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2007

Online at <https://mpra.ub.uni-muenchen.de/10994/>

MPRA Paper No. 10994, posted 10 Oct 2008 07:30 UTC

The obligations of VAT payers regarding the ‘reverse taxation’ and the tax adjustment for fixed assets

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Abstract: In accordance with the provisions of Title VI regarding VAT from the Fiscal Code, the suppliers and the beneficiaries of certain goods delivery or services registered with VAT aims, are obliged to apply *simplification measures* also called “reverse taxation”. The supplier is obliged to write on the issued invoices the mention “reverse taxation” without registering the afferent tax, and the beneficiary will write down the afferent tax and will emphasize it in tax deduction not only as a collected tax but also as a tax deductible, without paying the tax to the supplier.

For tax-exempted operations regarding the lease, the granting or the renting of fixed assets, as well as the construction delivery by any person, or of some part of it or of the land on which it is built, as well as of any other land, there are applied adjustment measures of the deducted/undeducted tax.

Key-words: tax adjustment, fixed asset, finishing-construction works, persons subject to taxation, “reverse taxation”

1. “Reverse taxation”

In fiscal legislation, the notion of reverse taxation was introduced by the Government’s Decision no 83/ the 19th of August 2004 for the modification and completion of the Fiscal Code, which foresaw that reverse taxation was to be applied for wastes and ferrous and non-ferrous metal wastes (inclusively for secondary raw materials resulted from their capitalization, plots of land and buildings or parts of buildings). By Law no 494/the 12th of November, 2004 for the approval of the Government’s Decision no 83/2004 there were also included in the same category timber and live animals.

The provisions regarding reverse taxation were applied starting with the 1st of January 2005.

By Law no 163/the 1st of June, 2005 for the approval of the Government’s Decision no 138/2004 for the modification and completion of the Fiscal Code, starting with the 3rd of June, 2005 the simplification measures were not applied anymore for live animals.

Starting with the 1st of January, 2007, according to Law no 343/the 17th of July, 2006 for the modification of the Fiscal Code, simplification measures are also applied for finishing-construction works, for goods and/or services delivered by bankrupt persons.

The goods and services for which the simplification measures are applied are the following:

1. wastes and secondary raw materials, resulted from their capitalization, defined according to OUG no 16/2001 regarding the management of industrial recyclable wastes, republished with its ulterior changes;
2. buildings, parts of buildings and plots of land of any kind, for whose furnishing the tax conditions are applied. By building we understand any construction directly linked to the ground, having one or more rooms, which serves to shelter people, animals and/or physical mobile assets;
3. finishing-construction works. Finishing-construction works refer to construction works, to mending, modernization, transformation and demolition works linked to a mobile asset. These are stipulated at section F “Constructions” division 45 from the Annex of the President of the National statistics Institute no

601/2002 regarding the actualization of the Classification of activities from the national economy CAEN, which observe the imposed conditions and take into account the exclusions foreseen within the framework of groups and classes of this division;

The division includes new works, reparations, completions and changes; raising buildings or prefab structures, on a building site as well as temporary constructions.

The categories of construction works which this division refers to are structured such as follows:

1. general constructions for buildings or civil engineering constructions;
2. special constructions for building or civil engineering constructions;
3. installation works for buildings;
4. finishing construction works for buildings.

General constructions refer to: the realization of integral buildings, buildings for offices, shops, public and utility buildings, buildings for farms and so on, engineering constructions or civil engineering constructions such as: highways, roads, streets, bridges, tunnels, railways, aerodromes, harbors and other marine and river projects, irrigation systems, sewerage works, industrial devices, pipes and electrical lines, sport grounds and so on.

Special constructions include: the construction of some parts of buildings and of civil engineering works or the preparation to this aim such as: fixation of pillars, foundation works, well drilling, cocking works, concrete works, masonry works, fixation of prefab elements, scaffoldings, roof fixation. This includes the realization of steel structures on condition that the components are not produced by the same plant.

Installation works include the installation of all types of utilities which make the construction function such as: technical-sanitary works, installation of heating and air conditioning systems, aerials, alarm systems and other electrical works, sprinkler systems, elevators and rolling stairs; isolation works (hydro and thermo-isolations, phonic isolation), refrigerating commercial plants, lighting installation and illuminated traffic signs, illuminated signs for railways, airports, harbors and so on. Reparations for these works are also included in this category.

Finishing works comprise the activities which contribute to the finishing of a construction such as: glass finishing, plasters, dye works, painting works, floor works or stuffing walls with ceramic plates or with other materials (parquetry, wall paper, moquette), floor polishing, fine joinery works, acoustic works, exterior cleaning. Reparations for these works are also included in this category.

VAT registered tax payers who did not apply the measures of simplification for the above mentioned finishing-construction works have the obligation to correct the issued invoices.

