Penerbit Akademia Baru

Journal of Advanced Research in Business and Management Studies

Journal homepage: www.akademiabaru.com/submit/index.php/arbms

ISSN: 2462-1935

Taxable Business Income in Palestine: Tax Treatment in Palestine for Depreciation Expense for Assets vs. Accounting Treatment According to International Accounting Standards

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ARTICLE INFO

Article history:
Received 29 February 2024
Received in revised form 31 March 2024
Accepted 16 April 2024
Available online 1 June 2024

Keywords:
Taxable income; accounting income; financial standards; dispute; tax assessors; financial statements; depreciation expense

ABSTRACT

Accounting is the source of information that any facility's relevant body requires in order to make economic judgments because it arranges the facility's financial reports regularly. The administration, for example, benefits from financial accounting findings because it uses them to plan, direct, and supervise financial operations. Additionally, it oversees and decides on the affairs of lenders, investors, governmental organizations, and scientific research institutions [3] There is a need for unified accounting standards to govern measuring and releasing information whenever financial reports are made in the age of globalization, the expansion of global marketplaces, and the beginning of the industrial revolution. Beneficiaries will be able to quickly compare them to assess and evaluate financial reports and make the most accurate decisions. In 1973, the International Accounting Standards Committee (IASC) issued the first international standards, the International Accounting Standards (IAS). They also wanted to make global business comparisons easier, increase transparency, and restore faith in financial reports. Later, the International Financial Reporting Standards (IFRS) replaced the International Accounting Standards (IAS) [9]. Moreover, the primary goals of commercial accounting and taxation are not the same. The former requires a straightforward representation of the actual data because it involves gathering information to monitor and make decisions; the latter—even though its primary goal is to increase revenue is frequently employed as a tool for the state's economic and social objectives [16]. The taxation reconciliation process often begins with the financial report's 'net income before taxation', unless there are special purpose financial reports that directly result in 'net [taxable] income'. Subsequently, this value is modified by a range of factors to provide 'net income' [6]. Net profit prepared according to international accounting standards, amending reports based on the approved income tax act to account for any liabilities in Palestine. The purpose of the research **is** to identify issues in the computation of taxable income in Palestine about which assessors and taxpayers have different opinions in Calculating the issue of depreciation assets and what is tax-recognized and what is not tax-accepted.

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https://doi.org/10.37934/arbms.36.1.1425

1. Introduction

The preparation and computation of accounting profit are prepared based on the accounting standards implemented in the respective country [11-14]. More than often, accounting profit would be different from tax profit due to differences that occurred between tax practices and accounting practices. In Palestine, international accounting standards are adopted to prepare the audited financial statements for both public joint-stock companies, private companies, and joint liability companies that are used for tax submission to tax assessors. Upon submission, the tax assessor will check the accuracy of the financial reports in reference to Income tax legislation and later determine the derivation of tax income. Based on that assessment, conflict arises between the taxpayers and tax assessors, and any unresolved dispute will be presented to the judge in court. Apparently, the tax assessor applies the income tax literally, and his judgment is applied to estimate in the absence of a specific clause in the income tax law.

The Palestinian economy suffers from many problems due to its economic dependence on the Israeli economy, as this dependence has led to weak general activity in the economic conditions in the Palestinian territories, a large increase in unemployment levels, and an environment that repels local and foreign investments [10].

1.1 The Relationship with the IIsraelis

According to the Paris Protocol signed by the Israelis and Palestinians in 1994, it was agreed to determine the tax relations between them as follows:

The taxpayers who apply the rules of Palestinian tax laws are:

i. All the people who practice any business in Palestinian areas.
ii. Palestinians who invest in the settlements and military areas have their files followed by the Israeli Liaison Income Department.
iii. In the case of an Israeli or Jerusalemite who runs a business inside Palestinian territory and includes the income of an Israeli employee or worker, the Israelis have the right to account for this income, considering it an underpayment to the Palestinians.
iv. The Israeli taxpayer who works in Areas A and B.
v. The Israeli taxpayer who works in area C and whose file is run by the Israeli Liaison ITD.
vi. Under the condition that company headquarters are not in Israeli areas, Palestinians earn money by selling goods to Israelis.
vii. The Palestinians earn their income by moving goods from Israelis to the Palestinian area and vice versa.

