Should accountants determine how much tax we pay?

International accounting standards
vs.
Taxable income and capital gains

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Thank you Vice-Chancellor.

Good evening ladies and gentlemen.

Thank you for taking the time this evening to come here and hear about accounting and taxation, particularly when I am aware that you could be in France watching rugby or enjoying a school holiday evening with your children.

As airline pilots now say to passengers, in recognition of the intense competition in the commercial aviation industry: “We know that you have a choice; thanks for choosing us”.

Like the airline pilots, Lord Macnaghten, sitting in the House of Lords in England in 1901, also had something engaging to say. In delivering his decision in London County Council v. The Attorney-General, he famously stated:

“Income tax, if I may be pardoned for saying so, is a tax on income.”

Lord Macnaghten identified the key question in the operation of an income tax system; viz. the identification of income, which is the object of the tax. Lord Macnaghten’s language seems to imply that this identification is obvious. But is it?

What are governments really trying to tax when they impose a levy on income?

The problem is that the word “income” means different things to different people. To properly understand the concept, it is necessary to revert briefly to the theoretical foundations of income, which underlie an income tax, and that means – for better or worse – looking at what economists have to say about the matter.

The starting point of the economic analysis is a recognition that, in terms of well-being, some members of any society are better off than others. Those who are better off command greater power over both tangible and intangible benefits and resources.

Those people also have the means to make a greater contribution to the welfare of society.

One of the social policy roles of governments is to even up, to a greater or lesser extent – depending on their political persuasion – the differences in well-being of members of the society. In doing so, governments must identify appropriate instruments to measure the well-being of those members.
However, “well-being” does not lend itself to an interpretation in readily quantifiable terms. It is highly subjective, abstract, and inherently complex because well-being can be construed as a standard of living or quality of life that necessitates consumption of a combination of material goods and services (that is, those provided by the market and public goods and services) on the one hand, and non-material intangible benefits (for example, an environment with clean air, cultural harmony and no crime) on the other hand.

The abstraction associated with well-being lies in these elusive factors. They are sometimes referred to as “psychic income”.

The difficulty is that you can not transfer intangible psychic benefits from one person to another. In reality, transfers can be affected only if there is some physical benefit that is capable of being uplifted from one person or group and allotted to another person or group.

Therefore, it is necessary to move from an abstraction of well-being to some representative surrogate, which is capable of measurement, if the concept is to be of any use to achieve the underlying social policy objectives.

So, in the real world, how is the social policy goal of redistribution of well-being achieved?

As an approximation of well-being, the consumption of material goods and services can be used, although it omits the ethereal component. Nevertheless,
consumption expenditure is an attractive proxy as a practical basis of taxation, as we see with our GST.

However, taking account of all the tenets of a good taxation system, it is taxes on income, rather than taxes on consumption, that prevail as the most significant, and internationally widespread, form of taxation.

Income tax casts a wider net than consumption tax, because not all income is spent on consumption. Some income is saved and invested in assets.

If the only tax in an economy were a consumption tax, and not all income is spent on consumption, income saved and invested would not be taxed. The principles of equity and economic neutrality tell us that income saved should not be treated favourably, but should also be subject to tax.

The most common justification for an income tax, as opposed to some sort of consumption tax, is that income tax is the fairest tax, because income reflects a person’s ability to pay tax.

Which brings us to the theoretical basis of income determination for tax policy purposes. The German, Georg von Schanz, and the Americans, Robert Haig and Henry Simons developed (independently) what is often referred to as the “Schanz-Haig-Simons” income model.

In essence, based on the principles that I have just outlined, they regarded taxable income as the sum of the increment in a person’s or entity’s wealth during a period and the value of their consumption during that period.

It is this notion of income that accountants have taken on board.

If tax is imposed on an annual basis, it logically follows that annual increments in economic power should be subject to tax. Necessarily, such an interpretation of an income tax base cannot be confined to money income because, at the extreme, a person may have no money inflow, but only unrealised non-cash assets.

