VAT in what direction? New approaches concerning the VAT

Anca BUZIERNESCU[1], Alin Stelian SELIȘTEANU[2], Radu BUZIERNESCU[3]
[1,3]The University from Craiova, [2]Romanian Court of Auditors
stelian.selisteanu@rcc.ro, radu@profcons.ro

Abstract. *It is known that, since its introduction, the VAT is the tax with the greatest contribution to the state budget of Romania, of about 46%, according to the budgetary estimations for the year 2017. Despite this fact, our country is confronting with the highest VAT gap from EU, collecting only 70% of what it should cash. In this context, it is very important to urgently adopt some administrative and fiscal measures for the reduction of the tax evasion in the VAT field, as well as measures for the improvement of the VAT collection degree: electronic invoicing, introducing the electronic cash registers, VAT Split, reverse charge.*

Key words: VAT, VAT gap, tax evasion, collection degree, VAT Split, reverse charge.

JEL Classification: H20, H30.

1. Introduction

The value added tax (VAT) is an indirect tax that applies for the added value in every stage of the economic circuit, respectively the production, the services and the distribution, inclusively the sales towards the final consumer. In the VAT context, the value added tax represents the difference between the sales and the purchases of the same stage form the economic circuit.

VAT is a modern tax, introduced in France in the year 1954, initially for services and for the wholesale trade and then generalized, in the year 1968, for other activities too, inclusively for the wholesale trade. Then, other states of the world have adopted the VAT, and the European Union (EU) has declared the VAT as a general tax for the member states, having as a purpose the harmonization of the VAT legislation on the whole territory of the Union, process that is still continuing today. By the way, one of the income sources of the budget of the European Union is represented by the transfer to the Union of a percentage from the estimated VAT to be collected by the member states and thus the resources based on VAT represent a percentage of 15% of the total incomes.

According to the EU Regulation, the member states can apply:

- a standard VAT rate, which should not be smaller than 15% or bigger than 25%;
- two reduced VAT rates, which should not be smaller than 5%.

VAT principles:

- *the universality* (scope) – is applied for all the operations realized by physical or judicial persons, which imply payments, with some exceptions;
- *the territoriality* – refers to the origin of the goods and their destination;
- *the eligibility for deductions* – reflects the fact that the VAT due to the state is equal with the difference between the collected VAT and the VAT that has been paid by purchases;
- *the transparency* – the VAT due to the state corresponds to the added value of the good that has been sold.

- *the uniqueness* – the charged VAT is equal with the VAT resulted by the application of the rates upon the whole fiscal value;
- *the fractionality* – the state charges VAT in every stage of the economic circuit.

2. Considerations regarding the incidence of VAT on the state budget and of the budgetary deficit in Romania

In Romania, the VAT has been introduced by the Governmental Emergency Order no. 3/1993 since the 1st of July 1993, and since then until now the legislation has suffered a lot of modifications, the legislator trying to keep up with the ingenuity of the economic agents that want to optimize, in any possible way, the tax payment.

The VAT rates from Romania, in 2017, are the following:

- *standard 19%*, since the 1st of January 2017;

- *reduced 9%* (drugs, food - exclusively drinks, restaurants, drinking water, fertilizers, accommodation);

- *reduced 5%* (school manuals, newspapers, cinemas, houses with a maximal surface of 120 square meters and maximum 450.000 lei).

In the developed countries of the world, the biggest part of the budget incomes is brought by the direct taxes applied for the profits of the companies (the profit tax) and for the work (income tax). Although, at a first sight, we could say that the direct taxes are the most favorite for the tax evasion (by not registering the incomes, by increasing the expenses, by the undeclared work, etc.), however in these countries the tax evasion, as a part of the hidden economy, is reduced because there is a real respect for the law and really high fiscal civics. Unfortunately, in Romania the accent is put on the indirect taxes (VAT and excise duties), taxes that however depend a lot on the consumption. Exactly from this reason the budget of our country is strongly influenced by the periods of economic recession, moment when the consumption suffers, this fact automatically implying drastic decreases in the cashing towards the state budget.

Even if for Romania it is more comfortable today to reply on the consumption and on the indirect taxes, especially on VAT, this fact does not mean that the tax evasion in the VAT field is reduced; on the contrary, because of the old control and collection technology, our country is on the first place in EU as far as the VAT gap is concerned. The VAT gap represents the non-collection degree of the VAT, which means the difference between the incomes from the VAT that have been expected to be cashed and the effectively collected sums to the state budget. Thus, the non-collection degree of the VAT that has been calculated for the year 2017 by the European Commission for Romania is of 40%. More exactly, the Romanian state collects now, from the VAT, only 11 milliards of Euros from the total sum that should be collected which is of about 18 milliards of Euros.

