THE INFLUENCE OF TAXES ON FINANCIAL EQUILIBRIUM

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Abstract. *In this paper, the authors present the method of evaluating the effect of taxation on the financial equilibrium of the company.*

Key words: working capital, working capital requirement, net treasury, net standing.

1. Financial diagnosis- the evaluation method of the company's equilibrium

The financial diagnosis is a group of instruments and methods which enable the appreciation of the financial standing and the performances of a company.

The purpose of the financial diagnosis is of evaluating the financial standing of the company. Basing on this diagnosis, there takes place the creation of a new strategy of maintaining and developing in the local economic environment. In a general sense, the finality of the financial diagnosis consists of providing financial information both to those inside the company and to the interested ones from outside the company.

When the issue of the diagnosis occurs inside the company (internal financial diagnosis), the users may be the leaders, current shareholders or employees. The objective is, in this case, to detect the possible situations of financial instability and to adopt new decisions concerning the administration of the company. These decisions are based on the identification of the origins and causes of the lack of balance and, on the other hand, on the determination of the curative measures.

When the issue occurs outside the company (external financial diagnosis), the users may be financial analysts, potential shareholders, banking and financial institutions or even the state. The objective pursued is the company's financial capacity of generating profit, the company'c capacity of paying its short term or long term obligations (the liquidity nad solvability of the company), as well as the company's value.

External users usually require a financial diagnosis either for crediting the company (especially banks), or for making the decision of entering the capital of a company (potential shareholders or other companies).

Both the internal and the external analysis have the objective of appreciating the performances of the company and the risks it faces and they refer to: profitability analysis, risk analysis and company's value analysis.

Irrespective of the results obtained by the company or of the unfolding of the events, the making of a financial diagnosis has to take place on a periodical basis. The financial diagnosis identifies the favorable and unfavorable factors that will influence the future activity of the company.

The information resulting from the financial diagnosis often have to be completed with information referring to the external milieu of the company (standing of the economy, of the industry), information referring to the technical and human potential, commerical and juridical potential , the company's management (information depending on companies). All these elements influence the financial performances of the company and determine its competitive nature.

The information required for making the financial diagnosis are taken from the simplified financial statements that include: balance sheet, profit and loss account, annex to the balance sheet.

2. The double meaning of taxes in the case of the economic unit

From the definition there can be extracted the following characteristics of taxes:

1. the compulsory nature of paying taxes and, in relation to this, their legality and legitimacy;
2. tax is a take over without equivalent and, in relation to this, there occurs the issue of the reversibilty of taxes and their redistributive role;
3. taxes' fundament and measure is the contributive capacity of each tax payer;
4. the double quality of taxes: resources for covering public expenses and fiscal leverages used by the state.

Stating that tax has as main purpose the overing of public expenses and to sustain the primary nature of its financial purpose implies the explict determination of al least four things:

- tax has a financial purpose: obtaining the necessary resources for covering public expenses;
- tax also has other purposes, also referring to the fulfillment of certain economic or social objectives;
- its objectives may be contradictory, therefore they must be harmonized;
- among its different objectives, the most important is the financial one.

Taxes have a double quality as far as the financial equilibrium of the companies or tax payers is concerned. Under this hypothesis, taxes represent, on the one hand, an expense for the companies or tax payers and, on the other hand, they represent their debt or obligation.

The development of the company is related to the ensurng of the economic equilibrium expressed as a value. The financial equilibrium expreses the equality and correlations between the required financial resources and the possibility of collecting these resources. The financial equilibrium of the company implies the covering of all the operational expenses out of own or borrowed incomes, of the expenses not shown in costs, of the development and modernization expenses, of the expenses with personnel and shareholders incentives, as well as of the contractual and financial obligations towards banks and state budget.

The activity of a company has to be performed so that there is ensured an equality among financial resources (R) and their use (F), so that R=F.