If these assets increase in value, the owner obtains a greater share of economic resources. If the assets are converted to cash at that increased value, greater consumption rights fall upon the owner.

If this improvement in well-being is not taxed, the ideal of fairness is breached. There is an ability to pay (in some form), which is not called upon.

Those who oppose taxing such capital gains – at least on an accrual (or unrealised) basis – consider ability to pay in terms of having cash on hand to fund a tax liability. In other words, the gain must be realised.
They argue that it is not equitable to require a person to pay tax on an accrued gain if that gain is not in a form that enables payment of the tax, or if assets need to be sold to provide cash to pay the tax.

This view found favour with the United States Supreme Court in 1920 in *Eisner v. Macomber*, where Justice Pitney said of a shareholder who received a bonus issue of shares:

“Without selling, the shareholder, *unless possessed of other resources*, has *not* the wherewithal to pay an income tax upon the [bonus issue]. Nothing could more clearly show that to tax a [bonus issue] is to tax a capital increase, and not income, than this demonstration that *in the nature of things* it requires conversion of capital in order to pay the tax.”

Why this should be so has never been convincingly justified. According to Justice Pitney, it is just “in the nature of things”!

I submit that it is not tenable to contend that ability to pay is absent simply because assets are not held in cash. Payments can be made, if necessary, by transferring the assets themselves. In New Zealand, tax payments on unrealised gains are already required under the tax law concerning, for example, financial arrangements and foreign investment funds.

**Accounting approach**

This reasoning certainly accords with the accounting approach to income measurement.

During the last 75 years, accounting has undertaken periodic income measurement largely in a business context on the basis of actual transactions.

Assumptions are made about the state of affairs at the end of each measurement period to ensure that all expenditure is matched with revenue derived in the period.

Income has been measured according to conventional historic cost accounting principles. More recently, a modified historic cost approach has been adopted, which places less reliance on the need for transactions with external parties, so that accounting income can be accrued on the basis of certain economic events, which generate value changes *before* a transaction takes place.

Therefore, in recent years, the accountants’ concept of income has moved, and continues to move, closer to the Schanz-Haig-Simons notion of income by incorporating unrealised gains, as well as the results of past transactions, into the income measurement.
An important point about the accounting approach to income measurement is that it is a well deliberated notion, formulated over a long period by accounting academic and practitioner experts drawn from all over the world into what is now called the International Accounting Standards Board. (The United States, of course, has its own comparable body!).

As we shall see shortly, the courts, in their development of the concept of income for tax purposes, have not had the advantage of this coherent approach to the formulation of the meaning of income.

The accounting concept of income has been promulgated via the International Accounting Standards Board’s accounting framework statement, which is a statement of accounting concepts.

That statement reflects the Schanz-Haig-Simons model by treating income as, to put it fairly simply, an increase in economic benefits derived by an entity during an accounting period (normally, one year) in the form of inflows or enhancements of assets (or decreases in liabilities), which result in an increase in wealth.

Accounting practice in the 20th century diverged from this fundamental concept in that, while capital gains are included in accounting income when they are realised, unrealised capital gains are incorporated only in selected circumstances.
Therefore, we can see that the accounting notion of income is **narrower** than the economics concept, principally because:

- Firstly, the psychic or intangible elements are omitted; and
- Secondly, not all **unrealised** gains are incorporated into it.

Nevertheless, the thrust of the current development of the accounting concept of income is to increasingly embrace unrealised market values, through an approach known as “fair value accounting”.

**Legal idea of taxable income**

Let us now turn to the legal concept of income.

Reverting to Lord Macnaghten: what did he have in mind when he made his famous statement: “income tax … is a tax on income”?

To answer that question, we must first appreciate that “income” is not defined in tax legislation. The courts have had to develop their own series of tests to decide whether or not a receipt or gain is income, and therefore subject to income tax.

