Managerial aspects of using deferred tax assets and liabilities in agricultural companies

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Abstract:

Study shows that managers of Serbian agriculture companies use accounting accruals for the non-current assets to create book-tax differences and influence effective tax rates. Also, we found that the synthetic variables of materiality show low materiality levels of deferred tax assets and liabilities, deferred tax expenses, and revenues reported in financial statements. But when those materiality variables are correlated with the non-current asset ratios, they are found to be positively associated, meaning that the more non-current assets are used in agriculture, the more material is deferred tax assets and liabilities in the statement of financial position and their effects on the effective tax rates.

Keywords: deferred tax assets, tax liabilities, tax planning, effective tax rates

1. Introduction

According to the World Bank statistics, Serbia's GDP share of agriculture, forestry, and fishing was 16.% in 1995 and then continuously dropped to the level of 6.3% in 2021. The peak of 18.4% was found in 1999, while the lowest value of 6.1% was reached in 2007. (https://data.worldbank.org/indicator/NV.AGR.TOTL.ZS?locations=RS) Among the Western Balkan Countries, Serbia's share of agriculture in GDP is in line with the least developed countries in the region, such as Montenegro (6.5%) and North Macedonia (7.2%) According

to this data agriculture is an extremely important industry that adds value to the Serbian GDP. In this context, it is also important to know how taxes are calculated by those companies and could managers influence tax calculations, especially when considering the idea that "a given tax measure is considered to be a "tax concession" to agriculture if it results in differential treatment to the sector in such a way that agriculture is favored, resulting in some foregone tax revenue, or "tax expenditure" (OECD;2020) This paper solves the problem of using deferred tax assets and liabilities by managers of Serbian agriculture companies as allowed by the *IAS 12 Income Taxes. IAS 12* requires an entity "to account for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves" (IFRS Foundation, 2021)

Rafay and Ajmal (2014) noted that the concept of deferred tax is notional, as no taxable person (subject of taxation – legal entity or individual) is allowed to defer his/her tax payments. In this context, deferred taxes are correlated to inter-period tax allocations based on the liability method applied by the IAS 12.

Because of that, feature managers may execute tax planning techniques in line with the standard that gives rise to book-tax differences in agriculture and livestock companies in Serbia. Vržina and Dimitrijevic (2020) show that effective corporate income tax rates (ETRs) in agricultural companies are significantly lower than the statutory corporate income tax rate meaning that managers apply tax planning to manage income taxes in agriculture. According to *IAS 12*, deferred tax liabilities are the amounts of income taxes payable in future periods for temporary taxable differences, while deferred tax assets are the amounts of income taxes recoverable in future periods. Tax assets deferred in the statement of financial position arise in respect of temporary deductible differences (mainly due to the depreciation of the non-current assets), the carryforward of unused tax losses, and the carryforward of unused tax credits. Deferred tax liabilities are mainly due to temporary differences from depreciation calculations for tax and financial reporting purposes. We assume that in agriculture companies, those temporary differences affect dependent variables (effective tax rate), which is why it is lower than the statutory rate of 15% in Serbia. A taxable temporary difference results in deferred tax liability when tax depreciation is accelerated than depreciation for financial reporting purposes, and vice versa is true; deferred tax assets arise when tax depreciation is lower than accounting depreciation. That is based on Procházka and Molin (2016), whose research shows that corporate taxation substantially contradicts the accounting principles of true and fair view and that executives simultaneously manage profit upward in financial reporting but taxable profit downward in tax reporting. Serbia is considered a country with low book-tax

conformity meaning that there is a difference between tax laws and accounting regulations for calculating income taxes. As pointed out by Procházka and Molin (2016), there is evidence that companies in countries with the one-book system (i.e., with high BTC) exercise fewer earnings management in their consolidated financial statements compared to firms with two-book systems (i.e., in countries with relatively independent accounting and tax regimes).

As Vržina (2022) points out, with tax planning strategies and tax avoidance, income taxes are important in managers' performance evaluations. In the Serbian economy, the main deferred taxes are derived from the depreciation of non-current assets, assets write-off, accounting for employee benefits, accounting for contingencies and evaluations of financial assets available for sale, tax losses, and tax credits. (VRŽINA, 2017; according to; VRŽINA, 2022).