The financial resources (R) of a company may be made up of incomes resulting from the basic activity and from other activities (V), financial incomes (Vf), extraordinary incomes (VE), liabilities of operation and those from the investment sector (Pe), bank and other financial institutions credits (C) and new cash contributions of shareholders and other resources (Ar), so that:

$$R = V + Vf + VE + Pe + C + A + Ar$$

The uses of resources can be represented by clients inventories and assimilates (S), expenses with personnel and other salarial rights (Ce), expenses with investments and modernization (Ci), research and development expenses (CE), non deductible expenses (Cn), payment of obligations to the state as taxes and the contributions to the social insurance budget (imp), payment of credits and corresponding interest (Rc) and other expenses (Ac), so that:

$$F = S + Cp + Ci + Ce + Cn + Imp + Rc + Ac.$$

Taking into account the financial resources and their use, the financial equilibrium of the company is presented through the following equality:

$$V + Vf + VE + Pe + C + A + Ar = S + Cp + Ci + Ce + Cn + Imp + Rc + Ac$$

Taxes may influence the financial equilibrium of the company. Taxes represent a factor of influence over the financial stability of a company as far as the two aspects analyzed – expense and debt- are concerned.

3. The effect of taxes on the net standing

The net standing calculted as difference among total assets and total debts provides a first (accounting) evaluation of the company at the end of the financial period. This fundametal equation of the balance sheet represents the net wealth of the shareholders, respectively the asset not engaged in debts.

Indicators	Period			
	S_1	S_2	S_3	S_4
Total assets	10.000	10.000	10.000	12.000
Debts	3.000	4.000	2.000	3.000
Out of which taxes	1.000	2.000	500	1.800

Net standing	7.000	6.000	8.000	3.000
Variation of net standing	x	6.000	- 2.000	1.000

NET STANDING = ASSET – DEBTS

The net standing presents an increase or decrease in timpe, a fact that signifies the increase or decrease of shareholders' equity.

Analyzing the due taxes, we may say that the increase, respectivley decrease, of the taxes included in total debts influences with a positive or negative effect the net standing of a company and, consequently, its financial equilibrium.

During the S_2 period with increased debts on the account of taxes, the net standing of the company decreases. Under these circumstances, the debts and expenses of the company increase and we may notice a fiscal pressure.

Net statement S_2 = 10.000 – 4.000 = 6.000

During S_3 period with the decrease of debts on the account of taxes, THE NET STATEMENT of the companies increases. Under these circumstances, the expenses and the debts of the companies decrease and we may notice a fiscal relaxation.

The net statement S_3 = 10.000 – 2.000 = 8.000

During the S_4 period, when the value of the asset is determined by other factors but from total debts we notice a increase of taxes. Under these circumstances, even if the net standing records an increase, we may say that the fiscal pressure is positive as compare to S_1.

Net statement S4 = 12.000 – 3.000 = 9.000

4. Working capital, measure of the financial equilibrium

In order to accomplish the financial equilibrium of the company, it is necessary to respect the principle of maturities parity according to which permanet allocations (intangibles) have to be financed on the account of permanent sources (shareholders' equity and long term credits) due to their slower rotation; cyclical allocation (non current assets) are financed on the account of the temporary sources (short term liabilities).

The higher permanent sources are as compared to permanent requirements of funds allocation, the more the company enjoys a security margin, which protects it from unforeseen events.

This surplus of permanent resources, resulting from the financing cycle of investments, may be rotated for renewing inventories and account receivable. This potential use is responsible for its name, which is working capital. It expresses the long term financial equilibrium and its contribution to the accomlishement of the equilibrium of short term financing.

WORKING CAPITAL = PERMENENT SOURCES – PERMANENT ALLOCATION

Working capital = (Shareholders' equity + Financial debts) – Net amortization non current assets.

INDICATORS	S1	S2	S3	S4
SHAREHOLDERS' EQUITY	790.000	802.000	925.000	1.123.000
FINANCIAL DEBTS	0	0	0	12.000
NET NON CURRENT ASSETS	800.000	839.000	972.000	1.160.000
WORKING CAPITAL	- 10.000	- 37.000	- 47.000	- 25.000
WORKING CAPITAL VARIATION		- 26.000	- 10.000	22.000

FR S1 = (790.000 + 0) – 800.000 = - 10.000

FR S2 = (802.000 + 0) – 839.000 = - 37.000

FR S3 = (925.000 +0) – 972.000 = - 47.000

FR S4 = (1.123.000 + 12.000) – 1.160.000 = - 25.000

FR VARIATION S2/S1 = - 37.000 - (-10.000) = - 26.000

FR VARIATION S3/S2 = - 47.000 - (-37.000) = - 10.000

FR VARIATION S4/S3 = - 25.000 - (-47.000) = 22.0000

The negative value of the working capital reflects the absorbtion of a part of the temporary resources for financing certain permanent needs, contrary to the principle of financial administration: to permenent needs there are allocated permanent sources, so that long term allocations are finances by short term resources. These situations may be less unfavorable if the company leads an investment policy – an orientation towards development. At any rate, a negative working capital has serious effects on treasury and payment capacity.