4. goods and /or services delivered or performed by persons in declared bankrupt state by definite and irrevocable decision;
5. timber material. Goods which can be framed within this category are timber mass on leg, as well the wooden material.¹

The compulsory condition for the application of simplification measures, respectively of “reverse taxation” is that both the supplier/purveyor and the beneficiary be persons registered with VAT aims, and that the operation be subject to taxation. Simplification measures are applied only for operations realized inside the country.

Suppliers/purveyors issue tax free invoices with the mention “reverse taxation” for deliveries of goods or services for which the simplification measures are applied, inclusively for

¹ the wooden material is stipulated in Article 2 a) from the Norms regarding the circulations of wooden materials and the control of their circulation and that of the installations for round wood processing, approved by the Government’s Decision no 427/2004, published in the Official Monitor no 328/the 16th of April, 2004, with ulterior modifications and completions.

cash advance payments. On the invoices received from suppliers, beneficiaries will write down the afferent tax, which they will emphasize as well as collected tax as deductible tax in tax deduction.

From an accounting point of view, the beneficiary will register during the fiscal period 4426=4427 with the afferent tax amount. The accounting registration 4426=4427 at the buyer's level is called VAT selfclearance, VAT collection at the level of deductible tax being assimilated with the payment of the tax by the supplier/purveyor.

If the supplier/purveyor didn't mention "reverse taxation" on the issued invoices, the beneficiary is obliged to apply "reverse taxation".

Tax payers with mixed regime who are beneficiaries of acquisitions subject to "reverse taxation" will deduce the tax in tax deduction within the limits and conditions of legal provisions regarding the right to deduction of the tax afferent to acquisitions performed by tax payer with mixed regime.

Suppliers/purveyors who are tax payers with mixed regime, for whom the deductible tax is deducted on the prorate basis, will take into account -in the prorate calculation – the value of deliveries/services for which they have applied "reverse taxation" as taxable operations.

In the case in which both the suppliers/purveyors and the beneficiaries do not apply the simplification measures, they will be forced by fiscal authorities to rectify the operations and to proceed to the application of "reverse taxation" according to the legal provisions. Thus, beneficiaries will proceed to the rectification of the book-keeping error regarding the deductible tax by the suppliers account, will proceed as well to the accounting registration 4426=4427 and will register it in the tax deduction on VAT registered at the end of the fiscal period in which the control was finalized, at the same level as regularizations. If the beneficiaries are mixed tax payers and the acquisitioned goods are destined to the realization of deductible operations or undeductible operations, the deductible tax amount will be determined on the basis of the prorate beginning with the date of the goods' procurement which are subject to "reverse taxation" and this will be written down at the regularization chapter from the deduction, which is not anymore affected by the application of the prorate from the current period.

If the operations for which – before Romania's integration into the European Union – the normal VAT taxation was applied and after the integration become subject to simplification measures, and for which advance payments were cashed before this date, the "reverse taxation" is applied only for the difference between the value of the delivery/services and the value of the advance payments cashed before the date of Romania's integration into the EU, as well as for any other advance payments or installments whose exigibility intervenes after the integration date.

As we can see from above, the application of these measures does not imply any VAT paying obligation at the state's budget. From this point of view, the operations subject to reverse taxation have the same effect as the tax-exempted operations with deduction rights.

2. Tax adjustment for fixed assets

The exertion of the right of deduction of the tax afferent to acquisitions procured by a tax payer is done within the conditions imposed by the law in force. Since the conditions existent at the date of the exertion of the deduction right are modified from various reasons (legislative modifications, modification of the goods' destination and so on), the deducted or undeducted tax adjustment has initially emerged as a necessity. A legislative modification intervened on the 1st of January, 2007, date since which a construction delivery, or a delivery of a construction part or of the land on which it is built, as well as of any other land are tax-exempted, except for a new construction, a part of a new construction or of a land on which there can be constructed a building. Consequently, tax adjustment is not applied for a new construction or for a part of it.

2.1. Tax adjustment for operations regarding the delivery of a building/construction, of a part of it, of the land on which it is built, as well as of any other land

A fixed asset or a part of a fixed asset is considered as being built, procured, transformed or modernized before Romania's integration date –the 1st of January 2007 – if the following conditions are observed:

-the fixed asset or a part of a fixed asset was used for the first time before the integration date;

-legal formalities for the transfer of the property title from the seller to the buyer were accomplished before the integration date;

- after transformation or modernization, the fixed asset was used for the first time before the integration date.

