Tax impact on the financial performance of companies

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Abstract: Income tax is one of the most important taxes which are levied on business results. Corporate tax can influence a companies' activity, starting with decision-making on location and continuing with financing decisions of the activity. Corporate taxation is one of permanent concerns of managers of enterprises, but also of the economic operator. This paper aims to demonstrate the connection beetween tax impact and the financial performance. This paper uses data from 27 real-estate companies between 2009 – 2013. This paper finds negative correlation between the effective tax rate and performance and a positive relations between levrage, profit margin and financial performance.

Keyword: Corporate taxation, financial performance, consolidated tax base

1. Introduction

Direct taxes, a consisted component of the income tax in any modern state, exercise their influence through the structure, type and degree of collection, and last but not least, at social level, through its impact on economic activities, on the taxpayer and on the company as a whole.

Once in the light of the development of faster economy and of the company's activities, each transaction, interaction between an enterprise and the social-economic environment generates corporate taxation. Concerning major components of direct taxes in the Member States of the European Union, the corporate tax and income tax represents the main funds to the state budge.

The study of this paper aims to present some of the indicators which can influence the performance of an enterprise. Among financial indicators, corporate taxation has an important impact on financial performance.

Literature review

Lately, it is taking into consideration the possibility of giving up on using corporate taxation. On account of the present economic situation, there are specialists in the field supporting this elimiation.

Economist Jeffrey A. Miron , in the article "Economic change we can believe in", explains the possibility of stimulating the economy by eliminating the corporate taxation. He said that a levy system efficiently should not apply taxes on profits, because they adversely affect decisions to accumulate and to invest. In his opinion, the elimination of tax on profit can stimulate economy both in the short term, but also in the long term,.

There are other negative aspects, such as rules and complications over the system. The author claims that the tax on profit favor certain industries and activities, distorting decisions lately. In addition to these considerations, the income tax is reducing financial transparency, making it difficult for investors to monitor companies' behavior.

This idea opponents claim that this tax is entitled, in view of the fact that the taxpayers with high income are holding companies in a disproportionate manner. They argue that firms have access to public goods, in general infrastructure, and takes advantage of public interventions, such as education employees, or a judicial system. For this reason, it would be natural that they pay taxes and fees to compensate for these benefits. The author claims in the end of the article that this tax burden is not supported only by the shareholders, but also by the employees by wages and consumers through higher prices. This idea is also supported by another American writer, Rob Norton in his book "Corporate Taxation" in the History Library of economics and Liberty magazine rested. The writer considers that, in the end, only people can pay taxes, and this is the main problem of the corporate tax. Economists found difficult task in determining upon who falls this fiscal burden.

Even the 17th century, Sir William Petty, one of the initiators of modern economics, maintains that taxes will be, in the end, paid by consumers. Later, certain economists considers that in this case this could not happen, because in theory, companies secure already a price that brings as much profit, and if they would increase more than the price of the goods, the demand for it would decrease.

Empirical evidence suggests that the corporate tax influences financing decision of a company. A recent study concludes that the increase by a percentage of the corporate tax, increases the debt/equity lever with values between 0.17 and 0.28.

A study published by American teachers, Kenneth Kim and Piman Limpaphayom "Taxes and firm size in the Pacific-basin emerging economies" concludes that there is a positive relationship between size of the company and the effective tax rate.

Authors analyzed 372 companies in Hong Kong, 601 in Korea, 361 in Malaysia, 251 in Taiwan and 245 in Thailand. They have used as independent variables total assets, the rate of debt/equity ratio, the market value and profitability firm, presented as the ratio of profit and turnover. After this study, the authors conclude that effective rate of taxation is positive correlated with company size and the fact that the profit margin is positive correlated with the effective tax rate.

In the same work, the authors considered that a company profitability should be translated into incresead effective taxation rates as the company will have a taxable income higher. This conclusion is even more pronounced in countries with progressive taxes, in their study being included Korea and Taiwan.

Another study, "Determinants of the variability in corporate effective data rates and tax reform: Evidence from Australia (2007) published in journal of accounting and public policy and carried out by the writers Richardson G. and R. Lanis documents the link between effective tax rate and the size of the company, capital structure and return on assets. They analyzed 128 companies in Australia during the period from 1997 to 1999 and 150 during the period 2001-2003.

The authors reached the conclusion that for the companies with a long history, the rate of effective taxation is negative correlated with size of the company.

As writers mentioned, this result depends on the individual country and what fiscal policy adopts. Also, the link between return on assets and the effective rate is a positive one.

A work published in the European Economic Review "Corporate taxation, Debt Financing offerings and foreign-plant ownership" shows a comparison between local companies and those held by foreign investors. These companies are analyzed from the point of view of the report of assets and liabilities, and the study is focused on the degree impact of the corporate tax.

