# Fiscal and Accounting Aspects Concerning the Reverse Charge in the Context of Accession to the European Union

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26 October 2007

# FISCAL AND ACCOUNTING ASPECTS CONCERNING THE REVERSE CHARGE IN THE CONTEXT OF ACCESSION TO THE EUROPEAN UNION

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**ABSTRACT**
As from 1 January 2007 the European Directives are transposed into the national legislation and the European Regulations are truthfully applicable. In the VAT field, the European Directives, as well as the Jurisprudence of the European Court of Justice were transposed into the Fiscal Code, Title VI. Since the accession date, the legislation in the VAT field is repealed and replaced with the legislation harmonized with the Community acquis. The elimination of customs barriers between the 27 Member States of the European Union brings news as concerns the application of the "reverse charge" procedure that is applied in Romania as from the year 2005 for residue transactions and transactions with ferrous and non-ferrous metal waste, with grounds or buildings or building parts or living animals among VAT payers. Thus, starting with1 January 2007, the reverse charge is binding and applicable to all intra-Community acquisitions. At the same time the reverse charge was also applied for imports until 15 April 2007.
In this paper I shall present aspects concerning the history of reverse charge in our country, accounting of operations and advantages and disadvantages of application of this procedure in the context of accession to the European Union.

**KEY WORDS**
Reverse charge, VAT, intra Community acquisitions, Fiscal Code, and imports.

## 1. Introduction

In Romania, as from 1 January 2007, the value-added tax has been undertaking a series of important changes. These changes are caused by the process of harmonization of the Romanian laws with the Community acquis. VAT was introduced in Romania starting with the year 1993, when it was founded on the basis of the EEC 6th Directive (Directive that regulates the VAT in all Member States), but without being truthfully observed, because at that moment our country was not yet a country candidate for accession. When Romania started negotiations with EU on taxation, it undertook to transpose in the national legislation the European Directives' provisions on VAT, 2001 being also the opening year of Chapter 10 of the Position Paper. Therefore Romania had the obligation to improve the regulatory environment in the VAT field (and not only) by correlating with the following Directives:

- Sixth Council Directive (77/388/EEC) of 17 May 1977 on harmonization of Member States laws concerning the turnover taxes - The common system of value-added tax, uniform basis of assessment;
- Eighth Council Directive (79/1072/EEC) of 6 December 1979 on harmonization of Member States legislations concerning the turnover taxes - VAT refund methods for the taxable persons who are not established inside the country.
- Thirteenth Council Directive (86/560/EEC) of 17 November 1986 on harmonization of Member States legislations concerning the turnover taxes - VAT refund methods for the taxable persons who are not established in the Community.
- Council Directive 83/181/EEC of 28 March 1983 laying down the field of application of Article 14 (1) (d) of Directive 77/388/EEC on exemption from value-added tax on the final importation of certain goods;
- Council Directive 69/169/EEC of 28 May 1969 on the harmonisation of provisions laid down by Law, Regulation or Administrative Action relating to exemption from turnover tax and excise duty on imports in international travel.

In the VAT field, the European Directives as well as the Jurisprudence of the European Court of Justice were transposed into the draft law of amendment of Title VI of the Fiscal Code, the old legislation being replaced by the legislation harmonized with the Community acquis.
The accession implied among others the elimination of customs barriers between the EU Member States and implicitly abolition of border controls on movement of goods between these states. Therefore, the export and import concepts disappeared in the relationship between the Member States, being replaced by concepts such as intra-Community delivery instead of export and intra-Community acquisition, instead of import. The goods

entered into a customs suspensive procedure are considered after accession as non-transfers. In the same time, the control on movement of goods between Member States is performed by the electronic system VIES (VAT International Exchange System) and on the basis of regulations that stipulate the conditions under which the Member States shall exchange information and multilateral controls in order to avoid fiscal fraud in the VAT field.

Starting with 01.01.2005 until the accession date, the VAT payer companies involved in internal transactions with lands, buildings, residue, with ferrous metal waste and woody materials came within the exception of some simplification measure in the VAT field, that is they shall not pay anymore the VAT for these operations; this procedure is called "reverse charge".

