THE IMPACT OF TAXES ON THE SELF-FINANCING CAPACITY OF THE ENTERPRISE

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Abstract: *Considered only as a tax levy, tax reduces the capacity of self-financing of the enterprise, like any other tax borne by natural or legal persons. Tax incidence, generated by tax systems and practiced in one country or another or during certain periods, occur at different levels to determine the results, evaluated in terms of profit or loss, knowing that profit can become an important source of financing of the company, along with amortization of fixed assets (property), which ensures the recovery of its value transmitted in costs and selling-purchasing prices of realized products. The purpose of this paper is to highlight the impact of taxes on self-financing capacity of the company.*

Keywords: *tax, cash-flow, gross operating surplus, self-financing capacity, financial result*

Acknowledgement*: This work was supported by the European Social Fund through Sectoral Operational Programe Human Resources Development 2007 – 2013, project number POSDRU/159/1.5/S/134197, project title "Performance and Excellence in Doctoral and Postdoctoral Research in Economic Sciences Domain in Romania".*

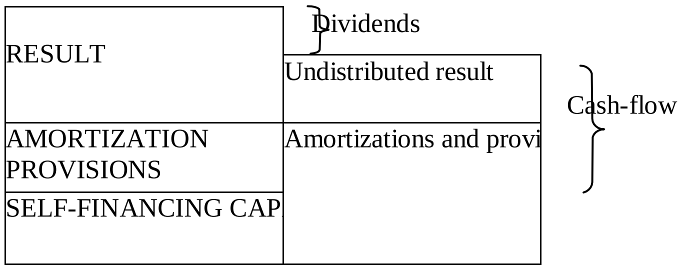
INTRODUCTION

The first internal source of funding may be used as long as there is a profit, and this is a traditional wealth that can be stored within each company allowing it to self-finance its future development. But its contribution to the self-financing of the company raises a complex issue of assessment, being considered three levels of appreciating the results.

Considered at a first level of evaluation, the financial result (profit) of the exercise is a resource that the company could conserve wholly or partly, after deducting the dividends and other distributions set in results. The undistributed part of the advantage is, therefore, a source of self-financing or self-financing element sprung of the business. Nevertheless, the result provides only a partial evaluation of this capacity to finance itself that it does not only take into account the increase in net wealth (income-expenses) obtained at the end.

In the case of a second level approach for assessing the results, the concept of monetary surplus provides more conclusive information about the financing capacity of a given period. This assessment is justified in that it measures the operating surplus as gross operating surplus (EBE) or a global surplus as self-financing capacity (CAF). This surplus corresponds to an excess of revenue surplus money (likely to be paid). It appears as a potential monetary surplus, ie an additional source of funds likely to be affected by self-financing and future business development. Taking into account the levies from profits for distributed dividends allows passing from simple self-financing capacity (CAF) to effective self-financing. The latter is obtained by subtracting from the capacity of dividends self-financing and other distributions from profit, as shown in Figure 1.

Figure no.1 The difference between cash-flow and self-financing capacity



Finally, at a third level it is released the incidence of these monetary surpluses on the financial balance, considering the contradictory effects that the activity exerts on the treasury. On the one hand, the enterprise activity involves the formation of self-financing resource scores pending to potential liquidity contributions. On the other hand, the same activity induces the need for additional financing weighing on the Treasury, making the need of working capital. Basically there is the following relationship between monetary surplus and liquidity of the company:

Self-financing capacity (CAF) –Variation of working capital need (ΔNFR) = Global surplus of Treasury (1)

Cash-flow – main method of establishing the company funds

Self-financing is the most common method of financing and assumes that the enterprise ensures its own development. Using as financial resources apart of the obtained profit in expired exercise and the amortization fund, the company is able to cover both the needs for replacement of fixed assets and increasing the economic active. Self-financing involves the formation of own funds and is characterized by retaining by the business a part of the financial results obtained from their activity.

Therefore, main method of establishing the enterprise funds, self-financing requires in advance the generation of revenue to cover costs and achieve a sufficient profit, part of which is reinvested to increase fixed assets and funding cycles of operation and its influence on the proportions largely profit taxation, including depreciation of fixed assets. It is also used as a source of self-financing and some surplus cash which occur as amortization determined by the wear of fixed assets in which is immobilized a part of the share capital of the company.

Self-financing is the original and fundamental method of financing. It is the original form of financing, since it corresponds to the first historical forms of capital progress. On the other hand, it is the basic form of funding as other ways of financing (direct funding or mediation) operates normally as simple anticipation of a future self-financing. In other words, an enterprise cannot access external funding unless it has real chance of reaching future self-financing that will allow reconstructing advances granted by third parties.