Practically, Romania, according to the law of the state budget for the year 2017, will have this year incomes at the state budget in sum of 117 milliards lei, from which the VAT will have a percentage of 46%, which means 54 milliards lei. In the same time, our country will face a budget deficit this year too, 2017, as it happened in every year from the last 26 years. This budget deficit will be of about 3% (24,5 milliards lei) from the GDP of Romania for 2017 (815 milliards lei). It results specifically from here the serious impact of the non-collected VAT upon the budget deficit of the state. Thus, an increase of the collection degree of the VAT from 60% to 87%, which means from 54 milliards lei to 78 milliards lei, would cover the budget deficit; without being necessary to apply other urgent measures, such as taxes and duties increases.

By the way, Romania still has the smallest incomes at the general consolidated state budget, as a percentage in the GDP, of only 29% expected for the year 2017, with 20 percentage points under Hungary, with 6 points under Bulgaria and with more than 15 points under the EU average. A country has a functional economy if this percentage is near 50%.

Romania, is still having the smallest budget incomes from EU						
The evolution of the budget incomes in the main countries from the ex-communist group, according to the last forecasts of the IMF (budget incomes as a percentage in GDP, %)						
Year	**EU average**	**Hungary**	**Czech Republic**	**Poland**	**Bulgaria**	**Hungary**
2017	**44,4**	48,8	40,3	39,8	34,9	**28,9**
2018	**44,4**	48,5	40,7	40,3	35,5	**30**
2019	**44,3**	47,2	40,8	40,1	35,3	**30,3**
2020	**44,2**	46	40,9	40	35,3	**30,3**
2021	**44,1**	43,5	40,9	40	35,3	**30,5**
2022	**44**	43,7	40,9	40	35,3	**30,5**
In 2015, the salaries of the budget employees have increased with 9,5%, and in the first nine months of this year with 21,4%. In the first eight months of 2017, the state investments have decreased with more than 50%, to 10,5 milliards lei, from 15 milliard lei in the first eight months of 2016.						

Source: IMF 2017

The evolution of the incomes, of the expenses and of the budget deficit of Romania until 2022, in the last report of IMF			
Year	**Budget incomes (% GDP)**	**Budget expenses (% GDP)**	**Budget deficit (cash, % GDP)**
2016	29	31,4	**2,4**
2017	28,9	31,9	**3**
2018	30	34,4	**4,4**
2019	30,3	34,9	**4,5**
2020	30,3	34,8	**4,5**
2021	30,5	34,7	**4,2**
2022	30,5	34,4	**3,9**

Source: FMI 2017

This problem of the non- collection degree determines Romania to stay a lot behind other member states as far as the integration speed in EU is concerned, the fear being, in our opinion, justified as far as a Europe with two speeds is concerned, competition within which our country is already going with the parking brake on.

✓ *Reasons*

We consider that the reasons for the weak VAT collection and for the very reduced percentage of the general consolidated budget income in GDP, are:

- the tax evasion in the VAT field and in the field of other taxes (carousel VAT frauds, fiscal optimization schemes used to avoid VAT and other taxes);

- an inadequate political attitude, a populist one, which sometimes seems to be done on purpose, being based on practicing some taxes and duties which are too small in certain cases (the tax for dividends, the income tax, etc.), corroborated with the chronic incapacity of collecting even these small taxes;
- the lack of some efficient mechanisms used to collect the VAT and the taxes in general;
- the bankruptcies and the big number of insolvencies faced by the business environment;
- the non-predictability in the field of the taxes and duties.

✓ *VAT gap decreasing measures*

In our opinion there are necessary the following urgent measures for stimulating the volunteer conformation for the correct calculation and for the payment in term of the VAT:

- intensifying the fight against the fiscal fraud;
- increasing the digitization degree for the relation contributor – fiscal authority, by introducing the electronic invoicing system and by using an invoicing software connected to the server of the National Agency of Fiscal Administration;
- introducing immediately the cash registers which should be provided with an electronic journal and the online data transmission towards the National Agency of Fiscal Administration;
- extending the VAT reverse charge;
- modernizing the collection system within the National Agency of Fiscal Administration;
- fiscal inspections mainly based on the electronic control;
- a better cooperation between the fiscal administrations from the member states;
- maintaining and extending the lottery for fiscal bills;
- adopting the Split VAT (deducted) in a formula that should not disturb so much the economic environment.