During the S_4 period, there may be noticed a tendency of improving this long term lack of balance, thw working capital, even if still negative, is half the value of that of the preceding year; the company better administers the resources attracted from shareholders or creditors.

5. The need of working capital – way of reflecting the financial equilibrium.

It is the expression of the short term financial equilibrium, of the equilibrium between the requirement and use of operational capital.

NFR = CYCLIC ALLOCATIONS – CYCLIC SOURCES

NFR = (INVENTORIES + ACCOUNTS RECEIVABLE) – OPERATIONAL DEBTS

INDICATORS	S1	S2	S3	S4
INVENTORIES	75.000	49.000	27.000	54.000
ACCOUNTS RECEIVABLE	88.000	820.000	71.000	61.000
DEBTS	330.000	653.000	1.053.000	963.000
NFR	- 167.000	- 522.000	- 955.000	- 848.000
NFR VARIATION		- 355.000	- 433.000	107.000

NFR S1 = (75.000 + 88.000) – 330.000 = - 167.000

NFR S2 = (49.000 + 82.000) - 653.000 = - 522.000

NFR S3 = (27.000 + 71.000) – 1.053.000 = - 655.000

NFR S4 = (54.000 + 61.000) – 963.000 = - 848.000

NFR VARIATION S2/S1 = - 522.000 - (-167.000) = -355.000

NFR VARIATION S3/S2 = -955.000 - (-522.000) = -433.000

NFR VARIATION S4/S3 = - 848.000 (-955.000) = 107.000

NFR is negative. There is a surplus of temporary resources, this standing is accepted only if it results from the increase of the rotation speed of current assets and the engagement of debts with more relaxed due times. Otherwise, it implies the inadequate administration of inventories.

6. Net treasury – form of reflecting the monetary resources of the company

Net treasury represents the difference between the working capital and the required working capital.

Net treasury is the most conclusive expression of the unfolding of a balanced and efficient activity. It indicates the quality of the general equilibrium of the company both for long and short term.

TN = WORKING CAPITAL – REQUIRED WORKING FUND

INDICATORS	S1	S2	S3	S4
WORKING CAPITAL	- 10.000	- 37.000	- 47.000	- 25.000
WORKING CAPITAL VARIATION		- 26.000	- 10.000	22.000
REQUIRED WORKING CAPITAL	- 167.000	- 522.000	- 955.000	- 848.000
REQUIRED WORKING CAPITAL VARIATION		- 355.000	- 433.000	107.000
NET TREASURY	157.000	458.000	908.000	823.000
NET TREASURY VARIATION		- 328.000	423.000	- 85.000

Net treasury is positive for all the years, showing that the financial periods ended with a monetray surplus, the real expression of net profit from balance account liability anf other monetary accumulations. The increase of net treasury in S_3 as compared to S_2 and, respectively, the decrease in S_4 as compared to S_3 represents the cash flow which goes to the shareholders as dividends to be cashed and/or profit to be reinvested.

7. Intermediary administration balance account – modalities for reflecting the company's efficient activity

TRADE MARGIN = GOODS SALE – COST OF THE SOLD MERCHANDISE

INDICATORS	S1	S2	S3	S4
GOODS SOLD	2.000.000	1.999.000	3.250.000	3.761.000
EX. WITH MERCHANDISE	1.300.000	1.200.000	1.695.000	1.642.000
TRADE MARGIN	700.000	799.000	1.555.000	2.119.000

PRODUCTION OF THE PERIOD = PRODUCTION SOLD +/- PRODUCTION RETAINED + INCOMES FROM PRODUCTION OF NON CURRENT ASSETS

INDICATORS	S1	S2	S3	S4
PRODUCTION SOLD	12.431.000	14.000.000	1.985.000	25.650.000
PRODUCTION RETAINED	0	27.000	116.000	117.000
INCOMES FROM PRODUCTION OF NON CURRENT ASSETS	2.195.000	3.286.000	3.700.000	3.546.000
PRODUCTION OF THE PERIOD	14.538.000	17.313.000	23.401.000	29.313.000

ADDED VALUE = TRADE MARGIN + PRODUCTION OF THE PERIOS – CONSUMPTION FROM THIRD PARTIES

The added value expresses the increase in the value resulted from the use of the production factors, especially work and capital, over the value of the materials, energy, services purchased from third parties.