Thus, a company receiving a bank loan will have to repay it on its future financial results, so of its self-financing. Self-financing is therefore a fundamental pivot on which lies the financing of the company.

The proportions of self-financing business capital formation depends primarily on the ability of the company to produce profit, but also the owners determination of sharing a particular part or all of the net profit for accumulation at the expense of dividends and the amount of depreciation (determined by inventory value of fixed assets and depreciation calculation system used by the enterprise).

In principle, long-term financing economic activity of agents is performed both by own funds (which are included along with cash flow and capital gains) and the time commitment (bond loans, loans from specialized financial institutions, bank loans, leasing credits).

Agent's activity because it creates advantages for both shareholders and for economic agents as legal entities. Shareholders are advantaged because, capitalizing part of the profit, increases the value of company stock, increases the shares held, thus increases their wealth. Besides that, reinvested profit is exempt from corporation tax or tax benefit from discounts, creating greater opportunities for economic operator's reinvestment.

Such fiscal treatment is clearly advantageous at the microeconomic level, as it increases economic interest in obtaining superior positive results with the discovery and mobilization of internal resources, good management of resources and choosing the most efficient structures of production and financial funds. Also, through its implications, enterprise development is contingent to its own business, what matters more for self-development of the company. It provides thus more reliable funding assumptions, an independent and stable source, given that in certain circumstances the company is facing with difficulty in collecting of the company capital in the financial market, giving it a touch of freedom of action of the company, meaning that financial autonomy gained through self-financing allows a full independence and resource management to financial institutions and banks. Implicitly, it gives the company a great deal of discretion in deciding on investment (operating assets expansion, replacement) providing useful realization of some investments and no waste of resources.

Simultaneously, such a tax system allows braking indebtedness and thus reducing financial costs, namely equity and efficiency measurement of financial return, which is the decisive factor in opening access to the capital market and attracting foreign capital.

It is significant that in the situation of some enterprises and especially those that do not have access to capital markets, self-financing is the only source of funding for a longer period. And for large companies listed on the stock exchange or not, maintaining and increasing economic potential depends to a greater extent on their serves set aside from profits, especially when the company needs resources and shareholders can not contribute to increasing social capital.

Moreover, it is admitted that the option to increase self-financing results from a genuine instinct of preservation of the enterprise for which the main purpose of financial policy is to maintain autonomy.

However, to these many benefits, self-financing also presents disadvantages, among which may be mentioned:

- Excessive favors self-financing enterprises within their financial resources risk to develop too slowly because of insufficient financing means and, therefore, may not become veto competition;
- self-financing is likely to be a factor of price increases (due to the fact that it follows to achieve a greater benefit);
- the excess of self- financing of a business may discourage its associates (due to the fact that they do not receive remuneration for their efforts), making it impossible to increase social capital when it is needed;
- the worst inconvenience results, however, in that the self-financing appears to be a free resource so that the enterprise shows a certain negligence in selecting its investments (investments less profitable).

On the other hand, it is recognized that the proportions of self-financing company also indicate its performance; the ability to effectively use the capital entrusted to investors and ensure attractive remuneration. For creditors the absolute and relative measure of self-financing certifies the repayment capacity, as well as the risk of default. Self-financing reflects the wealth retained by the company itself and is an internal resource for financing future exercise. Self-financing is determined by increase of resources derived from their own work and that will remain permanently available to finance the company's future.

In conceptual terms, self-financing knows more acceptances, in which ever proportions that can perform is also under the way in corporate tax.

In one of these meanings, net self-financing is considered part of the gross self-financing of which forms the company's own sources, more than required by the recovery on capital requirements, resulting in an increase of the assets. Net self financing ensures own financing company which is the pledge of its possibilities for future development. Net self-financing consists primarily of net income attribute able to equity, i.e. the profit remaining after employee participation in profits as well as remuneration of members or shareholders. Part of amortization fund that exceeds the actual depreciation of property may also constitute a resource of this type of cash-flow.

In this context, it relies on the free cash flow, which expresses the company's capacity to mobilize, together with amortization, total net profit for development.

In the financial and practical literature of some Western countries, the total self-financing (maintenance and net) plus share of profit intended for dividend payment (compensation of the shareholders or associates) is often called cash-flow. In this sense, it is also calculated the financial rate of cash flow, as the ratio of cash flow to sales. The rate allows assessing to what extent sales liberate amounts for maintaining economic and financial potential of the company, enrichment and remuneration of associates. The higher this ratio is, the greater the self financing capacity is. Cash-flow, in this sense, is also called margin and cash flow comprises net income, depreciation and some reservations so that it can be stated that represents the total funds available for reinvestment.