This has been done on a largely *ad hoc* basis, as cases have come before the courts. Consequently, the judicial notion of income is not as well conceptualised, and therefore not as theoretically robust, as the economics and accounting approaches.

The judicial analysis started (oddly enough) with a line of cases concerning Scottish ministers of religion who were reluctant to pay tax on collections from their parishioners during church services – on reflection, that may not sound particularly odd to you!

Through these cases, the courts began to establish that receipts had to have certain properties to constitute income.
They required the presence of:
- an incoming or inflow,
- convertibility into cash,
- periodicity or recurrence,
- a reward from employment or vocation, and
- realisation.

To illustrate, take a benefit match in cricket, where the gate takings (or a portion of them) are paid to a retiring cricketer. There is no doubt that accounting would treat the receipt by the cricketer as income.

However, the judicial approach may mean that the amount received by the cricketer is not income. This is because:
- the receipt does not manifest the characteristics of periodicity,
- it may not be a product of the cricketer’s labour (in the sense that his employment contract may have terminated by the time the benefit match takes place), or
- it is not income within the “ordinary” meaning of the word, as judges interpret it.

On the other hand, the amount paid to the cricketer is:
- an inflow,
- it may be regarded as a product of his labour generally, and
- it may be driven by a profit-making motive,

in which case the receipt would fall within the legal concept of income.
Weighing up these subjective criteria, and applying an “on balance” test, different judges come to different conclusions, which in some cases, treat such receipts as income, and in other cases do not.

So, we can see a narrowing down of the notion of income that is subject to tax, as we move up the pyramid from the economics concept, through the accounting concept, to the legal concept, which ultimately limits the tax base.

The greatest deficiency in the legal measurement of income is the exclusion of capital gains. Why is this?

There are two primary reasons, which, I suggest, explain the deficiency from the perspective of modern tax policy objectives.

First, income tax was originally imposed in England in 1797 by William Pitt’s so-called “triple assessment”, which was designed to be a temporary tax to fund the Napoleonic Wars.

Given its intended temporary nature, it does not seem unreasonable to exclude sporadic capital gains.

The second, and more common, explanation is that the judicial notion of income derives from the law of trusts, and to understand why we need to take a brief look at English history.

In the Middle Ages, land was the chief form of wealth, but it was rarely bought or sold. In essence land had no selling value, but only a rental value.

In the predominantly agricultural economy of 18th and 19th century England and Continental Europe, income was viewed as a physical product: the annual harvest, or the cash into which the harvest could be converted. Income in this sense recurred regularly with the passage of seasons.

Such income was related to the capital that produced it. Land was a physical, fixed and continuing source of the annual harvest. The harvest was separable from its source and was available for disposal or consumption without impairing the underlying capital.

Therefore, a fundamental feature of the judicial concept of income became separability of income from its source.

The need for a general concept of income first arose with the desire of English and European landowners to limit the inheritance of their estates to their heirs, such that those heirs could not dispose of the estates.
Thus, the estates were to be retained within a genealogical lineage, where they were held in trust for each succeeding heir, who was entitled only to the income from the estate during his (or, far less commonly, her) lifetime.

An heir was not entitled to the capital of an estate, increases of which, during his lifetime, were accumulated in the estate and passed on to produce income for his successors.

Consequently, a distinction between income, which could be consumed by a life tenant, and capital, which was to pass to remaindermen, was necessary.

Where property was not held in trust, the question of whether changes in its value was a component of income generally did not arise because of infrequent changes in ownership and because of the absence of any need (such as an income tax) to address the issue: the income and capital distinction was solely for the purposes of trust law.

As commerce became more sophisticated, asset portfolios began to include financial securities, as well as land. Nevertheless, the custom of measuring income by periodic inflows spread to all classes of society and assets, because of the predominant interests of the landed gentry.

**Trust law: bonus issue cases**

The income and capital distinction from trust law was transposed into income tax law in the 1921 English case, *Inland Revenue Commissioners v. Blott*.