This paper lays down the fiscal aspects concerning the reverse charge in Romania, before and especially after the accession, but also the aspects concerning the accounting of these operations. Last, but not the least, I shall lay out the advantages and disadvantages of application of this procedure in the context of Romania's accession to the EU.

## 2. Body of Paper

The reverse charge was introduced starting with 01.01.2005 for transactions within Romania, among the VAT payers, with ferrous and non-ferrous metal waste, with lands or buildings or building parts or living animals. [1]

Until 31.12.2004 beneficiaries were able to use the deducted tax for VAT payable or any other taxes and fees to be refunded or, in case they were exporters, they would require the VAT refund from the budget. It is well-known that during the cross-checks made on VAT refunds, more often than not it showed that suppliers which had to collect the VAT were bogus companies set up with the purpose of such fiscal schemes, prejudicing the state budget.

The reverse charge procedure is not a Romanian artifice; it is used by many European countries to prevent the budget refund of amounts that it did not collect.

The simplified procedure on VAT (reverse charge) was imposed because of the alarming signals received from the business environment and from the territorial fiscal bodies, who have repeatedly required legal measures to control tax avoidance that is strikingly manifested in the trade with waste products and immovable property. Practically, operations remain taxable, but VAT is no longer actually paid among companies registered as VAT payers. Therefore, the state budget either does not collect the VAT in this operations, which is without prejudice, since the tax that should be collected by traders with ferrous and non-ferrous metal waste, lands or buildings or building parts should be deducted by the beneficiaries. Moreover, the reverse charge may be applied on each stage of the economic circuit, regardless of how many shackles it passes through, but it is stopped when conditions are no longer met, that is one of the parties is not registered as VAT payer. Therefore the reverse charge is without prejudice to the state budget, because the main principles of the value-added tax are observed, that is this tax is paid by the final consumer.

Currently two periods can be delimited, that is between 01.01.2005 (procedure entry date) and the accession date, and after accession. We shall focus in this paper on the current period (after accession), also pointing out for comparison purposes the main aspects of the first stage.

After accession, the application of the reverse charge is binding on the suppliers and beneficiaries registered for VAT purposes for the following goods/services:

a) woody material;

b) wastes and secondary raw materials, resulted from their disposal [2];

c) buildings, building parts and lands of any kind;

d) goods and/or services delivered or provided by or to the persons in bankruptcy declared by final and irrevocable judgment;

e) construction - assembly works;

f) intra-Community acquisitions (regardless of their nature).

Before accession, the reverse charge implied invoicing as for any other taxable operation, only with the side mention "reverse charge". In order to assess the value of the goods without VAT, suppliers would make the general accounting registrations, registering for the VAT amount the VAT autoliquidation (4426=4427). Both the supplier and the beneficiary registered the invoice in the sales journal and in the purchase journal, the amounts being properly taken over in the VAT return. Suppliers deduced the VAT entirely at the output tax level from the invoices issued for deliveries of goods for which there was the "reverse charge" mention, even if they were VAT payers with mixed regime.

Beneficiaries used to make (before accession) and they continue to make (after accession) the general accounting registrations for an acquisition of goods or for an advance payment, as the case may be, for the value of goods or, as the case may be, the advance payment, without value-added tax and for the VAT amount they made the registration 4426=4427.

After the VAT return, beneficiaries – VAT payers with mixed regime – record (both before and after accession), the non-deductible tax afferent to the pro-rata in the expense accounts of the current fiscal year if the destination of goods/deliveries is to fully or partly make operations that do not have a deduction right (VAT being fully/partly registered on expenses: 635 = 4426). If they are intended for operations with deduction right, beneficiaries deduce the value-added tax entirely, without being influenced by the pro-rata.

In the seller's case, the value-add tax refund at the output tax level is similar to its collection, and for the purchaser, the value-added tax collection on the level of the tax recorded in the acquisition invoice is equivalent with its payment.

After accession the reverse charge implies only the "reverse charge" entry on the invoices issued for goods/services deliveries by the internal suppliers, without mentioning the afferent tax as well. On invoices received from suppliers, beneficiaries mention the afferent tax that they emphasize both as output tax (4427) and as input tax (4426) (4426 = 4427).