The taxpayer who is under the provisions of the Israeli income law:

i. Israelis and Jerusalemites who work in settlements or military zones.
ii. A Palestinian worker in Israel
iii. The income of an Israeli as a result of selling goods to Palestinian areas while not having his headquarters in Palestinian areas.
iv. The Israelis earned income from moving goods from Israel to the Palestinian area and vice versa.

Under the new Taxation Law of the Palestinian National Authority (PNA), it is the responsibility of the Ministry of Finance (MOF) to control the fiscal policy, i.e., the collection of revenue, through its public administration, which includes the General Administration of Customs, Excise, (VAT), Income Tax, Property Tax, General Petroleum Corporation, and General Administration of Grants, Profits, Fees, and other income.

Furthermore, the MOF is also responsible for monitoring financial, monetary, and economic performance and analysing and evaluating financial policies and tax procedures. Taxation procedures also include tax examination procedures in the ITD and the recruitment of staff that monitor financial statement analysis and negotiate income tax under the provisions of the Income tax legislation.

The income tax examinations by the assessors representing the MOF in Palestine and the financial auditing companies handled by international accounting standards are frequently at variance due to policy implementation differences. The tax examination is carried out by ensuring that companies comply with the income tax legislation, while taxpayers abide by international accounting standards, the latest international standards, and while this is done to ensure "fairness," it leads to a discrepancy in the amount of taxable income. However, all parties must realize the discrepancies in standards that have emerged.

1.2. Historical Development of the Concept of Taxation

The methods used by states to raise income have changed dramatically throughout the last century. Revenue systems were not systems at the end of the nineteenth century. Instead, they were a jumble of excises, charges, duties, and taxes on a dizzying array of goods and services, from men's hair powder to windows to salted cod. These many "taxes" were inefficient, easy to circumvent, administered inequitably, and generated little income. In 1900, no state collected more than 10% of GDP from all the hundreds of revenue sources combined [18]

As the twentieth century began, new political movements emerged, requiring voting rights for working-class people and a more equitable distribution of tax burdens. Taxation has very rapidly become a primary battleground for economic and ideological considerations. In former tax regimes, the poor paid substantially more taxes than the wealthy; once labour unions and working-and middle-class political parties gained power, their political representatives began to demand that taxes be employed to remedy capitalism's income and wealth distribution imbalance. Indeed, the origins of what we now call "modern" tax policies (i.e., efficient, universal, and equal taxes) were seen as a partial solution to modern society's growing inequality problem [15]

In response to these calls, certain industrializing countries adopted income and profit taxes. In each case, the income generated by these taxes was tiny, and only the wealthiest individuals and corporations had to pay them. As a result, they came to be known as class taxes [19]

However, it would be inaccurate to regard the establishment of progressive taxation as the result of a simple exercise of political power. In reality, progressive taxes were enacted in some cases before the lower classes were granted the opportunity to vote (e.g., in Japan, Germany, and Sweden). Instead, some industrializing countries experienced a broad shift in societal attitudes throughout this period. For many bureaucratic and fiscal elites, taxing industrialists' profits and income was a policy solution (concept) that would raise revenue while also being fair [7].

The concept of "ability to pay" was elevated to new heights when the First World War broke out. The price of "total war," as it was dubbed at the time, was immense. In other words, the state's fiscal demands grew significantly as the new tax models were established. As a result, the government suddenly had new financial and political options in addition to the traditional methods of financing war (debt). Consequently, "temporary" taxes such as "excess profits taxes," "war preparedness taxes," and "national defence levies" were enacted. Even though they were first paid only by businesses and a small percentage of society's wealthiest citizens, these taxes quickly became the primary source of revenue for many countries' national governments

The establishment of progressive income and corporation taxes during this time has far-reaching implications for future tax policies and the modern welfare state. First, these new charges brought in enormous quantities of money. Second, the underlying assumptions about how taxes could be raised effectively had shifted. It is clear that taxes can and should be used to redistribute wealth in the economy.

1.3 Different Types of Taxes
1.3.1 Income tax

It is represented by taxes that use income as a receptacle; the taxable material is income created by a natural or legal person. The precise definition of "income" is that some items considered income are not evaded and that the tax does not apply to money not classified as a payment.