There, the House of Lords decided that a bonus issue of shares did not constitute taxable income on the basis that the “sweeping language” used in an earlier House of Lords trust law case – which found that a bonus issue was not income of a life tenant – was intended to set out a principle of much wider application.

That inference mandated the income and capital distinction in income tax law.

The Law Lords did not consider the appropriateness of the trust law capital-income distinction in the context of the policy objectives (such as economic efficiency and equity) of an income tax.

From a tax policy perspective, there is absolutely no valid justification for the wider application of the trust law distinction between income and capital, applicable to a bonus issue case.

Interestingly, the development of the notion of income for tax purposes went in the opposite direction in the United States. There, realisation of capital gains had been far more frequent and conspicuous than in England and Europe.
The situation in America was attributable to geography and culture. During the 18th century colonization of America, land was plentiful and cheap. Ownership of land did not carry the social prestige that it did in England and Europe. The colonists felt no compulsion to keep land in the family.

The large immigrant population and the discovery and exploitation of natural resources were catalysts for rapid economic growth. Consequently, the value of land and businesses increased.

There was a high degree of mobility of entrepreneurs, which resulted in frequent and profitable realisation of accumulated wealth. Land was therefore often sold, just like other commodities.

Commonly, consumption was funded from capital gains.

Consequently, capital gains would often become indistinguishable from ordinary business profits. The Americans’ measure of wealth was determined by such gains.

In the light of this historical background, the sharp distinction between ordinary income and capital gains, which still prevails in England and the Commonwealth never obtained a hold in the United States.

The real question to be decided in the United States was whether a capital gain needed to be realised before it could be taxed.

As I mentioned earlier, the Supreme Court determined that unrealised increases in the value of assets (as distinct from realised gains) are not income.

So, for United States tax purposes, as in other countries, realisation of the gain prevailed over the Schanz-Haig-Simons notion of an accrued gain as an element of income.

**New Zealand**

But what about New Zealand?

The English courts’ approach might be understandable in the context of an agricultural economy:
- where commerce and trade were closely, and literally, related to produce from land and fruit from trees,
- where the value of the land and the trees did not change,
- where only rudimentary accounting practices existed, and
- where a landed estate was presumed to last forever.
By contrast, in colonial New Zealand land was plentiful, relative to the size of the country’s population. The early development of New Zealand was more akin to the frontier development of the United States than to the established order of England and Europe.

In New Zealand land was often traded and originally it was not commonly held in trusts.

Given that New Zealand environment, there was no logical foundation for the judicial assumption that English based notions of income and capital should automatically apply here – other than adherence to the doctrine of precedent.

In fact, New Zealand’s first income tax act, the Land and Income Tax Act 1891, did tax capital gains derived from the realisation of assets.

This was either far-sighted and – for legislation to be applied in practice at the time – conceptually, a well constructed piece of legislation – or it was a mistake! The latter explanation is more likely, because:
- firstly, New Zealand law closely followed English law, and there was no English precedent in 1891 to tax capital gains, and
- secondly, this part of New Zealand’s income tax legislation survived for only eight years!

The traditional legal concept of income is hardly relevant to, and clearly inadequate to deal with, today’s economy:
- where land is no longer the predominant income producing asset,
- where ownership of income producing assets frequently changes,
- where accounting measurement methodology is becoming increasingly sophisticated, and
- where business has evolved complex, commercial transactions.

Most countries recognise the limitations of the common law notion of income and have legislated to tax capital gains.

New Zealand is now the only OECD country not to do so, in one form or another.

New Zealand even lags behind many underdeveloped African countries, which recognised quite some time ago that realised capital gains represent income in its modern-day sense, and reflect the recipient’s ability to pay tax.