In case of purchase agreements of goods with instalment payment, valid concluded, before 31 December 2006 inclusive, which are carried on after the accession date as well, the exigibility of tax for the due instalments after the accession date comes on each date specified in the agreement for the instalments payment. In the case of leasing agreement valid concluded before 31 December 2006 inclusive and which are carried on after the accession date as well, the interests for the due instalments after the accession date are not included in the tax base.

In the case of movable tangible goods introduced in the country before the accession date by the leasing companies, Romanian legal persons, on the basis of leasing agreements concluded with the users, Romanian natural or legal persons and which entered into a customs import procedure with exemption from payment of all the import rights value, including VAT, if purchased by users after the accession date, the regulations in force on the date of entry into force of the agreement shall be implemented.

The investment objectives finalized by a capital asset whose year following the operating one is the year of Romania's accession to the European Union are subject to the adjustment regime of the input tax.

The tax exemption certificates issued until the accession date for delivery of goods and provision of services financed from aids or non-callable loans, granted by foreign governments, by international bodies and by non-profit and charity organizations from the country or from abroad or by natural persons, keep their validity during the objectives process. Supplement of the tax exemption certificates are not allowed after 1 January 2006.

In the case of binding agreements concluded until 31 December 2006 inclusive, the legal dispositions in force on the date of entry into force of the agreement shall be implemented for the following operations:

a) research, development and innovation activities, for fulfilment of programs, subprograms, projects and actions included in The National Research, Development and Innovation plan, in the core programs and in the sectorial programs, legally functioning [3], and the research, development and innovation activities financed in international, regional and bilateral partnership;

b) construction works, management, repairs and maintenance of monuments commemorating miltants, heroes, war victims and victims of the Revolution of December 1989.

The legal dispositions in force after the accession date shall apply to the previously provided additional papers to the agreements concluded after 1 January 2007 inclusive.

For the good performance guarantees deducted from the value of construction -assembly works, emphasized as such in invoices until 31 December 2006 inclusive, shall be implemented the legal dispositions in force on the date these guarantees are made, as concerns the VAT exigibility.

For the real property works that finalize with an immovable asset for which the prime contractors opted that, before 1 January 2007, that tax payment should be made on the date of the immovable asset delivery, there shall be implemented the legal dispositions in force on the date this option was made.

Joint ventures of Romanian taxable persons and taxable persons established abroad, or exclusively of taxable persons established abroad, registered as VAT payers, until 31 December 2006 inclusive, in accordance with the legislation in force on the constitution date, are considered distinct taxable persons and remain registered for VAT purposes until the end of the agreements they were constituted for.

For the advance payments collected until 31 December 2004 inclusive for goods deliveries, there shall be applied the fiscal regime on value-added tax on the date of the advance payment collection. The operation of advance payments adjustment does not affect the reverse charge application on the date of goods delivery invoicing.

The value-added tax for the goods deliveries made with instalment payment until 31 December 2004 inclusive shall be adjusted as follows: suppliers, respectively beneficiaries cancel the value-added tax for the instalments whose due date comes after the date of 1 January 2005 registered in the 4428 account in correspondence with the customers / suppliers account, shall make the accounting registration 4426=4427 with the VAT afferent for each instalment, at each date stipulated by the agreement for the instalment payment.

If the supplier/provider did not mention "reverse charge" in the invoices issued for the classified goods/services, the beneficiary must apply the reverse charge and must not pay the tax to the supplier/provider, he must make the "reverse charge" mention in the invoice and fulfil the above-mentioned obligations.

The taxable person who had the right to entire or partial tax refund and who, on or after the accession date do not opt for the charge or cancel the charge option of any of the stipulated operations for an immovable asset or part of it, build, purchased, changed or modernized before the accession date, shall adjust the tax. The taxable person who did not have the right to entire or partial tax refund for an immovable asset or part of it, build, purchased, changed or modernized before the accession date, opting for the charge of any of the stipulated operations, on or after the accession date, shall adjust the afferent input tax.

