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Paliu-Popa, Lucia and Ecobici, Nicolae

University of Constantin Brancusi Targu Jiu, Romania

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ACCOUNTING IMPLICATIONS OF TAXATION

Paliu-Popa Lucia, Ecobici Nicolae
Faculty of Economics, Constantin Brancusi University
Targu Jiu, 24, Victoriei Street, Gorj County
Romania

Email: univers_cont@yahoo.com, nicu.ecobici@utgjiu.ro

ABSTRACT

Romania's accession to the European Union required a series of changes in the fiscal legislation in order to harmonize it with the Community Regulations; the value-added tax, the new introduced concepts or mechanism being especially regarded at this indirect tax level, with the function to accelerate the implementation of the European Directives.

The changes made have a partial influence on how the fiscal liabilities are reflected in accounting, the latter representing in the same time a privileged source of information for the fiscal bodies.

We shall present in this paper the implications of taxation on accounting, dwelling on the simplification measures provided for in Law no. 571/2003 concerning the Fiscal Code (Article 160), the reverse charge and self-liquidation of the value-added tax.

For this purpose we shall approach the reverse charge evolution in our country, the method of documents drawing up, imposed by the fiscal regulations, the reflection in accounting of operations regarding deliveries of goods or supplies of services to which simplification measures are applied, both on the supplier/performer's side and on the beneficiary's side, and also the advantages and disadvantages of these fiscal regulations.

KEY WORDS

Taxation, accounting, value-added tax, simplification measures, reverse charge, self-liquidation.

1. Introduction

In Romania, as in other European countries (France, Germany etc.) accounting is obviously influenced by taxation if we take into account the fact that the norms specific to fiscal law and to accounting law are drawn up by the same organical structure, which is the Ministry of Economy and Finance that imposes regulations and procedures.

Accounting represents a privileged source of information for the fiscal bodies, and most of the liabilities to the consolidated budget, local budgets and other funds are

determined on the basis of data in accounting.

Many times it was attempted and it still is to determine a regulatory relationship between accountancy and taxation, namely to specify who influences more the other one.

From the points of view of various Romanian and foreign authors there can be identified several **scenarios**, namely:

- accounting is influenced by taxation, with different intervention degrees;
- accounting influences taxation;
- accounting is independent from taxation.

Regardless of the scenario we refer to, there certainly is *interdependence between accounting and taxation*, interdependence that is decisive in the fiscal management of an economic unit.

Romania's accession to the European Union required a series of changes in the fiscal legislation in order to harmonize it with the Community Regulations; the value-added tax, the new introduced concepts or mechanism being especially regarded at this indirect tax level, with the function to accelerate the implementation of the European Directives.

We shall present in this paper the implications of taxation on accounting, dwelling on *the simplification measures* provided for in Law no. 571/2003 concerning the Fiscal Code (Article 160), *the reverse charge* and *self-liquidation of the value-added tax*.

For this purpose we shall approach the reverse charge evolution in our country, the method of documents drawing up, imposed by the fiscal regulations, the reflection in accounting of operations regarding deliveries of goods or supplies of services to which simplification measures are applied, both on the supplier/performer's side and on the beneficiary's side, and also the conclusions we draw.

2. Body of Paper

REVERSE CHARGE EVOLUTION IN OUR COUNTRY

The reverse charge mechanism was introduced in the Romanian legislation ever since 2003, for services provided by non-residents, which are taxable in Romania,

for which the beneficiary had the obligation to pay the tax, however without actual payment of the value-added tax added to the state budget, but by directly recording it in the VAT return, both as input tax and as output tax, without influencing the cash flows.

As from 01 January 2005 the Ministry of Economy and Finance has extended this mechanism of value-added tax application to wastes, transactions with grounds and buildings of any kind and also with woody material, *with the mandatory condition for application of the simplification measures* that both the supplier and the beneficiary be registered for VAT purposes, without the possibility to opt for the reverse charge. [1]

The simplification measures also apply after 01 January 2007 for delivery or supply of the following goods and services:

- wastes and secondary raw materials, resulted from their disposal;
- buildings, building parts and grounds of any kind;
- buildings-assembly works;
- goods and/or services delivered or provided by/or to the persons in bankruptcy declared by final and irrevocable judgment;
- lumber

Considering the fact that both taxpayers and fiscal bodies are confronted with many problems concerning the application of the simplification measures, their clarification implies *knowledge and correct interpretation of the provisions provided for in the following regulatory acts:*

- Law no. 571/2003 concerning the Fiscal Code;
- Methodological norms for the Fiscal Code application;
- Order of the Ministry of Public Finance no. 155/2007 on the application of simplification measures for buildings-assembly works provided for in Article 160 from the Law no 571/2003 concerning the Fiscal Code;
- Government Emergency Ordinance no. 16/2001 on the management of recyclable industrial waste, republished, as further amended and supplemented;
- Order of the President of the National Institute of Statistics no. 601/2002 on updating the Classification of Activities of the National Economy-CANE, under Article 5 of the Government Decision no. 656/1997 concerning the approval of Classification of Activities of the National Economy - CANE;
- Government Decision no. 2139/2004 on the approval of the fixed assets classification and normal useful life catalogue.

