

FUNDAMENTALS OF EXPENSES' NON-DEDUCTIBILITY IN THE COMPANIES' INCOME TAX LAW: PORTUGUESE'S CASE

Susana Aldeia, Portucalense University

ABSTRACT

This paper aims to understand what kind of fundamentals can justify the tax adjustments imposed by the Portuguese Corporate Income Tax Law. For this purpose, it analyzes the legal dispositions and doctrine, particularly, it examines Portugal data sources: the Corporate Income Tax Law (Código do Imposto sobre o Rendimento das Pessoas Coletivas-CIRC) and doctrinal's understandings. The results show that a doctrinal interpretation identifies four reasons to tax correction. They are the technical and practical reasons, the separation between corporate and personal equity, the formal reasons; and the disincentive of the no moralistic behavior. This study helps to know better the corporate income tax's particularities. Although it is a relevant contribution to international tax law literature, and countries can analyze this experience and collect it to its profit, it only researches the Portugal case.

Keywords: Income Tax, Fundamentals of Expenses Non-Deductibility, Companies.

INTRODUCTION

For decades, several tax jurisdictions tried to implement the direct valuation method in the corporate income's taxation (Nabais, 2013). Portugal implements this regime with the approval of the Corporate Income Tax Law-*Imposto sobre o Rendimento das Pessoas Coletivas* (IRC), in 1989 (Santos, 1989). This law recognizes the accounting result as the starting point for the tax result determination. The doctrine considers that this method provides greater tax fairness, as it allows companies to be taxed, considering the effective companies' ability to pay taxes (Ferreira, 2014). Tax legislator complains this change as one of the most significant advances in corporate income taxation, so several countries following the change (Nabais, 2018). So, this theme maintains the interest of the researches, that justifies much international publishing in the last times (Aldeia, 2019; Alena et al., 2017; Baker, 2018; Benjasak & Bhattarai, 2019; Delgado et al., 2019; Freebairn, 2015; Gao et al., 2019; Hines, 2005).

Therefore, the several documents, it is possible to conclude that the issue is not very well explored, and to the best of our knowledge, there are no studies on Portuguese Case. In particular, there is a need to understand better what kind of principles can explain the tax corrections required for the Portuguese Corporate Income Tax Law. This research addresses this gap by studying the legal structure and doctrine that approaches the tax adjustments in Portuguese Corporate Income Tax Law. The research question tackled by the study is: What kind of fundamentals can justify the tax adjustments imposed by the Portuguese Corporate Income Tax Law? For this purpose, it examines the most relevant Portuguese corporate income tax dispositions, and doctrinal understandings. This text has four parts. The initial is the introduction, and it explains the subject context; the second section debates about the Portuguese corporation's

income tax base. The third, the essay investigates the tax correction's fundamentals. Moreover, then, in the fourth section, it gives conclusions.

REVIEW LITERATURE

Article 3.2 of the Portuguese corporate income tax law assumes an extensive notion of profit, according to patrimonial increment's theory. It means that the taxable profit is the values' difference of the equity between the end and the beginning of the tax period, with the corrections imposed by the same law (Nabais, 2015). Article 17.1 of the CIRC establish the general principle of determining the company's taxable profit based on accounting (Martins, 2012). It clarifies the concept of taxable profit, according to the CIRC, it is the net income's algebraic sum for the period, added of the positive and negative equity accounting changes of the same period, and not reflected in that result, eventually corrected under this law (Aguar, 2003). Thereby, the taxable profit has as basis the accounting profit, added of the unreflective equity variations (positive or negative) and fiscal corrections as outlined in this code (Portugal, 2001; Tavares, 1999). Thus, there are two domains, the accounting and taxation law, the purposes of each other justifies the differences of the treatment. The first one has as the primary goal the accounts' preparation to help users to make economic decisions; so, the financial information follows the generally accepted accounting principles (Melville, 2015). In the second one, it has the main objective of the tax revenues' collection obeying to tax justice principles (Nabais, 2015). So, the partial dependence's model justifies the acceptance by the taxation laws of the accounting profit (Palma, 2011). Differences between the accounting and tax scope may result in positive or negative accounting result's corrections. Thus, there is a positive correction when there are accounting expenses that are not accepted for tax purposes, and tax revenues that were not considered accounting income (Sarmiento et al., 2019). There are negative corrections when there is accounting income that is not relevant for tax purposes, and tax expenses that were not considered in the accounting result's calculation (Carlos et al., 2019).