Dimensions of released self-financing play the role of barometer for assessing the performance of the enterprise. It indicates potential investors that the company is able to use efficient capital and entrusted to provide attractive remuneration and in the case of call credit, absolute and relative size of self-financing certifies the repayment capacity, as well as the risk of default. Monetary surplus as a result of receipts and payments, representing the ability to finance itself, does not fully remain available for the company. Effective self-financing is the remaining amount available to the company, after the distribution of dividends and shares in employee benefits.

It is obvious that if the company does not pay dividends or distribute them in a smaller volume, it can reinvest whole or significant part of its profit, forming a basis for increased future income. Self-financing policy must be considered in reference to the profitability they emitter invested profits. It is necessary that the net return for shareholders remains the same, whether dividends, whether reinvested profits.

At the same time, we find that self-financing helps to increase the financial resources of the company, but determining the rate of return on reinvested profit, in the purposes of applying self-financing, it must be taken into account the tax incidence, ie of tax on income from dividends and reinvested profits.

We emphasize that, although funding sources that are formed in the enterprise and used immediately (fund depreciation, profit, reserve fund, etc.) appear to be "free", basically, they have a specific cost as belonging to shareholders and, if it were given to them, they could place them in exchange for remuneration.

In light of the particularities of achievement, home-financing funds of the enterprise are subject to inevitable constraints arising from the tax system applied, and in the foreground fiscal parameter affects both the profit and the depreciation in their capacity of components of self-financing.

It is also interesting the appreciation after which it can be accepted that the incidence of fiscal variable on self-financing highlights a questionable relationship, such as high taxation → high cash flow and vice versa. It relies on the idea that an oppressive tax policy incites the company to proceed with the capitalization of some profits as high as possible, finding in this destination lighter imposing conditions (fiscal incentives), which suggest a contradiction in terms.

Instead, regulations such as those relating to the reduction of the tax base of certain expenses (depreciation, loan repayments, interest payments, etc.), in order to strengthen the process can influence the distribution of dividends, rather than own financial resources growth. The distribution of dividends will depend on the tax law (company tax and personal taxation), company law and relations between shareholders and managers. Investors (shareholders) who are strongly taxed on income from dividends will vote in he general meeting of shareholders to distribute a dividend reduced in favor of reinvested profits, thus maximizing the enterprise value and the share of assets proper to each shareholder.

Consequently, the financing of home-grown resources of the enterprise and, in particular, requires an approach based on depreciation in relation to a tax variable. As a source of financing, the amounts accumulated on depreciation account do not manifest in the state of future cash payments of expenses, such as dividend distribution. In addition to these funding sources, direct tax does not exert effects, as depreciation expenses are deductible. Moreover, direct taxes represented mainly by income tax, stimulate its preference for using depreciation as a source that has the lowest specific cost of capital enterprise.

Therefore, it can be considered that investments whose anticipated returns are random are suitable to be financed primarily attributable to depreciation. This behavior is justified in practice and explained in theories by the uncertain investments that must be borne in equity from depreciation to reduce the risk of inability to honor debts where recourse to debt, amid obtaining negative effects.

In this regard, a study on a group of French companies showed that income taxhold back growt has hampers self-financing. The study also showed that if the income tax should be abolished, free cash flow would increase by more than 33.3%, the increase being even higher for small businesses.

Consequently, at the level of economic organization, the investor shall take into account in its spending a number of parameters, such as the tax rate on dividends and added value, the tax rate on individual income within tax (global). Especially in the case small and medium enterprises, where the main shareholder is usually, also head of the company, the calculation becomes complex because it must arbitrate between cash flow and external input, taking into account the impact of direct taxes paid by others as are those on dividends, etc., including indirect taxes, primarily VAT, with the implications of operations related to deduction, collection, payment and related reimbursement.

In the light of approached perspective a major financial returns to financial analysis based on the results account that provides information on the profitability of the company at different levels of appreciation, including self-financing opportunities. Together with the interim management balances, in the analysis based on the profit and loss account is calculated also self-financing capacity indicator, expressing the company's ability to secure development in monetary terms (receipts and payments) through its own funds. In this respect, self-financing capacity (CAF) is a result of confronting global monetary surplus revenue generating revenue generating expenditure payments across our operations during a financial year. Self-financing capacity is potential cash generated by the whole activity during the financial year which remain available to the company and can be used for self-financing.

Financial potential generated by the profitable activity of the company at the end of the financial year (CAF) is intended to remunerate equity (through dividends owed) and also to finance expansion investments (part of profit allocated for their establishment and development fund) and maintenance or renewal (through depreciation) in future years.

All these make from the capacity of self-expression a high economic indicator that reflects the financial strength of a company and also is the guarantee of its security and independence.

Businesses with good self-financing capacity decrease its financial risk, being able to overcome hard ships in times of economic crisis, when access to credit is difficult due to high interest.