THE METHOD OF DOCUMENTS DRAWING UP IMPOSED BY THE FISCAL REGULATIONS

The changes occurred in the fiscal laws concerning the simplification measures impose new regulations for drawing up of the financial and accounting documents.

Therefore, on the *invoices issued* for deliveries of goods or supplies of services, that are within the scope of the simplification measures, suppliers must enter the mention "reverse charge" without mentioning the afferent tax (during 01.01.2005–31.12.2006 there was also mentioned

the value of the value-added tax, without including it in the total amount).

On *the invoices received* from suppliers, beneficiaries shall enter the afferent tax emphasized both as output and input tax in the value-added tax return. Therefore for the operations subject to the simplifications measures, the payment of tax between supplier/performer and beneficiary is not made.

If after 01 January 2007 *invoices were incorrectly issued* by the goods suppliers or services performers, the beneficiary has to apply the reverse charge, not to make the tax payment to the supplier/performer, to make the "reverse charge" mention in the invoice and to fulfil the above-mentioned obligations for invoices issued or received.

If the *beneficiaries of an activity subjected to reverse charge are taxable persons with mixed regime* 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 amount adjustment line of the VAT return which is no longer affected by the pro-rata application from the current period.

Suppliers or service providers that are taxable persons with mixed regime shall take into account upon the pro-rata determination, as taxable operations, the value of deliveries or provisions for which they paid the reverse charge.

THE REFLECTION IN ACCOUNTING OF OPERATIONS REGARDING DELIVERIES OF GOODS OR SUPPLIES OF SERVICES TO WHICH SIMPLIFICATION MEASURES ARE APPLIED

Next we shall point out the registration method in the accounting of the supplier and beneficiary of deliveries of goods or supplies of services to which simplification measures are applied, entries that differ from one period to another according to the changes occurred in the fiscal laws.

For this purpose we shall proceed from selling/purchasing of a building within the scope of the simplification measures.

1) *Economic transactions performed until 31.12.2004* [2] Suppose that a company decided the disposal of a building with a selling value of 50.000 lei, including VAT of 19%. We know that the entry value of the building is of 100,000 lei, value that is paid off in a percent of 50%. This situation generates the following entries in accounting:

a) *In supplier's accounting:*

- selling (disposal) of the building to third parties:

461	=	%	59.500
"Various debtors"		7583	50.000
		"Income from selling assets and other capital transactions".	
		4427	9.500
		"Output value-added"	

tax"			
- write-off of the sold building, partly amortised:			
%	=	212	<u>100.000</u>
6583		„Buildings”	50.000
"Expenses concerning the assets disposed and other capital transactions".			
2812			50.000
"Amortization of buildings"			
- cashing of the receivable:			
5121	=	461	59.500
"Bank accounts in lei"		"Various debtors"	

b) *In beneficiary's accounting:*

- purchase of a building from third parties:

%	=	404	59.500
212		"Suppliers	50.000
"Buildings"		of assets"	
4426			9.500
"Input value-added tax"			
- reimbursement of debt:			
404	=	5121	59.500
"Assets suppliers"		"Bank accounts in lei"	

2) *Economic transactions performed during 01.01.2005-31.12.2006* [3]

Considering that starting from 01.01.05 buildings belong to the category of assets subjected to simplification measures regarding the reverse charge, the previous example generates the following records in accounting:

a) *In supplier's accounting:*

- selling of a building:

461	=	7583	50.000
"Various debtors"		"Income from selling assets and other capital transactions".	

- concomitantly, VAT self-liquidation:

4426	=	4427	9.500
"Input value-added tax"		"Output value-added tax"	

-inventory write-off from of the sold building, partly amortised:

%	=	212	<u>100.000</u>
6583		"Buildings"	50.000
"Expenses concerning the assets disposed and other capital transactions".			
2812			50.000
"Amortization of buildings"			

- cashing of the receivable:

5121	=	461	50.000
"Bank accounts in lei"		"Various debtors"	

b) *In beneficiary's accounting:*

- purchase of a building:

212	=	404	50.000
"Buildings"		"Assets suppliers"	

- concomitantly, VAT self-liquidation:

4426	=	4427	9.500
"Input value-added tax"		"Output value-added tax"	

- reimbursement of debt:

404	=	5121	50.000
"Assets suppliers"		"Bank accounts in lei"	

3) *Economic transactions performed after 01.01.2007*

The novelty nature provided for in Law no. 571/2003 on Fiscal Code after 01.01.2007 regards the fact that the value-added tax self-liquidation operates only in the beneficiary's accounting, the previous transactions being reflected as follows:

a) *In supplier's accounting:*

- selling of a building:

461	=	7583	50.000
"Various debtors"		"Income from selling assets and other capital transactions".	