The main purpose of this article is to find evidence that managers in agriculture companies in Serbia use deferred tax assets and liabilities in their statements of financial position to affect the amount of current tax expense paid in the period. The paper has been divided into the following parts: Introduction, Literature review, Data and Methodology, Research results, Interpretation of results, and concluding remarks. Research results can be used by managers in agriculture companies to highlight the widely used techniques of tax planning in the sector and to share knowledge to lower the tax burden. On the other hand, results can be used by the government to highlight the differences between financial reporting rules for agriculture companies and tax rules and to support the discussion of possible alignment between tax and financial reporting regulations.

2. Literature Review

As Vržina (2021) found, the tax risk is very important to be disclosed by companies, although there are no financial reporting obligations. Companies use risky tax strategies to avoid taxes that could be considered illegal by tax authorities, which is why disclosure of tax risk is extremely important information. Managers intentionally do not disclose that risk because of reasons that could lead government officials to detect inadequate tax planning strategies or illegal activities if done. The only disclosure companies make to explain in the footnotes how tax assets and liabilities arise. Vržina, Obradović, and Bogićević (2020) found the low quality of disclosure regarding deferred taxes of Serbian companies. Managers use temporary differences as any difference between the carrying amount of assets and liabilities and its tax base (MEAR, 2011). Mear (2011) uses a sample of companies from the New

Zealand Stock Exchange to find how the companies in question move from the income statement to the balance sheet approach when calculating income taxes after changes in New Zealand regulations and in light of the implementation of the IFRS. This research pointed out that changes in the financial reporting regulating regime affect current income taxes, deferred tax, and net tax assets and liabilities. It stressed the issue's complexity. Mear (2011) found that large book-tax differences could result from managers choosing income-increasing accruals as a part of their tax strategy. So, income tax calculations are quite important for managers as a tool by which they can attain earnings management goals. Firms whose income is larger in the books than the taxable income have less persistent earnings (HANLON, 2005). Deferred taxes are a researchable topic in accounting because they affect stock prices and cash flows, therefore, carrying informational value for investors and creditors. Investors interpret large positive book-tax differences (book income higher than taxable income) as a "red flag" and reduce their expectation of future earnings persistence for these firms (Hanlon, 2005). That is why the pre-tax book income to taxable income ratio could be used as a measure of accounting aggressiveness or conservatism. Hanlon and Heitzman (2010) found that the information in book-tax differences about tax avoidance is harder to document because valid tax outcomes are difficult to obtain, and those firms usually have a higher possibility of being audited by tax officials.

The other studies show the value relevance of deferred taxes for different users in affecting users' perception, market prices of shares, firm value, and risks. Rafay and Ajmal (2014) find that market prices reflect deferred tax line items in firms' financial position statements. Investors also tend to treat deferred tax line items (arising from operating, financing, and investing activities) differently. Egbunike and Okoye (2017) find that deferred taxes are a source of opportunistic earnings management and that there is a significant variation between the reported tax figures before and after IFRSs adoption and income tax rates. Amir, Kirschenheiter, and Willard (2001) find that aggregation does not hold; rather, deferred taxes are valued less than earnings and book value. Deferred taxes add value because they represent the deferral of tax payments, so their value is the net present value of the tax benefits. Amir, Kirschenheiter, and Willard (2001) interpret this result as the timing of the reversal of temporary differences matters, which is consistent with recent empirical work.

Eberhartinger, Genest, and Lee (2020) show that tax disclosure affects users' perceptions as long as it conveys unexpected information that challenges the anchor. However, when the detailed amounts of deferred tax are abnormally high, judgment differs

significantly. Acaranupong (2010) found that investors in ASEAN countries use only deferred tax assets to convey relevant information for assessing firm value.

In many countries, implementing *IAS 12 Income Taxes* is considered difficult in the Czech Republic, Russian Federation, and Europe (Trofimova, Prodanova, Nudel, Dikikh & Savina, 2020; Purina, 2016 and Procházka and Molin, 2016). Purina (2016) pointed out that active using of deferred taxes may suggest that the company plans and optimizes its tax burden effectively. Deferred tax liabilities result in lower tax liability in the current period and, therefore may be one of the indicators of tax optimization. Purina (2016) opts for using different tax planning strategies (either increasing deferred tax liability and decreasing current tax liability or vice versa). Procházka and Molin (2016) found that the dichotomy between tax and financial accounting can contribute to the opportunistic behavior of managers to manage revenue in financial statements and reduce taxable profits simultaneously.