If the competent fiscal bodies, upon the checks performed find that the simplification measures legally functioning [1] were not applied for these assets, they shall bind the beneficiaries to cancel the input tax through the suppliers' account, to make the accounting registration 4426=4427 and the registration in the VAT return drawn up at the end of the fiscal year when the check was finalized, in the

adjustments lines. If beneficiaries are mixed taxable persons and the assets purchased are intended to make operations both with and without deduction right, the VAT input tax shall be determined on pro-rata basis on the date of purchase of the assets subject to reverse charge and it shall be registered in the adjustments line of the VAT return which is no longer affected by the pro-rata application from the current period.

For a practical presentation of the accounting operations concerning the reverse charge, I shall present its registration method for one month of 2007, at a Romanian company.

- the acquisition of woody material - beech log - from a VAT payer company (the "reverse charge" mention is made on the invoice) - is registered on the invoice and receipt note basis - therefore the reverse charge is applied:

| | | | |
|---|---|---|---|
| 301 "Raw materials" | = | 401 "Suppliers" | 2.500 lei |

- concomitantly, for the value-added tax, although it is not mentioned in the invoice, the VAT autoliquidation registration is made:

| | | | |
|---|---|---|---|
| 4426 "VAT input tax" | = | 4427 "VAT output tax" | 475 lei |

- the acquisition of woody material - beech log - from a company that is not tax payer - is registered on the invoice and receipt note basis - therefore the reverse charge is not applied:

| | | | |
|---|---|---|---|
| 301 "Raw materials" | = | 401 "Suppliers" | 8.000 lei |

- the woody material consumption for production of lumber, according to the consumption note.

| | | | |
|---|---|---|---|
| 601 "Expenses on the raw materials" | = | 301 "Raw materials" | 6.500 lei |

- on the basis of the production report, the entry is registered in the end products management of the processed lumber:

| | | | |
|---|---|---|---|
| 345 "End products" | = | 711 "Variation in inventory" | 8.000 lei |

- the unit sells beech lumber to the legal VAT payer persons – therefore applies the reverse charge (the "reverse charge" mention is made on the invoice, without entering VAT). The selling of end products is registered according to the invoice:

| | | | |
|---|---|---|---|
| 411 "Customers" | = | 701 "Income from selling end products" | 6.000 lei |

- concomitantly, for the value-added tax, although it is not mentioned in the invoice, the VAT autoliquidation is reflected:

| | | | |
|---|---|---|---|
| 4426 "VAT input tax" | = | 4427 "VAT output tax" | 1.140 lei |

- the unit sells beech lumber to natural persons that are not VAT payers - therefore does not apply the reverse charge. The selling of end products is registered according to the invoice:

| | | | |
|---|---|---|---|
| 411 "Customers" | = | % | 4.760 lei |
| | | 701 "Income from selling end products" | 4.000 lei |
| | | 4427 "VAT output tax" | 760 lei |

- there is registered the discharge from administration of the end products sold through the accounting article:

| | | | |
|---|---|---|---|
| 711 "Variation in inventory" | = | 345 "End products" | 8.000 lei |

- VAT adjustment:

| | | | |
|---|---|---|---|
| 4427 "VAT output tax" | = | % | 2.375 lei |
| | | 4426 "VAT input tax" | 1.615 lei |
| | | 4423 "Payable VAT" | 760 lei |

To point out the intra-Community transactions (acquisitions and deliveries) subject to reverse charge, the same accounting formulas are used as those presented in the previous example for internal transactions.

The persons registered as VAT payers must submit to the competent fiscal bodies a VAT return for each fiscal year until 25th inclusive of the month following the one when the fiscal year ends. The VAT return shall include the amount of the input tax which gives rise to the deduction right in the reporting fiscal year and, as the case may be, the tax amount for which the deduction right is exercised, the amount of the output tax whose exigibility rises in the reporting fiscal year and, as the case may be, the amount of the output tax that was not registered in the VAT return of the fiscal year when the tax exigibility came into existence, as well as other information under the model laid down by the Ministry of Economy and Finance.

The unit draws up the centralizing registers of purchase and sales and the purchase and sales journals whose information represent the basis for drafting the value-added tax return.