In this conceptual background, this research aims to address one question: What kind of fundamentals can justify the tax adjustments imposed by the Portuguese Corporate Income Tax Law? In order to answer this question, it analyzes the legal dispositions and doctrine. It examines several data sources of Portugal: the corporate income tax law (*Código do Imposto sobre o Rendimento das Pessoas Coletivas*) and doctrinal understanding.

Fundamentals of Expenses Non-Deductibility

The accounting expenses' acceptance principle by the taxpayer suffers some deviations in specific cases predicted in the law (Portugal, 2001). Beyond the general requirements established in article 23 of the CIRC, other legal dispositions prohibit or enables some deductions partially, it is the case of the CIRC's article 23A and 34, for example (Amorim, 2013). These situations are exceptions to the conceptual identity rule between accounting and tax expenses (Tavares, 2002). In 2014, the Portuguese Government created a commission for corporate tax reform. This body introduced significant changes in the law, as well as the reorganization of disposition the articles in the law. The article 23A is a boundary norm of the accepted expenses, it establishes limits to fiscal deduction of the particular expenses; it is understood as an exceptional nature's rule owing to the tax deduction's general rule (Tavares, 2002). The doctrine identifies four reasons for non-

deductibility of accounting spending, in particular, technical reasons, to ensure the separation between personal and corporate heritage, formal reasons, and finally, by moralistic motivations.

In principle, and according to article 23.2.f) of the CIRC, tax and parafiscal expenses are deductible expenses, contributing to the reduction of tax revenue (PWC, 2018). However, following article 23A.1.a), the IRC is a non-deductible expense in the tax base's determination (Sousa, 2018). Tavares (2002) considers this exception has technical and practical reasons for simplifying the tax revenue's calculation. The acceptance of the tax as a fiscal cost represents to assume an intermediate value that contributes to profit's determination; furthermore, to accept the corporate tax as a fiscal spending represents an evident violation of the accounting accruals basis principle because this is a cost from the previous exercise.

Cozian (1995) defends the separation of corporate and individual equity; it means that several times the business world watching to a confusion between the companies' property and the managers or shareholders assets (Morais, 2009). Legal persons, managers, and shareholders have each one individual equity, and companies do not can assume the managers and shareholders personal expenses. Company assets need to be safeguarded against external entities' expenses. Furthermore, the imputation of personal expenses to companies represents a fraud against the tax authority, constituting a double benefit. In the manager's sphere, it represents an untaxed income because the company pays the personal expense of the manager. In the companies' domain, to take on these transactions as tax expenses decrease the tax base and, consequently, it decreases the revenue collection (Nabais, 2018).

Portugal (2001) observes that the moralistic character does not allow the tax law to accepts infractions to mandatory rules. Thus, the corporate law does not admit the fines and the compensatory and default interest, without contractual origin, as the tax expense. Also, it does not recognize any expenses arising from behaviour contrary to any activity's regulation; or illicit expenses, namely, those that result from behaviours that indicate the violation of Portuguese criminal law. Although these expenses have accounting natures, they are not a tax expense because it is expressly said in the article 23A.1.e) and d) of the CIRC. According to Poveda (1988), the acceptance of this spending represents to makes the State participate in the illicit taxpayer act due to the financial repercussion of the taxpayer's fine.

Morais (2009) talks about the compliance with imposed formal procedures, do the law requires the documentary proof of tax expenses. Ferreira (2007) consider the not acceptance of the effective tax expenditure, due to the formal reasons, represents to the taxation of an unreal companies' profit, do not respect taxpayer's ability to pay.

Thereby, the doctrine point four tax non-deductibility fundamentals of certain accounting expenses, namely,

1. For technical and practical reasons;
2. To safeguard the separation between the corporate and personal assets (of the partners and/or members of the executive body);
3. For formal reasons and, finally,
4. Due to the "*moralistic*" vector of the Tax Law (Tavares, 2002).

CONCLUSIONS

The main objective of this paper is to understand the fundamentals of spending non-deductibility in the Portuguese corporate income tax law. The results show that the tax adjustments to the corporate income tax law came about with the approval of the Portuguese

corporate income tax law in 1989. With this law, the Portuguese tax jurisdiction no longer needs to adequately regulate accounting rules and tax rules, because tax law assumes the accounting result although subject to fiscal adjustments. With this amendment, there is no more duplicity of rules. There are four reasons found that justify corrections, positive or negative, it means, the technical and practical reasons; the separation between corporate and personal equity; the formal reasons; and finally, the disincentive of the no moralistic behavior. Those fundamentals justify legal dispositions in the IRC as the Article 23-A that does not allow the tax consideration of the accounting expenses such as the corporate tax, the partial depreciation's deduction of the tourism vehicles, or the recognition of last month's electricity bill because invoice do not observe the formal requirements or a fine borne by the company. Although they are a justified fundamental, they make the Portuguese tax system more complex.