1.3.2 Taxes on capital

Capital is described as what a taxpayer owns over time, whether material goods, fixed assets, or moral assets like bonds or money.

Taxes on capital take many forms, including:

i. Regular Capital Taxes: They are imposed on the value of the taxpayer's wealth as a whole or a portion of it, and their prices are typically low because their base is broader, allowing for vast revenues to be added.
ii. Exceptional Tax on Capital: This is similar to the previous one in that it uses capital as its base, but it differs in that the low price of regular tax is imposed in exceptional circumstances where the state needs a large sum of money to pay huge debts.
iii. Taxes on Estate: These are taxes imposed on all the possessions of individuals when they die.

1.3.3 Tax on consumption

They are taxes imposed on how individuals spend their income; there are several ways to do this, namely:

i. Taxes on Customs: Customs taxes have a long history dating back to the Middle Ages, and their formation is connected with social structure, representing the high level of trade and values among nations.
ii. Production Taxes: These are levied on locally produced goods. They are comparable to customs taxes in that the tax base of customs taxes is international products, but the tax base of production taxes is local products.

1.3.4 Trade activity and expense taxes

Taxes are imposed not only on what individuals earn but also on what they spend. That’s why there are many new laws regarding taxes on trade activity and expenses, or even their transactions. For example, legislation taxes are one of the examples of this tax. Even though most foreign and Arab financial laws call them fees, they are taxes [1].

2. Taxation’s Purpose

The goal of taxation is to raise funds for the state and other government entities responsible for their duties. The fundamental objective of the tax in slave and feudal regimes was to gather money to support the state's demands, which were essentially the needs of the monarchs and the royal court. In capitalist countries, tax aims include fiscal and non-fiscal objectives met through various financial policy objectives. As a result, the task is not solely taxation for recognizing state funds; with an increasing number of taxpayers and a growing number of tax types, it is now possible to use taxes as a financial instrument for more efficient and flexible implementation of multiple economic and social goals. In practice, the so-called "restrictive" and "expansive" tax policies exist. The market disorder arises when market demand exceeds the total market supply. In these instances, restrictive tax policy measures limit the buying power of tributary taxes while simultaneously lowering overall demand, resulting in a restrictive tax policy. If, on the other hand, the whole market supply exceeds the overall demand, expansionary tax policy measures affect all expansion of power, focused on raising the purchasing power of tax tributaries as well as increasing overall demand. Microeconomic and social aims of the state, such as price stability, maximum employment, and a balance of payment surplus, can be realised through tax policy [20].

3. The Key Rules of Taxation

Taxes are one of the primary sources of the state that implements the principle of social solidarity, as it levies taxes, values them, and pays them on time.

Given the cross-over of benefits earned by countries that impose taxes, guidelines should have been published and enforced whenever a tax is imposed. These rules are known as "tax rules" and they measure the well-being of taxes by having both the collected tax and fairness. Fairness, certainty, convenience, and efficiency are among the rules. Adam Smith, the father of modern economics and a philosopher and economic theorist, was the first to establish the following rules.

i. Fairness means that all group members take responsibility for the payment of the state according to their income under its protection. Adam Smith says that relative tax suits members’ incomes based on the principle that the funder's service increases as one’s income increases. This logic was common in the 18th and 19th centuries, the theory of financial contracts.
ii. Certainty: Smith sees that a good tax is clear and free of any party influence. In other words, it should be described in terms of what is paid, when it is due, and the way of collecting. According to this rule, the funder or eligible taxpayers will have a heads-up regarding their commitments to the state and the ability to defend themselves from any power abuse or violence.
iii. Suitability means that every tax should be collected at its best time, in the best way for the subjects to taxes in order not to be disturbed. The best time to collect taxes is when

the taxed person gets the income. Harvest time is the best time to collect crop farming income.

iv. Economy Base means that the cost of collecting taxes should not exceed what goes into the state's budget; this means that the state should choose an economically sound path so that the taxpayer does not bear a misplaced sacrifice and the gap between what it pays and what goes into the state treasury diminishes. According to economic theory, the ideal taxes are those with a minimal collection cost and a high yield.