This added value represents the source of monetary accumulations out of which there is made the remuneration of the direct and indirect participants to the economic activity of the company: personnel, state, creditors, shareholders and company through the capacity of financing itself.

INDICATORS	S1	S2	S3	S4
TRADE MARGIN	700.000	799.000	1.555.000	2.119.000
PRODUCTION FOR THE PERIOD	14.538.000	17.313.000	23.401.000	29.313.000
CONSUMPTION WITH THIRD PARTIES	6.989.000	7.555.000	8.617.000	9.834.000
ADDED VALUE	8.849.000	10.557.000	16.338.000	21.598.000

GROSS SURPLUS
FROM OPERATIONAL ACTIVITIES (EBE) = ADDED VALUE
+ SUBVENTIONS
- EXPENSES WITH THE PERSONNEL
- TAXES

INDICATORS	S1	S2	S3	S4
ADDED VALUE	8.849.000	10.557.000	16.338.000	21.598.000
INCOMES FROM SUBVENTION	0	0	0	0
EXPENSES WITH TAXES	79.000	237.000	992.000	1.342.000
EXPENSES WITH THE PERSONNEL	1.298.000	2.325.000	3.922.000	3.730.000
EBE	7.472.000	7.995.000	11.424.000	16.526.000

EBE expresses the gross accumulation from the operational activity, taking into account the fact that anortization and provisions are only expenses calculated, not paid. EBE expresses the potential capacity of self financing investments (from amortizations, provisions and profit), paying the debts to the state budget and remuneration of capital investors (shareholders and creditors).

The self financing capacity expresses a financial surplus resulting from the profitable activity of the company. It has only a potential character if not sustained by effective financial means. The monetary surplus resulting from the increase of net treasury during the most recent financial periods shows that the largest part of this self financing capacity is sustained by an available treasury.

8. Conclusions of the tax effects on the financial equilibium

The finances of the companies represent the main, basic link of the entire financial and credit system. This statement bases on the fact that most of the monetary funds formed on different levels result from the incomes created in the basic cells of the economy through taxes. The financial phenomenon emerges from the realtions that the company has with all the companies, the state and other institutions.

On a overstructural level, the finances of the company appear as a branch of financial science, which analyzes the mechanisms and processes of procuring and administering financial resources, their sources and destinations, in order to satisfy the different needs and to obtain profit.

In a company there may be created numerous funds, among which: fixed asset fund, working capital, reserve funds, scientific research funds, funds for training, rewarding and including employees in the profit disctribution. These funds that ensure the financial equilibrium of the company are conditioned by the total amount of taxes to be sustained.

The fiscal pressure may cause a state of financial lack of balance, respectively fiscal relaxation may generate financial equilibrium. Companies, through financial mechanisms and their specific methods may proceed to the formation and administration of capital.

The investment process implies, at a certain point, an amount of financial resources in a direction that might produce incomes during several successive periods of time.

Investments represent expenses that are made for obtainingfixed assets. For the financial manager, investment is, first of all, a decision of making capital intangible for the purpose of obtaining a future profitability. If the budgetary constraint of taxes is a strong one, the company cannot get the used funds.

The payment capacity expresses the possibility that a company should cope with due payments towards suppliers, employees, bansk, state budget, social insurances budget and social protection.

Payment capaicty refers to the report between a certain part of liquid assets – main liquidities - and due time payment obligations.

Under the circumstances of an exaggerated fiscal pressure, taxes have a negative influence over the financial stability of the companies, expressed as financial balance. NET STANDING, WORKING CAPITAL, REQUIRED WORKING CAPITAL, NET TREASURY and by intermediary administration balance accounts: TRADE MARGIN, PRODUCTION FOR THE PERIOD, ADDED VALUE, GROSS SURPLUS FROM OPERATIONAL ACTIVITIES, NET RESULT, SELF FINANCING CAPACITY, LIQUIDITY, SOLVABILITY.

Fiscal pressure via taxes negatively influences the administration rates. Under the circumstances of fiscal relaxation, taxes have a positive influence over the indicators of financial balance.

An effect of taxes is also held by the concordance between the measure of taxes and the paying capacity of the companies.

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