We think it is necessary to mention that each taxable VAT payer must draw up and submit to the competent fiscal bodies informative and recapitulative statements regarding the intra-Community deliveries, acquisitions etc, that shall include a series of information concerning the total amounts for each supplier/customer, afferent to the activities performed etc., that is: 390 VIES Statement - Recapitulative Statement concerning the intra-Community deliveries/acquisitions of goods, the Informative Statement 392 concerning the deliveries of goods and provisions of services, the Informative Statement 393 concerning the income obtained from selling tickets for international passenger road transport, with the departure from Romania, 394 - Informative Statement concerning deliveries/provisions and acquisitions performed within the country.

### 3. Conclusions

Romania's accession to the EU has determined and is still going to determine a series of important changes in all the fields.

The changes in the VAT field caused by Romania's accession to the EU determine all the economic operators that until the end of 2006 used to make imports, exports, lohn operations or other transactions that implied goods movements between Romania and another Member State, to become acquainted with the documents to be drawn up, the date when the tax exigibility comes into existence, statements to be submitted and especially the regulations on intra-Community operations (reverse charge). Regulations are very important because only if they know them, they will have the possibility to apply the exemption from VAT for an intra-Community delivery, according to the documents they submit to justify this exemption. For the intra-Community acquisitions, the economic operators registered for VAT purposes shall not make the actual payment, but shall apply the reverse charge, the payment through the VAT return (4426 = 4427).

As concerns the service provisions, there are important changes as well. As from the accession, there is a new concept, the intra-Community transport of goods, with different regulations unlike the international transport of goods between the Member States and the third countries. Thus, the international transport of goods afferent to an import or export was and shall remain exempt from VAT, while the intra-Community transport of goods is not exempt from VAT, but if the customer delivers the transporter a valid VAT code from a Member State other than Romania, from where the transport leaves, then the customer shall pay the tax in his country and the Romanian transporter shall make the invoice without VAT (reverse charge). Mutually, when an economic operator from Romania contracts a transport with a transporter from another Member State, he will have to communicate his VAT code from Romania and therefore shall owe the afferent tax in Romania, however not making the actual payment, but applying the reverse charge rule, that is payment through the VAT return. The other provisions of services, when the customer or provider is established in another Member State, have different regulations after accession as well. The communication of the registration code for VAT purposes is very important, in most of the cases leading to provider's invoicing without VAT and to application of the reverse charge by the customer from another Member State, if the latter is registered for VAT purposes.

Since the accession date, the utilization of fiscal invoices with special regime is no longer mandatory, due to the fact that by abolishing of custom borders, the goods circulate accompanied by invoices issued by every Member State, which have to be accepted in the state of intra-Community acquisition, irrespective of their forms, if they comply with the minimal information settled by the Directive. The provisions on electronic invoicing were implemented in Title VI on VAT of the Fiscal Code and they are binding as from the date of Romania's accession to the European Union. Of course, the economic operators who have in stock special fiscal invoices since the end of 2006 may use them after the accession date as well, to consume them. Any economic operator may also customize his invoices, but without being determined to do so.

The application of simplification measures continues after accession as well for those who shall opt for charging of real property transactions that is currently known as reverse charge.

As from the accession date, a series of exemptions from VAT that are in line with the Community acquis shall be eliminated. Among the most important ones I'd like to remind the exemption from VAT for: research, development activities, fee for commodity exchange transactions and the income obtained by the Transferable Securities Companies for administration and deposit of shares, equity securities, debt securities, transactions financed from non-callable funds, granted by foreign governments and international bodies, veterinary medical care. Besides the eliminated exemptions from VAT, a series of mandatory exemptions from VAT was introduced in the harmonized legislation, such as: exemption of postal public services, exemption for gold deliveries to the country by the National Bank of Romania, exemption for leasing or immovable property transactions, exemption for the sale of land of any kind, except the building land, exemption from VAT for the sale of old buildings.

