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System of VAT Payable upon Receipt – Facility or Burden?

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Abstract: Amid the growing discontent of the Romanian business environment regarding the collection and hence, payment to the state budget of the value added tax (VAT) related to the claims arising from the goods delivered, work performed or services provided to third parties, claims that, because of the economic and financial blockade mostly created by public institutions are not collected in good time for the payment of the related tax obligations, the State, by Government Ordinance no. 15 from the end of August 2012, "tried" to eliminate this drawback by introducing the system of VAT payable upon receipt. But, on the one hand, the system was applied in a discriminatory manner, since January 1, 2013, only by entities normally registered for VAT, which during October 1, 2011 - September 30, 2012, had a turnover of up to RON 2,250,000 inclusive, and on the other hand, the effect is not what the entities expected, since VAT is not always collected only upon receipt of claims, but also before that time, if the amounts are not received within 90 days. However, VAT deduction is not allowed in the same period from issue of the invoice, if the beneficiary failed to pay the debt, thus violating the principle of neutrality of VAT, circumstances that may adversely affect the taxpayers. In this context, using the theoretical approach and the empirical research, we will prove that the application of VAT system payable upon receipt does not benefit the entities, regardless of the category in which they fall; but the disadvantages outweigh the benefits and the positive effects can be reflected only in the state budget.

Keywords: VAT payable upon receipt, chargeability of VAT, VAT deduction, VAT payment, undue VAT, collection.

1. Introduction

Amid the growing economic and financial deadlock, mostly generated by the state through the public institutions that do not have sufficient cash allocated from the state budget for the payment of liabilities arising from the goods purchased, works or services performed by others, in particular private companies and under the business environment pressure, at the end of August 2012, the Romanian Government was “forced” to issue an order [2] which was initially thought to eliminate the shortcomings caused by the legal provisions in force at the time, [5] in that entities are no longer required to pay value added tax on the income obtained from carrying out the business before its collection from the recipient of goods, works or services.

Although a taxpayer inequity could have been eliminated, we believe that the State enacted the VAT cash accounting system because, in a first stage of implementation, the state budget would have been faced with major imbalances as a result of reduced revenue from VAT collection. Although the system is applied in a discriminatory manner from January 1, 2013, only by entities normally registered for VAT, which during October 1, 2011 - September 30, 2012, had a turnover of up to RON 2,250,000 inclusive, it also draws in its mechanism entities that do not fall into this category, and that have contractual relationship with entities necessarily using this system, and thus being adversely affected by the legislation that “at first sight” does not apply to them.

Using a theoretical approach and empirical research, we will prove that the implementation of VAT cash accounting system is not a tax relief, as presented, as it does not bring benefits to taxpayers, regardless of the category in which they fall. We believe that the positive effects can be noted, at least in the first six months, or longer only at the state budget through a superior collection, because entities accumulate debts outstanding from 2012, which they are going to pay in the first months of 2013, with an average age of six months, so they are unable to pay liabilities for the current year, leading to VAT deduction and therefore reduced VAT to be paid to the state budget.

2 Special features of the VAT cash accounting system. Benefits and drawbacks.

In the context of Romania's accession to the European Union, we can estimate that as of January 1, 2007, there have been significant changes in the tax area, [5] which specifically addressed the value added tax, changes that were imposed by harmonization of the national legislation with that of the EU states, [4] which was subsequently amended, continuously complemented, so as to keep up with the European legislation [3] and to meet the needs of the State regarding VAT contribution to the establishment of the state budget.

Thus, although the common system of value added tax [4] states that the taxable event occurs and, therefore, VAT becomes chargeable when the goods are delivered, the work is performed or services are rendered, there are some exceptions which allow the Member States of the European Union to provide other dates for certain transactions or categories of taxable persons, when VAT becomes chargeable (on the invoice date; in a certain period of time from the taxable event, if the invoice was not issued or was prepared late; no later than the date of receipt of the claim). In addition, the common system of value added, referring to billing, enables the EU Member States to defer the deduction right under an optional system which provides for a certain ceiling for the taxable persons applying it, until the VAT related to the goods purchased, services and work performed for the taxpayer was paid to the supplier. [3]

Therefore, we believe that the tax system applied in Romania as from January 1, 2013, in terms of value added tax, does not comply with the European provisions, because it is not an optional, but a mandatory system, and its introduction is not

a tax relief, but a tool whereby tax authorities, as legislators, are trying, on the one hand, to reduce tax evasion and, on the other hand, to collect a large amount from the value added tax to the state budget, if we consider that in the early months of 2013, entities are unable to deduct VAT for payments of outstanding suppliers on December 31, 2012, and the settlement is necessarily done in order of age. [1, 6]

Considering that by applying this system, VAT is collected at the supplying entity, on the invoice receipt date, but no later than 90 days after its issuance, [6] without allowing in return the beneficiary entity to deduct VAT at the same time, it appears that the tax system established does not observe the principle of neutrality in VAT, neither for the entities applying VAT cash accounting as we have shown in the previous presentation, nor for the taxpayers not applying the said system, entities that collect VAT on the invoice date regardless of the beneficiary and deduct VAT on the invoice payment, if the supplier falls into the category of taxable persons applying VAT cash accounting system.