What then is so precious about New Zealand excluding capital gains from its income tax base?
- It cannot be – as I hope that I have already demonstrated – the lack of a robust theory of income.
- It cannot be because it is not an internationally accepted “best” practice.
- Is it because we have a stronger attachment to the common law of England than even the English, since they introduced a capital gains tax long ago? I don’t think so.

I suggest that is it simply because of a lack of political will to take on vested interest groups.

Clearly, then, the superior accounting notion of income has the advantage of casting a wider net than the current legal approach to capture not only traditional income flows but also a broader variety of gains.

And that is one good reason to embrace the accounting concept of income for income tax purposes in New Zealand.

As far as practically possible, we should be trying to remove the delineation between the legal and accounting ideas of income so that taxation is imposed on a wider income base.

Aside from the comprehensive nature of the accounting concept of income, the argument in favour of its use as a basis for income tax is driven primarily by tax simplification and reduction in compliance costs objectives. And these are admirable goals considering that the latest version of the re-written Income Tax Act is 3,031 pages long!

However, there is another very important reason why the use of the accounting measure of income is superior from a tax policy perspective. It is that the accounting approach is premised on economic substance or reality.
The *Statements of Accounting Concepts*, which underpin accounting standards, require that the accounting measure of income reflects the economic substance of a transaction or event, rather than its legal form, where that substance and form conflict.

To explain what I mean, let me return to the cricketer who is fortunate enough to have a benefit match in his honour.

The New Zealand Income Tax Act attempts to circumvent the variable judicial outcomes concerning the income or non-income status of the proceeds of the match received by the cricketer by specifically providing that such payments made to a cricketer by his former employer constitute assessable income.

Unfortunately this statutory provision, in itself, is rather weak because it is very easy to interpose an intermediary entity between the cricketer and the cricket body that employed him, so that the legal form of the new arrangement is such that the cricketer does not receive his payment directly from his employer, as required for the statute to be effective.

In those circumstances, the legal form of the arrangement circumvents the tax impost.

But accounting will have none of this. Applying its increase in assets test, the question simply is:

“Has the cricketer obtained an increase in economic benefits in the form of inflows of assets?”

And the answer is obviously: “yes he has”.

Accounting is not concerned with the nature of the source of that increase, i.e. how it comes about that the cricketer received the amount. Accounting is concerned only with the economic reality that the cricketer’s wealth has increased as a result.

**Opposition to alignment of accounting and tax income measurement**

Those people who oppose the use of the accounting measure of income for tax purposes do so for a number of reasons. The main one concerns the different purposes of the two measures.

The argument usually runs along the lines that the goal of accounting profit measurement in financial reports is to provide useful information to the users of those reports to make informed investment decisions, while the goal of the taxable income figure is:
- to provide the basis for the equitable collection of income tax to fund government expenditure, and also
- often to influence a taxpayer’s behaviour (typically through offering tax incentives), and
- to facilitate income redistribution (for example, via low income rebates of tax).

The accounting measure of income is founded upon the **reliability** of that piece of information.

In other words, it must be able to be depended upon by readers (who include tax administrators) to represent faithfully the net result of numerous financial transactions and events, which took place during the measurement period.

To achieve that, the accounting profit figure must be compiled in a neutral way, meaning that it must be free from any bias of the accountant who is calculating the figure.

These attributes of reliability, faithful representation and neutrality, which underpin the compilation of the accounting income figure, are, of course, **equally relevant** to the measurement of income as the base upon which to impose tax.

Opponents of a closer alignment of accounting and tax income measurement sometimes overlook that accounting net profit, based on those generally accepted accounting principles, is **already in practice** embodied in the taxable income figure.

To put it another way, much of an entity’s taxable income has **already** been determined in accordance with accounting principles and practice.

This accounting net profit is reconciled with assessable income, by making adjustments to accounting income and expenditure to meet particular statutory requirements.

Of course, not all business taxpayers apply international accounting standards to arrive at their accounting net profit figure. To the extent that they do, life is easier not only for the taxpayer but also for tax administrators, because they do not have to incur the administrative costs of trying to figure out what taxpayers have done to get to their accounting profit figure.