4. The Historical Development of Income Tax in Palestine

Income tax has been officially levied since the British Mandate and the issuing of the first income tax statute (3/1941), which went into effect on September 1st, 1941. Hence, Palestine was the fourth country to adopt an income tax. This law established an administrative authority responsible for implementing the articles of the law and establishing tax channels, including for individuals subject to tax who earn income from their profession or trade. It also comprised employee salaries and wages, retirement benefits, the net value of the annual rent of any building or rented land from its shares or interests, and the rents of any building [4].

It is critical to include the productive expenses of eligible taxpayers to earn their income, keeping in mind the unity of the income of both husbands and wives.

An assessment year was added, along with the principle of regional matters. Also, an increasing tax was imposed on individuals' income, starting from 5% to 30%, as well as a profitable tax on companies, at 15%.

This law adopted the idea of self-assessment, organized the ways of assessment, objection, and appeal, and the procedures of collection and the penalties for not paying them.

Then, this law was amended (13/1947), which changed the previous ones a lot except in the part of the channels of tax, adding new areas of tax such as profits of any property not including lands, buildings, and industrial buildings; profits of exports; and agricultural profits excluding the value of the land upon which there are buildings. This law had an ascendant pattern on the income of ordinary people; the number of tax groups was lowered to six, starting from 5% and going up to 50%, with a 25% relative tax on corporate profits.

These taxes remained in the Gaza Strip after 1948, and the tax situation remained unchanged because the Egyptian administration maintained it during the British Mandate. However, the law's implementation (13/1947) ended with the end of the British Mandate when the Jordanian government issued new tax laws. Then, in Palestine, the temporary Law (50/1951) was passed, combining the income tax legislation in the West Bank (Palestine) and East Bank (Jordan). Then, it was replaced by the Jordanian law (12/1954), which established a new department for income tax related to the Minister of Finance. Also, it increased taxation categories by adding the annual net value of rents for any building or used land from its owner, retirement salaries, and profits from stocks and interests. In addition, it added a new procedure that was appealing as a stage for distinguishing the estimation decision in the court of cassation. Furthermore, it granted personal and domestic pardons and increased tax rates.

Still, the development in the area of income tax happened when the law (25/1964) was issued, causing a dramatic change in the concept of income. To begin with, it didn't get to the income definition directly; it narrated the elements of income subject to taxes. Also, it didn't impose the condition of being available and periodic for any commodity to be subject to taxes. It considered the income from one deal subject to taxes, such as paying cash for selling a trademark. It also expanded and increased the escalation in tax rates as it stated to have an appeal court session for income tax, which took the issues in tax disputes and adopted the regional calibre in income tax imposition.

In 1967, the Palestinian lands fell completely under Israeli occupation, keeping the tax situation as it was. Still, the military rule ordered the law (2/1967) specifying key issues for exercising legislative power during the occupation, one of which is the recognition of the independence of the Israeli legislative regulation of the West Bank and Gaza Strip. Also, it was decided that the legislative authorities in Gaza and the West Bank are under the control of the Israeli military commander or representative.

In 1967, the Israeli military commander ordered that income, customs, and real estate taxes be kept in the West Bank and Gaza Strip until he directed otherwise. Based on that, the rates of tax were modified escalators-wise from 5.5% to 55%, and then they were turned from 8% to 48% of the income, leading to the increase of corporate companies' profits tax to 37.5% in Gaza and 38.5 % in the West Bank.

In addition to the previous amendments, the Israeli occupation authorities made many substantial changes to this law through multiple military orders so that only the outer cover remains of this law, and all the amendments were in the interest of the occupation authorities. These amendments, represented in military orders, included an annual amendment in the tax categories. Also, there was the cancellation of political, economic, and family exemptions, deductions, and advances. It also replaced the authority of local courts to consider decisions of tax assessors, appeals, and objections with a military objection committee whose members are not judges, as these amendments and orders included the Palestinian Law (13/47) applied in Gaza.

The situation in the Palestinian territories in all areas of life remained subject to the authorities of the Israeli military occupation until the administrative responsibility for these lands was transferred to the PNA following the agreements signed with the Israeli side in 1993, in which the powers of managing the Palestinian territories shifted to the PNA. They included the tax powers stipulated by the Paris Economic Agreement in 1994, and it cancelled all military orders related to taxes and their collection, as well as a set of facilities and modifications approved by the Palestinian Council of Ministers in early 1995, which included amending tax brackets and rates, reducing these rates, and amending and increasing personal and family exemptions.