Consequently, we believe that the VAT cash accounting system applicable in a discriminatory manner from January 1, which also contains ambiguities, in that it excludes the transactions settled in cash, although the date of payment/receipt also refers to the date of payment/receipt through pay office, according to the supporting receipts, in addition to not constituting a tax relief granted to taxpayers, leads to increased administrative costs incurred by the entities in order to implement this system and increased operating time for the documents received from suppliers, for which the recipients are required to verify the correct application of VAT cash accounting system by suppliers, by mentioning "VAT cash accounting" on the invoice, referring in this respect to the Records of taxable persons registered for VAT purposes. [7]

Furthermore, changes have been made in both the sales and purchase ledgers of the taxable person applying VAT cash accounting system and in the purchase ledgers of people not applying this system but purchasing from entities applying VAT cash accounting, forms recording for each fiscal period the differences in undue VAT, related, on the one hand, to output VAT, and on the other hand, to input VAT, minimum information necessary both for entities and tax authorities in order to control these categories of taxpayers.

In the context of the above, we'd like to prove next that the application of this system, in addition

to being burdensome for the economic experts in the field, provides taxable persons with no benefits amid the economic and financial deadlock that led to outstanding debts of considerable age, and the positive effects on the cash flow of entities are still long in coming.

Thus, analyzing the trade relations taking place between two entities (supplier and recipient) and

taking into account, for each of them, one of the two categories in which they can be classified in terms of VAT cash accounting system, there appear four combinations for which the method of determining tax chargeability is presented in Table no. 1.

Table no. 1 Chargeability of VAT

Supplier		Recipient		State (Output VAT – Input VAT)
Category	VAT chargeability (VAT collection)	Category	VAT chargeability (VAT deduction)	
Applies the VAT cash accounting system.	On receipt of the invoice, but no later than 90 days from the date of issue.	Applies the VAT cash accounting system.	On invoice payment.	Collects output VAT related to outstanding invoices within 90 days of issue. Zero effect for invoices previously collected.
Applies the VAT cash accounting system.	On receipt of the invoice, but no later than 90 days from the date of issue.	Does not apply the VAT cash accounting system.	On invoice payment.	Collects output VAT related to outstanding invoices within 90 days of issue. Zero effect for invoices previously collected.
Does not apply the VAT cash accounting system.	On the invoice date.	Applies the VAT cash accounting system.	On invoice payment.	Collects output VAT related to the invoices issued.
Does not apply the VAT cash accounting system.	On the invoice date.	Does not apply the VAT cash accounting system.	On the invoice date.	Zero effect.

Commenting on this situation, we must say that, although the recipient fails to pay the commercial debts within 90 days from the date of invoice, the supplier is required to collect VAT related to the invoices issued, without having the legislator enable the recipient to deduct VAT within the same period; a circumstances leading to payment to the state budget of a tax collected by the recipient.

Thus, the State stands to gain when the taxable persons classified in the category of those applying VAT cash accounting system do not receive the amount of claims within 90 days from the date of invoice, which makes us believe that this system is actually deferred payment of VAT and not a tax relief, as wanted by the business environment. Moreover, the State stands to gain, considering that in our country, the average length of payment of commercial debts exceeds by far the limit of 90 days and, in the public institutions and not only there are arrears, particularly to the business environment, whose age exceeds the period established by legislators. The State is also on top if the supplier does not apply the VAT cash

accounting system, being required to collect VAT on the date of invoice to a recipient that does not apply the said system, recipient that can only deduct VAT on the invoice payment.

a) In order to support the previous claims, in what follows we will analyze the fiscal impact as a result of applying this system as of January 1, 2013 at the entity that does not fall into the category of those taxable persons (B), but having trade relations with entities applying this system (A, as a supplier and C, as a recipient). Thus, we believe that the entity subject to the tax study makes purchases in January 2013 in the amount of RON 49,600 including VAT, value also reached by the sales made; both debts and claims are going to be settled at a later date. However, entity B paid outstanding debts worth RON 10,000.

From a fiscal standpoint, because the debt to supplier B, representing purchases made in January, failed to be paid, entity B is unable to deduct VAT; the same treatment of non-deductibility applies to VAT related to the outstanding amount of RON 10,000, paid in

January, outstanding on December 31, 2012. But, the same treatment does not apply to VAT related to the supplies made, which is payable on the date of invoice, resulting for entity B a value added tax to be paid to the state budget in the amount of RON 9,600, which can not be deducted by recipient C, that failed to pay the supplier. Consequently, although entity B does not apply the VAT cash accounting system because it enters into relations with entities applying this tax system, it is required to pay in January the VAT on the invoices issued without being able to deduct VAT for the purchases made and unpaid or for the paid arrears outstanding at the end of the year. However, if the same transactions were carried out in December 2012, when the VAT cash accounting system was not introduced, then entity B had no tax liability, such as VAT, as the output VAT of RON 9,600 was cancelled when closing the VAT accounts with deductible VAT of the same value, corresponding to the monthly purchases made.