In this context, it is worth noting that in New Zealand, there is a movement towards mandatory adoption of financial reporting standards by small entities, (albeit that that requirement has recently been temporarily deferred).
The opponents of alignment of the income measurements also argue that, by requiring accounting standards to be applied for tax purposes, accounting standards setters will be affected by the knowledge that the standards they set will have a tax impact.

It is hard to believe that international accounting standards, - which are devised by upstanding members of the accounting profession drawn from a variety of countries, - which are compiled within the context of underlying statements of accounting concepts and principles, and - which form the basis of national financial reporting standards in different jurisdictions,

will be contorted to reflect the tax laws of a particular country or countries.

To me, it does not seem realistic that accounting standards setters will digress from their fundamental objective of prescribing rules, designed to reflect reality – which, after all, is what the general users of financial statements seek – simply to depress a reported profit figure so that the reporting entity’s tax is minimized.

The reality, of course, is that if accounting profits are hidden for that reason, the disclosed profits available for distribution to the owners of an entity are correspondingly reduced, when in fact profits do exist, and are available for distribution – not to mention the accountants’ potential exposure to remedies sought by aggrieved users who have relied on misleading financial statements.

A further argument against closer alignment is that accounting profit measurement is tempered by considerations of relevance, materiality and conservatism or prudence.

To deal with the latter first, conservatism or prudence, as a basis for financial reporting, was certainly important in the last part of the 19th century and for most of the 20th century. The accountant’s conservative disposition towards income recognition (and asset valuation) intensified after the valuation abuses and over-optimism of the 1920s, and their dire consequences in the 1930s.

Such an approach comes down, of course, to a personal judgement call, and leaves income measurement open to manipulation. It lacks any sound theoretical basis.

In recognition of these shortcomings, the conceptual frameworks for accounting, which emerged in the latter part of the 20th century, place less emphasis on conservatism and prudence, and more emphasis on the requirement of neutrality, to give a reliable or faithfully represented picture of the reality of what occurred in the measurement period.
Measuring income, whether for accounting purposes or for tax purposes, is not an exact science.

Some countries (particularly in Europe) tolerate a greater link between the accounting and tax measurements of income. They appear not to be quite as obsessed with taxing the last dollar, as perhaps we are in New Zealand.

They would seem to be more prepared to compromise total accuracy by taking a “reasonable” approach to getting it “more or less” right, with greater simplicity, at a lower compliance cost, thereby achieving a greater degree of engagement with more taxpayers.

This is an approach that New Zealand tax policymakers might consider.

Many of the differences between tax accounting and financial accounting turn on timing matters, i.e. where these differences arise, sooner or later the income is recognised and expenditure is deductible – it is just the income or expense appears in a different period for tax purposes from that in which it appears for accounting purposes.

I would suggest that in this area there is quite some room for tax policymakers to compromise on precision in order to make the income tax system simpler – which means condensing those 3,031 pages – and thereby reduce taxpayer compliance costs.

This would also allow the tax administration’s audit focus to be placed on taxpayer compliance with proper accounting practice and on permanent differences; that is, where items of accounting income have been omitted from the income tax base for good, or items of expenditure that never appear in the accounting income statement are claimed as deductions for tax purposes.

**Full alignment**

You might have sensed by now that I quite like the idea of accounting playing a greater role in the determination of taxable income.

However, the present reality is that full alignment of the accounting measure of income and the measure of income for tax purposes is simply not possible.

This is because current tax policy thinking in most countries is to ensure that the tax system can be used to do to things other than merely measure income, which arises from historical events.

In this respect, there are two areas of significant deviation.
First, governments typically want to provide incentives through the tax system to modify taxpayer behaviour. This is why, for example, we have a 20% uplift for tax depreciation deductions, over and above the accounting depreciation expense on certain assets.