Managers of agriculture companies could attain earnings management goals using book-tax accruals, and those accruals could affect firm value and users' perception and firm tax risk. So, simultaneously using book-tax accruals twofold effect could be achieved: influence on the income in financial reporting and influence on the taxable income in the tax report. That is why many authors use deferred tax expense to detect earnings management (PHILLIPS, PINCUS & REGO, 2003; HOLLAND JACKSON, 2004; PHILLIPS, PINCUS REGO & WAN, 2004; SCHRAN & WONG, 2004; DHALIWAL, GLEASON, & MILLS, 2004; NOOR & AZIZ, 2007 and SOLIMAN & ALI, 2020)

From all of the above said, the following two research questions could be derived:

Research question 1: Managers use deferred taxes in the statement of financial position and deferred tax expenses and revenues in the income statement to make a tax planning strategy and affect effective tax rates in agriculture companies.

Research question 2: The materiality of deferred taxes used by managers of agriculture companies is closely associated with the value of non-current assets and their utilization as a tool of tax planning.

3. Data and Methodology

The research sample comprises agricultural and livestock companies (under Eurostat activity codes 0111 – Cultivation of grain (except rice), legumes and oilseeds, 0130- Cultivation of planted materials, 0142- Breeding of other cattle and buffaloes, 0146- Pigs breeding, 0150- Combination of cultivated plants) located in Serbia, that was active with the

highest revenue generated in the period and taking the form of limited liability companies. The PKS Partner database (https://pkspartner.rs/sr/) is used for identifying companies. The sample consists of 50 companies, but only 30 have complete data for the analysis in 2016-2020. Using descriptive statistics and correlation, we have considered all relations between 4 explanatory variables used in the research that describe the share of assets used and their utilization (Share of Non-current assets in total assets, Non-current assets utilization) and how those Non-current assets are financed (Share of Non-current assets in total equity, Share of Non-current assets in long term debts and equity, MAT1 and MAT2) and dependent variables (ETR- Accounting, ETR-Cash flow). The statistical software STATA has been used to calculate descriptive statistics of variables used. The Pearson correlation coefficient (pwcorr) is used to establish a correlation between explanatory and dependent variables. This coefficient could perfectly match our research goals because we tried to measure correlation and not causality of variables in the dataset. The regression analysis has also been conducted to deeply explore the possible linear relationship between variables.

Variables taken into the analysis are explained in the following table:

Table 1: Variable description

Variables	**Explanation**
ETR The accounting-based effective tax rate Fan and Chen (2017); Fan and Chen (2022)	Tax expense/Profit before taxes
ETR The cash flow-based effective tax rate**,** Fan and Chen (2017); Fan and Chen (2022)	Cash paid for taxes/Profit before taxes
MAT1 (Vržina, 2022), materiality variable	(Deferred tax assets -Deferred tax liabilities): Total assets
MAT2 (Vržina, 2022), materiality variable	The result from deferred tax revenues and expenses: Operating revenue
Share of Non-current assets in total equity	Non-current assets /Total equity

Share of Non-current assets in total long-term debts and equity	Non-current assets /Long term debt+Equity
Share of Non-current assets in total assets	Non-current assets /Total assets
Coefficient of Non-current assets utilization	Net sales Revenue/Net book value of non-current assets

4. Research results

The next section of the paper presents a statistical analysis of the dataset.

4.1. Descriptive statistics

Analysis of variables of our importance will be conducted using the following descriptive attributes: mean, min, maximum, standard deviation, and a number of observations of variables.