3. The deduction payment system for the VAT (Split VAT)

One of the measures adopted by the government for the improvement of the VAT collection process is to adopt the deduction payment system for the VAT (Split VAT).

We should mention the fact that this mechanism does not modify the judicial regime for the Value Added Tax as it can be found in the Fiscal Code and its methodological norms of application. Thus, the rules concerning the VAT payment, exercising the right of VAT deduction, elaborating the VAT return and paying the VAT towards the state budget remain unchanged.

However this system changes the VAT payment manner for the clients and which corresponds to the taxable operations, as well as the manner of using the sums representing the VAT that has been collected by the suppliers of goods/services, as we will present in details in the following paragraphs.

Synthetically, the split payment mechanism for the VAT supposes the following:

➢ the taxable persons that have been registered for VAT aims are also obliged to practice the VAT Split and the public institutions that have been registered for VAT aims must open at least an account that should be dedicated for cashing and paying the VAT (the account will be opened at the Treasury and at credit institutions).

➢ the beneficiaries – the public institutions, the taxable persons, excepting the physical persons that have not been registered and that do not have the obligation of being registered for VAT aims (the authorized physical persons, the individual enterprises, the free professions – that have not been registered), have the obligation of paying the VAT corresponding to the taxable operations in the VAT account of the supplier/service performer (in case of a bank transfer).

- the supplier/ service performer is obliged to pay/deposit in his VAT account, the VAT corresponding to the difference between the cashing operations and the cash payments, within a term of 7 working days since the cashing day.
- the supplier/ service performer is obliged to pay in his VAT account, the VAT corresponding to the credit/debit cards cashing operations or with cash substitutes, within a term of 7 working days since the cashing day.
- the sums from the VAT dedicated account are only used by the supplier/ service performer for paying the tax corresponding to his purchases towards his suppliers/ services performers and for paying the tax due to the state budget.
- the owner has the possibility of transferring sums from the VAT accounts into a current account only with the approval of the National Agency for Fiscal Administration, but the sums required for transfer represent the VAT value financed by the owner for the payment of his purchases (VAT corresponding to the taxable purchases paid with cash / using credit/debit cards or cash substitutes) or sums used by him for making payments in the VAT accounts. The National Agency for Fiscal Administration offers a term of maximum 3 working days for the transfer approval.
- the cash withdrawal from the VAT account is forbidden.
- the cash payments or by using the credit/debit cards or cash substitutes cannot be done split.
- in order to exemplify the split payment mechanism for the VAT, we will present, in the following paragraphs, some case studies.

1. The supplier A has issued, after the 1st of January 2018, an invoice towards the Client B, with a value of 238 lei, from which 38 lei as VAT, who will pay after the 1st of January 2018. The supplier A is a taxable person registered for VAT aims and he compulsorily applies the VAT split payment system. Reported to the client's situation, respectively the manner used to do the payment, we can distinguish the following situations:

Client	The payment by bank credit transfer
Taxable person registered for VAT aims– he compulsorily applies the split payment system	The client will do the payment in this way: -38 lei from his VAT account in the supplier's VAT account. -200 lei from his current account in the supplier's current account.
Taxable person unregistered for VAT aims (the companies that apply the special exemption limit for the small companies; associations and foundations)	The client will do the payment in the following way: -38 lei from his current account in supplier's VAT account -200 from his current account in the supplier's VAT account.
Taxable physical/ judicial person, unregistered for VAT aims (Authorized Physical Persons, Individual Enterprise, etc.)	The client will do the payment in the following way -split payment of 200 lei in the current account and 38 lei in the VAT account or - 238 lei in the current account; the supplier is obliged, in a term of 7 working days, to transfer in his own VAT account the sum of 38 lei.

Payment using the credit/ debit card–for all the categories of clients	The client does not realize a split payment. The client pays 238 lei from his current account in the supplier's current account. The supplier is obliged to pay 38 lei in the VAT account, in a term of 7 working days since the cashing day.
Cash payment – for all the categories of clients	The client does not realize a split payment. The supplier is obliged to deposit/ pay in the VAT account the sum of 38 lei, in a term of 7 working days since the cashing day. If, on that day, the Supplier has also done cash payments in sum of 119 lei from which 19 lei as VAT, the Supplier is obliged to deposit in the VAT account the sum of 19 lei, in term of 7 working days.