This paper helps to understand better the corporate income tax's specificities, although it is a relevant contribution to international tax law literature, and countries can analyze this experience and collect it to its profit, it only researches the Portugal case. So, it could be attractive to analyses other European countries such as Spain, that has the same corporate tax system; or even though India that has a different one.

REFERENCES

- Aguiar, N.T.S.S. (2003). Normative models of the relationship between tax profit and commercial accounting. *Finance*, 13(1), 39-49.
- Aldeia, S.C.R. (2019). The going concern's accounting principle and its incorporation in corporate income tax law of Spain. *Paper presented at the 39th International Scientific Conference on Economic and Social Development-Sustainability from an Economic and Social Perspective*.
- Alena, A., Lucia, M., & Slavomíra, M. (2017). Meta-analysis categorization of EU countries in the context of corporate income tax. *Contaduría y Administración*, 62(3), 1001-1018.
- Amorim, J.C. (2013). *The deductibility of expenses in terms of IRC-General considerations*.
- Baker, P.L. (2018). An analysis of the corporate income tax policy of less developed countries. *Scandinavian Journal of Economics*, 120(2), 400-427.
- Benjasak, C., & Bhattarai, K. (2019). General equilibrium impacts of VAT and corporate income tax in Thailand. *International Advances in Economic Research*, 25(3), 263-276.
- Carlos, A.B., Abreu, I.A., Durão, J.R., & Pimenta, M.E. (2019). *Tax guide in Portugal*. Lisboa: Quid Juris.
- Cozian, M. (1995). *Company tax briefs: Litec*.
- Delgado, F.J., Fernández-Rodríguez, E., Martínez-Arias, A., & Presno, M.J. (2019). Club convergence in the corporate income tax: The case of European effective rates. *Physica A: Statistical Mechanics and its Applications*, 523(1), 942-953.
- Ferreira, R.M.F. (2007). Concepts of costs and income for the year? Confrontation with other notions. *Magazine of Chartered Accountants*, 83(1), 37-40.
- Ferreira, R.M.F. (2014). The new Portuguese tax reforms of the 21st century. *Public Finance and Tax Law Magazine*, 7(2), 193-215.
- Freebairn, J. (2015). Who pays the Australian corporate income tax? *Australian Economic Review*, 48(4), 357-368.
- Gao, W., Lu, Y., & Shi, X. (2019). Trade liberalization and corporate income tax avoidance. *Economic Inquiry*, 57(4), 1963-1980.
- Hines, J.R.J. (2005). *Corporate taxation and international competition*. Retrieved from <https://www.researchgate.net/publication/41676659>
- Martins, H. (2012). Corporate income tax. In *Taxation Lessons* (pp. 215-288). Coimbra: Almedina.
- Melville, A. (2015). *International financial reporting: A practical guide*. Person.
- Morais, R.D. (2009). *Notes to the IRC*. Coimbra: Almedina.
- Nabais, J.C. (2013). The determination of the taxable matter in the IRC. *Public Finance, Taxation and Development Magazine-RFPTD*. Retrieved from <http://www.e-publicacoes.uerj.br/index.php/rfptd/issue/current>
- Nabais, J.C. (2015). *Fiscal right*. Coimbra: Almedina.

- Nabais, J.C. (2018). *Introduction to corporate tax law*. Coimbra: Almedina.
- Palma, C.C. (2011). Some considerations on the relationship between accounting and taxation. In *Estudos em memória do Prof. Doutor J.L. Saldanha Sanches* (pp. 625-654). Coimbra: Coimbra Editora.
- Portugal, A.M. (2001). IRC cost deductibility: Reflections on costs incurred in exempt and untaxed activities. *Fiscal Science and Technique*, 401(1), 55-121.
- Poveda, V.G. (1988). *Corporation tax: Pyramid editions*.
- PWC. (2018). *Annotated tax collection 2018: King of books*.
- Santos, J.C.G. (1989). Tax reform, corporate tax rates and tax benefits. *Fiscal Science and Technique*, 354(1), 95-110.
- Sarmiento, J.M., Nunes, R., & Pinto, M.M. (2019). *Theoretical-practical IRC manual*. Coimbra: Almedina.
- Sousa, A. (2018). *Completion of IRC template 22 declaration: Order of certified Accountants*.
- Tavares, T.M.C.C. (1999). *The partial dependency relationship between accounting and tax law in determining the taxable income of legal persons: Some reflections on the level of costs*.
- Tavares, T.M.C.C. (2002). Deductibility of IRC costs. *Fisco*, 101(1), 37-44.