underlying the accrual basis. This assumption is also identified by the IASB's Conceptual Framework.

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