Table 1: Descriptive statistics of main explanatory and dependent variables

stats	ETRcf	ETRa	MAT1	MAT2	nca_te	nca_de	nca_ta	ncau
mean	.2184631	.1422448	.002403	-.0001031	1.559333	.8413333	.3593333	48.86867
max	6.435387	.9323024	.0413993	.0074789	20.6	4.1	.8	3786.1
min	0	0	-.0177328	-.0143202	0	0	0	.5
std.dev.	.6190873	.0996106	.0082726	.0026134	2.469848	.6722882	.2095366	333.1197
N (obs)	150	150	150	150	150	150	150	150

Source: Authors' calculations

In the previous table, ETRa, which represents the dependent variable, takes an average value of .1422448, meaning that approximately 14% is the average tax rate of Serbian agriculture companies, while the average cash flow tax rate (ETRcf) in the same period is .2184631 or 21,8%. All other variables are considered explanatory. MAT1 average value of .002403 means that less than 0.2% of total assets are deferred taxes in agricultural companies. Also, the materiality variable MAT2 average value is .0001031 or 0.0103%. That means that the share of the results of deferred taxes in the income statement in total operating revenue is extremely small. MAT1 and MAT2, defined as materiality variables, highlight that the materiality of deferred taxes in statements of financial position and income statements is below the threshold value (threshold is usually 1% or 5%). The share of Non-current assets in total equity (nca_te) mean value in agriculture is 1.5, meaning that, on average total non-current assets are 1.5 times covered by equity. Nca_de represents the share of non-current

assets in long-term debts and equity, showing that 0.8413333 of non-current assets are financed from long-term debts and equity. The average value of the share of non-current assets in total assets (nca_ta) is .3593333, or 35.9% of total assets are non-current. Non-current assets utilization, which takes the form of a coefficient, has an average value of 48.86867, meaning that non-current assets are 48.8 times used in the business to create agricultural revenue. The above-mentioned ratio helps determine the efficiency with which a company utilizes all its non-current assets, which is extremely high. But this could also mean that assets are significantly depreciated in the agriculture industry. The main asset utilization ratio is represented as Revenue over Net book value. In agriculture net book value of non-current assets is quite low compared to high revenue, which could influence this ratio to take a mean value of 48.8.

Table 2: Descriptive statistics of absolute variables connected with income taxes

stats	dta	dtl	cte	coit
mean	72312.41	74121.59	121221.1	105414.9
max	1826823	2582064	1731695	1440165
min	0	0	0	0
std.dev.	220778.1	386413.6	221229.1	188483.2
N (obs)	150	150	150	150

Source: Authors' calculations

Table 2 analysis adds additional light to the usage of deferred taxes in agriculture companies. The total average of deferred tax assets (dta) is 72,312 Eur, while the average value of deferred tax liabilities (dtl) is 74,121 EUR, meaning that companies, on average, use more deferred tax liabilities in the statement of financial position. The mean value of the current tax expense (cte) in the income statement is 121,221 EUR, while the cash outflow paid for the income taxes (coit) average value is 105,414 EUR.

4.2. Pearson coefficient of correlation analysis

The results of the Pearson correlation analysis are presented in the table below.

Table 3: Pearson correlation analysis

	ETRcf	ETRa	MAT1	MAT2	nca_te	nca_de	nca_ta	ncau
ETRcf	1.0000							
ETRa	0.1938**	1.0000						
	0.0175							
MAT1	-0.0584	-0.0396	1.0000					
	0.4780	0.6305						
MAT2	0.2175***	0.1075	-0.1201	1.0000				
	0.0075	0.1905	0.1433					
nca_te	-0.0261	0.1718**	0.0423	-0.0578	1.0000			
	0.7511	0.0355	0.6072	0.4824				
nca_de	0.0234	0.3595***	0.1587*	-0.0734	0.3293***	1.0000		
	0.7762	0.0000	0.0524	0.3718	0.0000			
nca_ta	0.1415*	-0.0873	0.3289***	-0.0474	0.1802**	0.1292	1.0000	
	0.0840	0.2879	0.0000	0.5647	0.0274	0.1150		
Ncau	-0.0369	0.0150	-0.0422	0.0049	-0.0793	-0.1518*	-0.2293***	1.0000
	0.6538	0.8555	0.6080	0.9528	0.3348	0.0636	0.0048	

Source: Authors' calculations

This table shows that ETRcf correlates positively MAT2 variable and with nca_te or that effective tax rate cash flow based correlates with the materiality of deferred taxes in the income statement and with the share of non-current assets in total assets. The results for the ETRa show that it correlates with nca_de positively and nca_de or that there is an association between effective tax rates and how non-current assets were financed (through equity or debt and equity). MAT1 correlates with nca_de and with nca_ta, meaning that material values of deferred tax assets and liabilities are positively correlated with the total share of non-current assets in total assets and its share in debt and equity. Ncau or non-current asset utilization correlates negatively with the share of non-current assets in total assets meaning that companies with more non-current assets do not utilize them efficiently.