Determination of self-financing must consider both economic and financial variables. Economic variables are based on sales forecasts (quantity xprices) and forecasting costs (raw materials, fuel, salaries, etc.). Financial variables are considering lending policy pursued by enterprise that gives rise to financial expenses, depreciation policy that can charge different costs for some years and profit distribution policy that sizes volume that dividends distributed to shareholders, participations in profits or increasing reserve funds.

Self-financing capacity can be determined based on cascade interim management balances; After calculating value added, EBE, operational result, current result, net result, CAFP is as follows:

$$CAF_p = Rnet + A + Prov \qquad (2)$$

$$CAF_r = CAF_p - R_{CAF} \quad (3)$$

where:
CAF_p = capacity of potential self-financing;
CAF_r = capacity of real self-financing;
R_{CAF}= distributions from CAF represented by dividends and shares in profits;
Rnet= net result of the exercise;
A= amortizations;
Prov= provisions

The literature highlights several opinion trends on the calculation of the CAF. In principle, the CAF is calculated from current revenue and expenditure management likely to turn immediately and forward the cash flows. Assessment of the cash flow from the outturn account can be achieved during two equivalent methods: deductive method and additional methods.

When applying the deductive method, self-financing capacity is the difference between revenues collected (corresponding to actual or future receipts) and expenses payable (corresponding to actual payments or future). This method is based on the logical definition of the cash flow of the firm, obtained by the following formula for calculation:

CAF= (Collectible revenues –Revenues from disposals) – Payable expenses (4)

This method takesas its starting point the gross surplus of exploitation that ignores the fiscal elements, as it does not into account the profit tax. At EBE is added all income likely to beearned (operational, financial and exceptional) and deducted all expenses likely to be paid.

CAF = EBE + Other earned revenues (without revenues from disposals) – Other payable expenses (5)

Therefore, deductive method, called "differentiated" or subtractive show to set up the cash flow. Based on the calculation, some authors may call it the “descending method" or the “decreasing method".

In a system based on GIS Cascada, self-financing capacity is determined according to a relation of the form:

CAF=gross surplus of exploitation+other operating income-operating expenses+financial income (a) – Financial expenses (b) + extraordinary income (c) -exceptional expenses (d) - tax (6)

where:
a) no reversals of provisions;
b) no financial calculated depreciation and provisions;

c) without revenues from the sale of assets; share part of subsidies paid on earnings for the year; reversals of exceptional provisions;
d) without net book value of the assets transferred; Exceptional calculated depreciation and provisions.

It is note worthy that retained exceptional income and expenses to determine the cash flow refers only to operations management. In contrast, income and expenses of exceptional capital operations are excluded from the calculation. Also, capital operations include investment subsidies and for income investments amounts which are not considered in calculating the cash flow because they are a simple description of accounting and, therefore, does not imply a cash flow.

Self-financing capacity shows a higher sensitivity compared to EBE, as it is influenced by depreciation, provisions and income taxes. From the calculation procedure it is noted that these items are deductible and the last one which is decreased is just the income tax. In compensation, however, one can say that the deductive method includes calculating all the elements that generate cash flows of the company. Through limitations and advantages, these two concepts (EBE and CAF) are complementary and not at all exclusive. The indicator calculated to be relevant in terms of interpretation, it is necessary to deflate or correct price index growth so as to make possible a comparison between the values recorded in dynamics.

For the purposes of some more realistic assessments, it appears to be helpful the indicator for the year ending deflation operation using the following relationship:

$$I_{pr0} = \frac{I_{pr1}}{1 + r_{i1/0}} \quad (7)$$

Ipr_1 = indicator for the year ending expressed in prices of current year;
Ipr_0 = indicator for the year ending expressed in base year prices;
$r_{i1/0}$= inflation rate during that specific year.

In turn, additional method yields the same result of CAF but has the merit to highlight the accounting items that do not generate cash flows. The logic of this method is given by taking into account all the elements that were not highlighted in the first method. In the additional process it starts from the net result for the year, so after deducting income tax, the influence of taxation being significant from the beginning. At the net result for the year are added calculated charges (depreciation and provisions) unpaid at a certain maturity and deducted income calculated (reversals of provisions). This method called "analytical" (by I.Pantea) and "upward" (by P. Brezeanu) shows the composition of the indicator elements. To the extent that CAFdoes not deal only with the current management operations, exceptional capital operations (income from the disposal of assets) will be excluded from the calculation.

CAF= net result of the year (accounting net income)+ calculated expenses-calculated revenues – revenues from disposals (8)

CONCLUSIONS

Regardless of the method of calculation envisaged, taxation of financial results has serious implicationson the behavior of accompany in economic and financial performance and in self-financing capacity, and its knowledge is indispensable to a modern financial management at the enterprise level.

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