If the three taxable persons applied the VAT cash accounting system, then the company B, although paying the amount of RON 10,000, was not able to deduct VAT, as the debts came from 2012, and the unsettled purchases and deliveries of the month did not lead to the chargeability of VAT related to them.

If we consider that the entities applying this tax system can regularly purchase goods or services from a limited number of suppliers then, at the end of 2012, they were likely to have a large number of outstanding invoices, which attracts non-deductibility of VAT related to the payments made, at least in early 2013, depending on the age of the outstanding debts.

b) Based on the previous situation we believe that the three entities apply the VAT cash accounting system, and in January 2013 the same transactions took place, with the specification that the settlements do not occur within 90 days of the invoice date (January 28, 2013).

From a fiscal standpoint, April 2013 (April 29, since according to the provisions of Art. 101 of the Code of Civil Procedure, the days when the time limit began or expired are not taken into account), [6], entity B is required to pay the amount of RON 9,600 as 90 days of the invoice date have past, although the claim was not charged, and in return entity C was not able to deduct VAT.

In this case, as in many other cases that may arise, both for the taxable persons applying the system and for those not applying it, the State is the one that stands to gain, which shows that the entire mechanism of developing the VAT cash accounting

system was designed and created for the State, at the expense of the business environment. The only concession to taxpayers concerns their possibility to choose, for invoices containing multiple VAT rates, partially received/paid, the goods or services covered by the payment/receipt.

In addition, we believe that the large entities that do not apply this system but are adversely affected in terms of tax by the business partners applying the VAT cash accounting system will be forced to select suppliers based on their tax treatment, so as to be able to deduct VAT when the invoice is received from suppliers; VAT which comes to balance the VAT collected at the time of invoicing to recipients, which would eliminate any difficulties in the cash flows. But, by this approach, taxpayers using this system come to be gradually eliminated from the transactional circle of "the great", which leads to difficulties in delivery of goods, performance of works or provision of services to third parties.

3 Conclusions

Without resuming the conclusions already drawn, we estimate that the State stands to gain from this "so-called" tax relief granted to entities by establishing the VAT cash accounting system as of January 1, 2013. In fact, it is only a postponement by 90 days of the payment of VAT related to the invoices issued, which does not come to compensate the "burden" enacted by the State by not allowing the same delay to deduct the VAT corresponding to received and outstanding invoices. Thus, the entities applying this system are forced to collect VAT without being provided in return with the same conditions for deduction, while those that do not fall into the category of entities applying this tax system, collect VAT for all deliveries, without being able to deduct VAT before paying the invoices to the companies applying the VAT cash accounting system, resulting in a breach of the principle of neutrality of VAT.

In order to eliminate these drawbacks, we suggest that the deferment period of VAT chargeability, if settlement is not achieved, should coincide, both upon its collection and deduction, and the VAT cash accounting system should apply to all categories of taxable persons registered for VAT at the end of 2012, thus eliminating the ceiling of RON 2,250,000 established as turnover for VAT for the period October 1, 2011 - September 30, 2012, suggestion which will result in a considerable reduction of the workload imposed

by the audit of entities that are currently applying the VAT cash accounting system.

We also consider that amid a pronounced economic and financial deadlock, the maximum period of 90 days established from the date of invoice is not a realistic time frame; its increase to a minimum of 180 days or its elimination is closer to the reality existing in all entities that accumulate significant outstanding debts and claims; such solution will also facilitate the work of economic professionals who will no longer have to prepare distinct records on terms of collection/payment of claims/debts or chargeability of VAT. If the legislature fails to take into account any of the proposals made, likely to help the business environment in our opinion, and based on the consideration that most of the financial and economic deadlock is due to the state institutions' failure to pay the debts to the private sector, we believe that they should be required to pay at least the VAT included in the invoice, if they failed to pay the outstanding debts within 90 days from the invoice, VAT that the suppliers applying the VAT cash accounting system collect and pay to the state budget. But, we are sceptical about adoption by the State of legislative acts which would not benefit it, given the insufficient revenue to the state budget.

References:

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- [3] *** *Council Directive 2010/45/EU of 13 July 2010 amending Directive 2006/112/EC on the common system of value added tax as regards the invoicing rules*, published in the Official Journal of the European Union no. L 189 of 22 July 2010.
- [4] *** *Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax*, published in the Official Journal of the European Union no. L 347 of 11 December 2006, as further amended and supplemented.
- [5] *** *Law no. 571 of 22 December 2003 on the Tax Code*, published in the Official Gazette no. 927 of 23 December 2003, as further amended and supplemented.
- [6] *** *Code of Civil Procedure*.
- [7] *** <http://www.anaf.ro/public/wps/portal/ANAF/Informatii/Infoagec/TVA>.