4.3. Regression analysis

Regression analysis will be presented using the following equations:

Equation 1:

ETRcf = (0.0616188) MAT1 + (0.114067) MAT2 + (0.1118006) nca_te + (-0.7866997) nca_de + (0.319206) nca_ta + (0.3119774) ncau

From the total of 36 observations, all explanatory variables do not significantly influence ETRcf except for the variable MAT1. The regression coefficient (R^2) shows 6.4%, which means that the materiality variable MAT1 explains 6.4% of variations in the ETRcf.

Equation 2:

ETRa = (0.1824402) MAT1 + (-0.0205706) MAT2 + (0.0326477) nca_te + (-0.00610015) nca_de + (0.0939821) nca_ta + (0.1406974) ncau

In 37 observations, five explanatory variables have no significant influence on ETRa as the dependent variable, and the only statistical significance shows the MAT1 variable. The regression coefficient (R^2) shows that this variable explains 20.1% of the value of ETRa.

5. Interpretation of the results

As Vržina and Dimitrijevic (2020) emphasized, the impact of corporate income taxes may seem trivial, but when current and cash ETR is taken as a measure, the impact depends on whether temporary book-tax differences were used or permanent differences. If permanent differences are used employed, ETR impacts profitability. Book tax differences are mainly due to temporary taxable differences stemming from the depreciation of non-current assets. As regression analysis shows materiality of using book-tax differences in the statement of financial position explains 6.4% of the effective tax rate based on cash flow bases, while 20.1% of the effective tax rate variations are explained with the usage of the statement of financial position tax-book differences. It can be seen from it that MAT1 and MAT2 represent variables that could be used to show how deferred taxes are created in the statement of financial position (MAT1) and the income statement (MAT2). The more material the deferred tax assets and liabilities in the statement of financial position, the more ETR- accounting-based variations are explained. That partially supports the first research question that Serbian agriculture companies' managers chose deferred taxes to influence the effective tax rates. Our results show that book-tax differences correlate with the effective tax rate, as pointed out by Hanlon and Heitzman (2010).

Descriptive statistics show that most Serbian agriculture companies use deferred tax liability in the statement of financial position, whose mean value is approximately 74,000 EUR with a standard deviation of more than 386,000 EUR showing significant differences between sampled companies. Temporary differences in deferred tax assets have a mean value of approx. 72,000 EUR with a standard deviation of approx. 220,000 EUR. Those deferred liabilities arise when there is a difference between economic and tax depreciation. The theory supports that it never reverses if the company continuously buys new non-current assets (Sansing, 1998). Vržina (2022) said that tax expenses are considered variables that measure managers' efficiency when tax planning strategies could be executed. That is the case of the agriculture industry in Serbia and its managers. Having MAT1 associated positively with the changes in total non-current assets points out the case of using accounting for the non-current assets to create temporary book-tax differences that are materialized in the values of deferred tax liabilities and assets in the statement of financial position of agriculture companies. So, the second research question is supported by the sample results. Wong (2005) found that if firms experience growth in investments in depreciable assets and continue to use comprehensive tax allocation, an unintended and potentially ever-growing liability that has no cash outflow implications is reported on the statement of financial position could result in adverse consequences such as perceived increased risk, leading to higher borrowing costs and debt covenant violation. So, managers of Serbian agriculture companies should be cautious when using non-current assets accounting to create book-tax differences because of their perceived risk.

6. Conclusion

This study examined whether managers of agriculture companies use deferred tax assets and liabilities to create accruals that affect effective tax rate calculations. We explored that issue using a sample of Serbian agricultural companies. The research covered 30 Serbian limited liability companies with the highest revenue from 2016 to 2020. We use a regression model to provide an empirical investigation of the correlation between effective tax rates and non-current assets variables. The regression coefficient shows that the materiality of deferred taxes in the statements of financial position affects the effective tax rate. The empirical investigation of what affects materiality reveals that the share of non-current assets in total assets is associated with it, therefore, supporting our second research question as well. Results

from this research confirm the findings from previous studies that accounting accruals could be used for tax planning in the agriculture industry.

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