-inventory write-off from of the sold building, partly amortised:

%	=	212	<u>100.000</u>
6583		„Buildings”	50.000
"Expenses concerning the assets disposed and other capital transactions".			
2812			50.000
"Amortization of buildings"			

- cashing of the receivable:

5121	=	461	50.000
"Bank accounts in lei"		"Various debtors"	

b) *In beneficiary's accounting:*

- purchase of a building:

212	=	404	50.000
"Buildings"		"Assets suppliers"	

- concomitantly:

4426	=	4427	9.500
"Input value-added tax"		"Output value-added tax"	

- reimbursement of debt:

404	=	5121	50.000
"Assets suppliers"		"Bank accounts in lei"	

Analysing the previous example in the three management periods we have the following results:

- until 01.01.2004 the supplier for the building selling collects the value-added tax that he has to pay to the general consolidated budget in the amount of 9.500 lei, and for the building purchase the beneficiary pays the supplier the value-added tax with the same nature as the input tax in the amount of 9.500 lei that he may recover

from the general consolidated budget, thus influencing the cash flows both on supplier's side, beneficiary's and on the state budget;

- during 01.01.2005 – 31.12.2006 the simplification measures on reverse charge apply both for the supplier and the beneficiary, however without making the actual payment of the amount of 9.500 lei and without influencing the cash flows. In this situation, the input value-added tax and the output value-added tax are artificially increased with the amount of 9.500 lei that appears in the verification balance sheets of the supplier and beneficiary side and also in the VAT return;
- after 01.01.2007 the difference from the previous period lies in the fact that the value-added tax self-liquidation, that is the accounting entry 4426 = 4427 is made only on the purchaser's side, being reflected in the VAT return and in the verification balance sheet.

3. Conclusions

We draw the conclusion from the above-mentioned that in our country there is an interdependence between accounting and taxation and the fiscal regulations influence more often than not the way fiscal liabilities are determined and registered in accounting.

The simplification measures on reverse charge have facilitated the cash settlement process of the value-added tax between economic agents and between these and the general consolidated budget in the case of certain assets.

This procedure was introduced in order to control tax avoidance in the field of trade with ferrous and non-ferrous metal waste, with lands and buildings or building parts, woody material, buildings-assembly works, measure that is also used in other European states to prevent the budget refund of amounts that it did not collect.

Therefore these transactions remain taxable, but the value-added tax is no longer actually paid between the economic agents registered for VAT purposes, it is no longer paid to the general consolidated budget and it is not recoverable anymore, thus improving the management and collection of value-added tax by reducing the number of applications for refund, eliminating the possibility to refund from the state budget amounts that were not collected and thus relieving the territorial fiscal bodies from the checks they had to perform in order to solve the applications for VAT refund.

Being applied to deliveries of immovable assets and to lands, it controls the fraud that may occur if these assets are initially sold with a small amount and after successive transactions their value increases up to the last link that requires value-added tax refund, without being paid to the general consolidated budget if one trader disappears from the circle and does not collect the value-added tax.

In order to apply correctly the simplification measures regarding the reverse charge, the following *aspects* must be considered:

- the correct classification of goods and services for whose delivery or supply the simplification measures are applied in accordance with the provisions of the regulatory acts in force;
- the mandatory condition for application of the reverse charge is that both the supplier and the beneficiary be taxable persons registered for VAT purposes, being applied only for the operations performed within the country;
- on the invoices issued for deliveries of goods or supplies of services, that are within the scope of the simplification measures, suppliers/performers must enter the mention "reverse charge" without mentioning the afferent tax;
- on the invoices received from suppliers/performers, beneficiaries must enter the afferent tax that they emphasize both as output and input tax, registering it in the purchase journal, in the sales journal and in the value-added tax return, making the entry 4426 = 4427, called self-liquidation of value-added tax, its collection on the level of the input tax being assimilated with the payment of tax to supplier/performer;
- if the beneficiary has a mixed regime of value-added tax and the assets purchased are intended to make operations both with and without deduction right, the amount of the value-added tax shall be determined on pro-rata basis from 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;
- if the supplier/performer is a taxable person with mixed regime, he/she shall include in the pro-rata calculation the value of deliveries or provisions subject to reverse charge. The implementation of simplification measures on reverse charge proved to be difficult for the economic entities after 01.01.2007 because of the difficulties encountered in the classification of services in the category of buildings-assembly works.

References

- [1] Law no. 571/2003 concerning the Fiscal Code, Title VI, Article 160¹ simplification measure in the VAT field in order to control tax avoidance.
- [2] L. Paliu-Popa, *Contabilitatea financiară armonizată, [Harmonized Financial Accounting]*, vol. II, Spirit Românesc Publishing House, Craiova, 2003.
- [3] L. Paliu-Popa, *Contabilitate financiară II, [Financial Accounting II]*, Academic Publishing House Brâncuși, Targu Jiu, 2007.