These laws remained in effect until the PNA approved the income tax law (ITL) (17/2004), which came into effect on January 1, 2005, as it put into place a package of financial and economic legislation that helped in the growth of the Palestinian economy. It was accomplished by creating a suitable environment for investment and achieving justice without imposing massive financial loads as liabilities on low-income property owners. They increased the value of family and personal exemptions and recognized many exemptions not previously realized in the old laws, such as home purchases and medical treatment expenses for those charged. After that, the amended ITL (17/2004) was issued, including amendments and exemptions for residents.

In 2011, the Palestinian Income Tax Law No.8 for 2011 was issued, which introduced many amendments. The law's conversion of currency from dollars to shekels, taxpayer tax exemption increases, rate increases on some permitted tax charges and an expansion of tax categories present notable challenges. Table 1 describing the total amount of taxes paid in the State of Palestine over the previous years from the taxpayers, in addition to the proportion of the overall revenue the amount is in Israeli thousands.

Table 1
Total amount of taxes paid in the State of Palestine

The year	2021
Total cash receipt from taxes in Palestine	13,204,648
Total cash receipt from taxes, others, Grants and loans from banks in Palestine	17,242,194
The percentage of tax receipts out of the total receipts in Palestine. Total cash from taxes / total cash receipt	76.58%
The percentage of tax receipts from income tax out of the total receipts in Palestine. Total cash from income tax /total cash receipt	3.56%
Percentage of income tax revenue out of tax revenues in Palestine	4.65%

5. Income Tax Administration in General

The PNA took over the administration of the tax system in its regions in December 1994, using the Jordanian income tax law (ITL) (25/64) in the West Bank and Egyptian law (13/1947) in the Gaza Strip. Since the authorities assumed the duties of administering income tax, they have attempted to change the tax culture of taxpayers from one of a tax imposed by the occupation to one of national duty and a contribution to building the institutions of the Palestinian state [2]

The income tax department (ITD) has also worked on developing income tax law (ITL), as it issued a law (17/2004), which was applied in all areas of the PNA starting in 2005. Then, it made amendments to this law by the Decree of Law 21, which was agreed to be applied beginning in 2012.

Furthermore, the ITD is still working on updating the ITL by monitoring its weaknesses and amending it in preparation for reaching a tax law that efficiently and effectively achieves the required goals, takes into account the economic conditions of the taxpayers, and encourages their voluntary commitment in a manner that does not conflict with the investment promotion policy.

It is making numerous attempts to raise the efficiency of its employees by holding training courses for them, whether internal or external, as well as working to find the computerised programs necessary for the department to carry out its work with high efficiency and provide optimum service to the taxpayers.

6. Research Questions

The study aims to recognize areas of dispute between assessors and taxpayers when calculating taxable profits in Palestine, particularly regarding depreciation expenses for assets and identify the reasons for the disagreement and propose a vision to reduce the gap between accounting income and tax income.

7. Methodology

A qualitative technique is used to collect documents from income tax offices that show how to settle accounting income and convert it to taxable income in order to meet the research goals. A qualitative approach that includes field notes, official records, and financial statements is used to record the disagreement between the taxpayers and the income tax department (ITD), which is allowed to obtain taxable income by collecting tax revenues from the state government. While the

ITD relies on tax law, the taxpayer uses international measurement standards to determine the accounting income.

Records are the mechanism by which ITD and taxpayers' debate is documented when the two sides' arguments get increasingly intense.

When confronted with a matter specified in international standards but not in the Palestinian ITL, each side is correct and does not understand the other. When an agreement cannot be reached, a judgment in absentia is used, which heads back to the courts. These issues are examined using the work papers and assessment decisions found in the ITD's tax file. The taxpayer retains a copy for records and provides a copy of the approved tax decision to the firm's owners.

The researcher collected the points of disagreement related to depreciation expenses for assets to identify the reasons for the disagreement and propose a vision to reduce the gap between accounting income and tax income.

8. Taxable Profit and Accounting Profit

Many researchers have discussed aligning taxable and accounting profits for a long time. Academics argue whether accounting systems give a better way to estimate a company's income and tax it.