2. The supplier A has issued, before the 1st of January 2018, the invoice towards the Client B, in sum of 238 lei, from which 38 lei as VAT, who pays after the 1st of January 2018. The supplier A is a taxable person registered for VAT aims and he compulsorily applies the VAT split payment system.

Payment by bank credit transfer All the categories of clients	The client will do the payment in the following way: - split payment - 200 lei in the current account and 38 lei in the VAT account or - 238 lei in the current account; but the supplier is obliged to transfer in his own VAT account, in term of 7 working days, the sum of 38 lei.

3. The supplier A has issued after the 1st of October 2017, an invoice towards the Client B, with a value of 238 lei, from which 38 lei as VAT, who will pay in the period: 1st of October 2017 – 31st of December 2017. The supplier A is a taxable person registered for VAT aims and he has chosen to apply the VAT split payment system since the 1st of October 2017. Reported to the client's situation, we can distinguish the following situations:

Client	The payment by bank credit transfer
Taxable person registered for VAT aims– he applies, by his option, the split payment system	The client will do the payment in this way: -38 lei from his VAT account in the supplier's VAT account. -200 lei from his current account in the supplier's current account.
Taxable person unregistered for VAT aims (the companies that apply the special exemption limit for the small companies; associations and foundations)	The client will do the payment in the following way -split payment of 200 lei in the current account and 38 lei in the VAT account or - 238 lei in the current account; the supplier is obliged, in a term of 7 working days, to transfer in his own VAT account the sum of 38 lei.

Taxable physical/ judicial person, unregistered for VAT aims (Authorized Physical Persons, Individual Enterprise, etc.)	The client will do the payment in the following way -split payment of 200 lei in the current account and 38 lei in the VAT account or - 238 lei in the current account; the supplier is obliged, in a term of 7 working days, to transfer in his own VAT account the sum of 38 lei.

4. The supplier A has issued, before the 1^{st} of October 2017, an invoice towards the Client B, in sum of 238 lei, from which 38 lei as VAT, who pays in the period: 1^{st} of October 2017-31^{st} of December 2017. The supplier A is the taxable person, registered for VAT aims and he has chosen to apply the VAT split payment system since the 1^{st} of October 2017.

The payment by bank credit transfer All the categories of clients	The client will do the payment in the following way -split payment of 200 lei in the current account and 38 lei in the VAT account or - 238 lei in the current account; the supplier is obliged, in a term of 7 working days, to transfer in his own VAT account the sum of 38 lei.

5. Taxable person registered for VAT aims, who has in his VAT account the sum of 1000 lei, from which he pays the VAT in sum of 700 lei, corresponding to the taxable purchases in the suppliers' VAT accounts. The company has to pay towards the state budget the VAT resulted from the expense account in sum of 500 lei. In order to do the VAT payment towards the budget, the taxable person will transfer, from his current account in the VAT account, the sum of 200 lei and then he will do the VAT payment towards the budget, in sum of 500 lei. Then, he can ask, from the National Agency for Fiscal Administration, the approval for the transfer of the sum of 200 lei, from the VAT account in his current account, opened at the same credit institution/ from the VAT account, opened at the Treasury, in his current account opened at the Treasury.

At the elaboration date of this article, the measure for the VAT Split is in a process for the Parliament's approval, thus it will suffer some modifications, in the sense of restraining its compulsory application since the 1^{st} of January 2018, only for the private and public companies that are subjected to an insolvency process or that have some debts towards the state budget.

4. Conclusions

From the facts presented above, it results, without any doubt, that the < VAT Split > mechanism, with the general and compulsory application, presents some clear advantages for the state budget but also some major disadvantages for the persons that have been registered for VAT aims, generated by the high costs for the implementation of the mechanism necessary to adopt the computer systems, for the additional staff who is necessary in order to process the payments, the payments of banking commissions, the insufficient time of the system implementation. But, the biggest effect will be felt by the small companies, whose cash flows will be blocked, they being thus obliged to attract new financing resources.

The VAT is the main contributor to the state budget and, unfortunately, it is not used at its maximal capacity. Exactly from this reason, it is necessary a reorganization of the way of thinking the fiscal policy as far as the VAT is concerned, and, from this point of view, the Split VAT could be a beginning.

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