There have been analyzed 32.067 european companies and it has been found that companies with foreign capital have a debt ratio greater than local companies. In most tax systems, the interest charges are deductible income tax calculation, therefore such incentives lead to a rate of debt/equity ratio higher. Successful multinational companies have the capacity to allocate debt over the area in which they operate, giving fiscal incentives which have an effect on the company's financial structure. The authors have come to the conclusion that the rate of debt/equity ratio to multinational companies is 1.7 percentage points higher than in the firms on the domestic market.

In the work " Determinants of the variability in corporate effective tax data rates: Evidence from longitudinal data" carried out by Sanjav Gupta, Kaye Newbery, the authors have studied determinants effective tax variability of taxation to the company in the period before and after the fiscal reform in the United States in 1986.

Number companies taken in the analysis was 823 during the period from 1982 to 1985 and 915 during the period from 1987 to 1990. Fiscal reform in the United States of America, from 1986, has simplified tax code and has eliminated some deductions (rate of profit tax has been reduced from 46% to 34 %, and income tax paid by individuals from 50% to 28 %). This reform has been the most significant change in tax structure of the United States in the last 50 years. This study shows that effective rate of taxation is not associated with company size when the relation is examined along time for firms with long history.

Finally, the results show that effective rate of taxation is positive correlated with company performance, these correlations thus continuing and after fiscal reform in 1986 which suggested that when actual tax rate increases, company's performance is reduced.

The database comprises a number of 26 companies from the real estate sector. The paper aims make an analysis of this companies to observe the impact pf the corporate tax and other indicators on the financial performance, as wellas the development of indicators in the period of crisis.

Period of analysis is 2009-2013.Data were taken from the Damodaram database,complementing where it was needed with data in the financial statements of companies.These data have been entered in excel in order to form panel database and data processing was carried out in Eviews.

The main factors of financial performance indicators analyzed in this work are:

- ROE – return on equity;
- N_PM – net profit margin;
- D_E – debt to equity;
- T_R – effective tax rate.

3. The empirical results

Initially, the database includes 35 companies, from real estate sector, but the lack of data for certain companies and as a result of the application of procedure, removing minimum and maximum absolutes, the final database has 26 companies.

Dependent Variable: ROE				
Variable	Coefficent	Std.Error	t-Statistic	Prob.
C	0,082979	0,023606	3,51513	0,0006
N_PM	0,058789	0,006645	8,757375	0.0000
T_R	-0,153808	0,076667	-2,006196	0,0472
D_E	0,030783	0,008448	3,643983	0,0004
R-SQUARED	0,457455	Mean dependent var		0,119759
F-STATISTIC	32,602390	S.D. dependent var		0,09214
PROB (F-STATISTIC)	0,000000	Durbin-Watson stat		1,903559

In this model, all the coefficients are significant statistically because they probabilitaties are below 5 %. The model in the assembly expressed significant correlation statistically because likelihood F-statistical summary (0.0 %) is less than 5 %. The coefficient of determination R2 indicates that identify factors explain financial performance in a proportion of 45 %. This proportion is one which is acceptable, in view of the fact that ROE is influenced by multiple factors than those used in this study, factors such as: asset rotation.

The effect of financial levrage on business performance is positive. This result may be explained by imposing tax on profit, in whose account, the interest charges are tax deductible, which leads to a profit higher. This is supported by Halp (1998), in whose analysis shows that a higher proportion of borrowed capital in the company's leads to an increase of risk, but also an increase of the rates of return.

The net profit margin has the greatest positive impact on the profitability equity. Thus, any change of positive net margin will result in an increase in profitability. This is possible, and due to the presence in the calculation of profit in both indicators.

According to the results, the influence of the effective tax rate is negative. The same was obtained in their studies and Derauhid and Zhang (2003) and Md Noor et al. (2010). The negative correlation for economic profitability can be explained by the fact that businesses more efficient and profitable record effective tax rates lower, a possible reason that these companies profitable by management, as much advantage of existing tax incentives.

5.Conclusions

The impact of the policy on tax financial performance of the company has been extensively debated in numerous studies in international and national literature. (Modigliani and Miller, 1963; Gupta, 1997; Vintila,2005 ; Stancu, 2007).

Currently, in Europe, the EU members will have their own system for the taxation of profits, although imposition of a common consolidated tax base has created numerous discussions over time.

With regard to the objective of every company to maximize your profits, athe effective tax rate should be an important factor in the management strategy. This indicator is different at each company, being influenced by the financing decisions , the decision for the distribution of dividends and of the accounting rules of the country in which they carry out their activity. Taking into account the crisis caused in 2008 which had a significant impact on financial performance of the company, we have made a study of 26 companies in Europe in the real estate sector.

Following this study, the main conclusion that we can come off is that effective tax rate has a negative influence on financial performance. This can be explained by an increase in non-deductible expenses or increasing taxable base which gives rise to a decrease in the net profit.

We have seen that an increase in the debt burden could contribute to an increase in the company's performance. In this way, by debt/equity ratio, businesses receive deduction of expenditure with interest which is likely to increase profits. An increase in the debt burden will contribute to an increase of risk, but also to an increase in the cost-effectiveness.

In conclusion, the results of the study of this work are similar to those obtained in previous studies, national and international.

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