The second reason why tax policy might deviate from accounting policy is that, in certain circumstances, the government may actually not want to tax on the basis of the reality reflected in the accounting income measurement.

Although this may sound strange, it is perfectly justifiable. For instance, where two companies in a multi-national group of companies – or different divisions within one company – engage in transfer pricing; that is, they set artificial prices in transactions between themselves in order to avoid tax in one jurisdiction or the other.

In these circumstances, accounting reflects the reality of the prices at which the transactions actually took place. To defeat the tax avoidance driving such transfer pricing arrangements, governments typically want to tax these transactions on an arm’s length basis. That means that the accounting income figure must be adjusted.

“Half-way House”

The trouble with the New Zealand income tax law in respect of income measurement is that it is not coherent or consistent.

Accounting evidence has been used in numerous tax cases to measure gross income or revenue (on an accrual basis), but less so for the determination of deductible expenditure.

This is because the income tax legislation provides a so-called “code” for the deduction of expenditure, but it is “opened ended” with respect to the derivation of revenue.

It seems peculiar and inconsistent that Parliament is content with the situation where accounting is OK for one side of the profit measurement equation, but not for the other side.

So, we use accounting rules to determine when income is derived for tax purposes, but we apply common law rules to determine what expenditure is deductible and what is not, and to carve out capital gains.

In addition, we adopt the accountants’ concept of income by taxing unrealised gains that arise from movements in market values of financial arrangements, and the economist’s notion of income by taxing unrealised movements in the value of foreign investment funds.
What we need is a conceptually sound and rational Income Tax Act.

That can be achieved by adopting the accounting measure of income as the basis of taxation, and overlaying that with a very limited number of adjustments of the types that I have mentioned, to reflect a different tax policy intent.

To achieve that successfully, I would endorse the approach suggested for the United Kingdom, viz. to embody in the tax legislation a provision that identifies specifically where accounting standards and generally accepted accounting practice are not to apply for income tax purposes.

This does not mean that the Courts do not have a role to play. Their job is statutory interpretation.

If the accounting measurement of income, based on accounting standards and generally accepted accounting practice, were to play a greater role in formulating the income tax base, the Courts would be required to adjudicate in disputes about whether the facts of particular cases fell within the words of the accounting standards or within generally accepted accounting practice; for example, to determine whether the facts of a particular situation evince a presently existing obligation, which requires the recognition of an expense in calculating income.

Conclusion

So to conclude:

The basis of accounting is truth and fairness; that is, to give a true and fair view of the economic reality of the events on which accounting purports to report.

That is achieved by applying generally accepted accounting practice and principles, which are reflected in the accounting standards.

To the extent that the income tax system does not tax on essentially the same basis, it is deficient. Subject to the limited sorts of qualifications that I have mentioned, what we’re trying to measure is basically the same thing, albeit to achieve different purposes.

If we move down the track of more closely aligning accounting income and taxable income, small enterprises will need to adopt international financial reporting standards. At least as a medium-term objective, that is quite feasible.

However, a closer alignment of the income tax base with accounting income measurement inevitably means a movement towards fair value accounting.
Internationally, current tax policy thinking is reluctant to embrace such an holistic approach. Recent experience in Australia has rejected such an approach, but that is not to say that it should not be explored further, particularly as valuation methodology becomes more sophisticated, and as we devise ways of funding tax liabilities that arise from unrealised gains.

However, the immediate practical focus should be on a more general adoption of accounting standards, coupled with legislation precisely detailing where deviation from accounting standards and practice is required for tax purposes.

Therefore, to answer the question posed in the title of this lecture:

“Should accountants determine how much tax we pay?”

**Should Accountants Determine How Much Tax We Pay?**

**Yes, but …..**

A qualified “yes”. Accountants should play a greater role in determining the amount of tax we pay, but they cannot expect a seamless alliance of the accounting and tax measures of income in the immediate future.

Thank you once again for your attendance and your interest.