According to a previous study [5], there are substantial discrepancies in the aims of the tax and financial reporting systems. The requirement to incorporate accounting standards into the legal system challenges how accounting standards will be implemented for tax purposes. Jurisdictions that have historically chosen the road of total, or nearly total, dependency are thought to be drifting away from alignment. Most European Union (EU) members are still assessing the impact of IAS and are not ready to proceed. Adoption of such rules for tax purposes would necessitate a sophisticated and political process at the commission level. Much work has to be done within the EU to get agreement on this. Legal concepts of capital and income may seem outdated, but they sometimes reflect common understandings that underlie consensus about tax systems. The neutrality of taxation may be a desideratum, but governments will not wish to give up the ability to use tax as an economic tool, however ineffective it may be.

At first glance, the computation of variables like income, expenditure, and profit for commercial accounting and taxation should be the same. Although it is generally accurate, there are some situations where alternative values are preferable. Of course, the main argument is that accounting and taxation exist for distinct reasons.

For various reasons, financial reporting regulations and procedures may not always be appropriate for establishing an ultimate tax obligation. Accounting and tax objectives, challenges in defining economic terms, and administrative effectiveness are among them [8].

Simon James [17] did another study on the intersection between financial accounting and tax accounting. It drew attention to IAS 12, income tax, one of the new IFRS adopted in this standard, which focused on deferred tax, or the reconciliation of tax and accounting-based performance and position metrics. A high amount of deferred tax might suggest that the accounting and tax laws for one or more items are at odds. A more aggressive depreciation allowance for tax purposes than for accounting ones; for example, will result in a deferred tax balance. The difference between accounting and tax rules can be seen in the deferred tax balance.

9. Result

Differences between the provisions under Palestine's legislation and the accounting processing under international accounting standards for the depreciation expense for assets:

9.1. Depreciation Method
9.1.1 Method according to Palestinian income tax law

The depreciation method approved according to the tax law is the straight installment only.

9.1.2 Method according accounting standards

Methods for calculating the depreciation of fixed assets including:

i. Straight-line method: Allocates an equal portion of the asset's cost to each period of its useful life.
ii. Diminishing balance method: Applies a fixed percentage rate to the carrying amount of the asset to calculate depreciation. The rate is often higher in the earlier years of the asset's life and decreases over time.
iii. Units of production method: Depreciation is based on the actual usage or production of the asset.
iv. Sum-of-the-years'-digits method: Depreciation is accelerated, with more depreciation recognized in the earlier years of the asset's life.

9.2 Depreciation Ratio
9.2.1 Depreciation ratio according to Palestinian income tax law

The ratios determined by Income tax instructions for the year 2004 according to Income Tax Law No. 17of 2004a specific percentage of each asset.

9.2.2 Depreciation ratio according accounting standards

Determined based on company policy.

9.3 Is the Expense Recognized Or Not for Tax Purposes?
9.3.1 Depreciation expense for non-industrial building according to Palestinian income tax law

The value of land and non-industrial properties is not depreciated.

9.3.2 Depreciation expense for non-industrial building according to accounting standards

Property, Plant, and Equipment: This category includes buildings, machinery, equipment, vehicles, and furniture is subject to depreciation under international accounting standards.

10. Conclusion

The reason for the difference between tax legislation and international accounting standards is the difference in timing for each of them. Regardless of the depreciation method used over the life of the asset, the same value will be depreciated in both cases. The differences between the two parties are temporary differences resulting from the time difference.

The tax administration's determination of specific percentages of depreciation of the asset over the life of the asset is nothing but a process of postponing the depreciation expense for subsequent years and increasing the taxable profit in the first years. It is also a matter of the timing difference in recognizing the entire expense. The instructions of the Income Tax Law require the recognition of 10% of the automobile depreciation expense in When accounting standards allow what is consistent with the company's policy in adopting the asset depreciation rate.

The difference in tax and accounting objectives appears in the point of contention related to the non-recognition of tax on consumption expenses for industrial buildings, as there are some tax rules that seek to maximize tax revenues, and they also interfere in economic and social life, as they are considered a means of the political and social economy of the state. While international accounting standards seek to enhance transparency and credibility in presenting financial statements while maintaining complete impartiality.

11. Recommend

Make an effort to adapt accounting standards to the tax system to ensure the achievement of the objectives of each and coordination between them, and that the tax system is familiar with all the principles on which accounting standards are built.

Acknowledgement
This research was not funded any grant.

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