1) In the following situations, the persons subject to taxation *are obliged to adjust the deductible tax, respectively the undeductible tax* on entire calendar years, on a limited 5-year period:

- the person subject to taxation *had the right to integral or partial deduction of the tax afferent to a construction or of a part of it*, of the land on which it is situated or of any other land on which one cannot build, and at or after the integration date, *does not choose taxation of these operations*;
- -the person subject to *taxation had the right to integral or partial deduction of the afferent tax*, but at or after the integration date *does not choose the operations' taxation*, and the value of each transformation or modernization accomplished after the integration date *does not exceed 20%* of the construction's value, exclusively the land's value, after transformation or modernization;
- the person subject to taxation did not have *the right to integral or partial deduction of the afferent tax*, but at or after the integration date *chooses the operations' taxation*;
- the person subject to *taxation did not have the right to integral or partial deduction of the afferent tax*, but at or after the integration date *chooses the operations' taxation*, and the value of each transformation or modernization accomplished after the integration date *does not exceed 20%* of the construction's value, exclusively the land's value, after transformation or modernization;

2) *The following tax payers will adjust the deducted and the undeducted tax before and after the integration date, on a 20-year period, the adjustment method being calculated on entire calendar years:*

- the person subject to *taxation who had the right to integral or partial deduction of the afferent tax*, but at or after the integration date *does not choose the operations' taxation*, and the value of each transformation or modernization accomplished after the integration date *exceeds 20%* of the construction's value, exclusively the land's value, after transformation or modernization;
- the person subject to *taxation who did not have the right to integral or partial deduction of the afferent tax*, but at or after the integration date *chooses the operations' taxation*, and the value of each transformation or modernization accomplished after the integration date *exceeds 20%* of the construction's value, exclusively the land's value, after transformation or modernization.

2.2. Tax adjustment for operations regarding the leasing, the granting and the renting of fixed assets

A. The adjustment of deducted tax:

1) In the following situations, tax payers are obliged to adjust the deducted tax for acquisitioned fixed assets, built or modernized in the past 5 years, proportionally with the part from the fixed asset which will be used for the accomplishment of operations regarding

the leasing, the granting and the renting of fixed assets and proportionally with the number of months during which the good will be used in taxation regime:

-a person subject to taxation *who had the right to integral or partial tax deduction, at or after the integration date, does not choose taxation or annuls the taxation option* of any of these operations;

-a person subject to taxation *who had the right to integral or partial deduction of the afferent tax but does not choose taxation or annuls the taxation option*, at or after the integration date, and the value of each transformation or modernization realized after the integration date *does not exceed 20%* of the value of the fixed asset or of a part of it, exclusively the land's value, after transformation or modernization.

The adjustment is done on a five-year period, the adjustment period being applied each month. The undeductible tax obtained by adjustment is registered from an accounting point of view on expenses, as well as in the journal for purchases and it is taken over correspondingly in the VAT deduction for the fiscal period during which the person subject to taxation begins the deduction regime.

2) The person subject to taxation *who had the right to integral or partial deduction of the afferent tax but does not choose taxation or annuls the taxation option*, at or after the integration date, and the value of each transformation or modernization realized after the integration date *exceeds 20%* of the value of the fixed asset or of a part of it, exclusively the land's value, after transformation or modernization, the adjustment method being calculated on entire calendar years.

B. The adjustment of undeducted tax:

1) In the following situations, the persons subject to taxation can deduce out of the undeducted tax afferent to acquisitioned fixed assets, built or modernized in the past 5 years, proportionally with the part of each fixed asset which will be used for the accomplishment of these operations and proportionally with the number of months in which the good will be used in taxation regime:

-the person subject to taxation *did not have the right to integral or partial tax deduction* but, at or after the integration date, *chooses taxation for any of these operations*;

- the person subject to taxation *did not have the right to integral or partial deduction of the afferent tax, but chooses operations' taxation*, at or after the integration date, for fixed assets transformed or modernized after the integration date, and the value of each transformation or modernization accomplished after the integration date *does not exceed 20%* of the value of the fixed asset or of a part of it, exclusively the land's value, after transformation or modernization.

Adjustment is done on a five-year period, the adjustment method being applied each month. The deducted tax is registered from an accounting point of view by the diminution of expenses, as well in the journal for purchases and it is taken over correspondingly in the VAT deduction for the fiscal period during which the person subject to taxation begins the deduction regime.

2) The person subject to taxation *who did not have the right to integral or partial deduction of the afferent tax, but chooses operations' taxation*, at or after the integration date, for fixed assets transformed or modernized after the integration date, and the value of each transformation or modernization accomplished after the integration date *exceeds 20%* of the value of the fixed asset or of a part of it, exclusively the land's value, after transformation or modernization, will proceed to the adjustment of the tax deducted on a 20-year period, the adjustment method being calculated on entire calendar years.

From what we have mentioned above, it results that adjustment should be done by all tax payers, irrespective of whether or not they had or didn't have the right to deduction and irrespective of whether or not they choose taxation of the exempted operations.

Depending on these elements, the adjustment can be in favor or to the disadvantage of the tax payer.

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