Adoption of the harmonized legislation in VAT filed is the legal foundation for creation of the interoperativity system concerning the exchange of information in the VAT field with the Member States of the European Union. This exchange of information is necessary because after the accession date, as a consequence of elimination of customs barriers, the movement of goods between the Member States is no longer subject to border controls (Statement 308 - Application for Refund for the taxable persons not registered for VAT purposes in Romania, established in another Member State of the European Union; Statement 313 - Application for Refund for the taxable persons not registered for VAT purposes in Romania, established outside the Community; Statement 390 VIES - Recapitulative Statement concerning the intra-Community deliveries/acquisitions of goods; Informative Statement 392 concerning the deliveries of goods and provisions of services; Informative Statement 393 concerning the income obtained from selling tickets for international passenger road transport, with the departure from Romania, Statement 394 - Informative Statement concerning deliveries/provisions and acquisitions performed within the country). The information in these Recapitulative Statements are transferred in VIES and thus the Member States can check the transactions performed. For example, when an intra-Community acquisition is reported in Romania, it will be possible to check the supplier who reported the intra-Community acquisition, that is, if he has a number valid for VAT purposes in his Member State and if the transaction is declared in this state. Currently, the Recapitulative Statements filled-in and filed by the economic operators from Romania do not allow the fiscal bodies to perform

serious checks and there are still many problems in this field. For example, within the Gorj County, more than 50% of the statements 390 and 394 registered errors concerning the information entered by the economic operators (generally these errors consisted in registration codes as VAT payers incorrectly filled-in.) I think it will take some time until the reporting system is settled according to the standards of EU Member States.

The harmonized legislation on VAT is also the legal foundation for calculating the contribution of Romania to the Community Budget, the value-added tax being one of the most important resources of the calculation basis for this contribution.

The reverse charge was also applied for imports until 15 April 2007. Because of decrease with about 40% of the consolidated budget revenues representing VAT for the first quarter of the year 2007 compared with the same period of the previous year, the Ministry of Economy and Finance has rightfully decided to eliminate the reverse charge procedure for imports (acquisitions from states other than the Member States of EU) of goods and services.

The simplified procedure, also called "reverse charge" is used in many European states to prevent the budget refund of amounts that it did not collect.

The measure was imposed because of the alarming signals received from the business environment and from the territorial fiscal bodies, who have repeatedly required legal measures to control tax avoidance that is strikingly manifested in the trade with waste products and immovable property. Practically, operations remain taxable, but the value-added tax is no longer actually paid among the economic agents registered as VAT payers. Therefore, the state budget either does not collect the VAT in this operations, which is without prejudice, since the tax that should be collected by traders with ferrous and non-ferrous metal waste, lands or buildings or building parts should be deducted by the beneficiaries (including the beneficiaries of intra-Community acquisitions of any kind).

It is well-known that during the cross-checks made upon VAT refunds, more often than not it shows that suppliers which had to collect the VAT are bogus companies set up with the purpose of such fiscal schemes, prejudicing the state budget. The advantages of this method regarding the wastes lies in the fact that exporters will no longer require the VAT refund, because the deducted tax is also collected in the same time, as a consequence of the supplier's failure to pay. This way the management and collection of VAT are improved by reducing the number of applications for refund, thus relieving the territorial fiscal bodies and by eliminating the possibility to refund from the state budget amounts that were not collected.

As for the lands and immovable assets, the CAROUSEL fiscal fraud is controlled, this fraud consists in selling a building or a land at an initial small value and after successive transactions their value increases up to the last link that requires VAT refund. One trader, who did not collect VAT would disappear from the circle, thus prejudicing the state budget. By applying the reverse charge this type of fiscal schemes will be also eliminated.

Notice that the reverse charge is not applied in the relationship with a final consumer that is a person who is not registered as VAT payer, because he/she should pay the value-added tax, not having any deduction right. Therefore the reverse charge method is without prejudice to the state budget, because the main principles of the value-added tax are observed, that is this tax is paid by the final consumer.

**References**


[1] Fiscal Code, Title VI, Article $160^{1}$ simplification measure in the VAT field in order to control tax avoidance.

[2] Government Emergency Ordinance no. 16/2001 on the management of recyclable industrial waste, republished, as further amended and supplemented.

[3] Government Ordinance no. 57/2002 concerning the scientific research and technological development, approved with amendments and changes by Law no. 324/2003, as further amended and supplemented.

[4] Sixth Directive, or Council Directive 77/388/EC of 17 May 1977, on the harmonisation of the laws of the Member States relating to turnover taxes - common system of value added tax: uniform basis of assessment, published in the Official Journal of the European Communities (OJ) no. L 145 of 13 June 1977, with its subsequent changes and amendments.