

METHODOLOGICAL AND PRACTICAL ASPECTS CONCERNING THE VAT COLLECTION SYSTEM

Case study made in a company operating in the construction sector

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Abstract

This paper presents the impact of the collected VAT on a company acting in the construction field in the current economic environment; the study is based on data provided by the company before and after applying the VAT collection system. The research reflects the VAT payable on State Budget three times: before its entry into the system, its activity during the application system and its situation in 2014 when the company can choose between staying in the system or getting out of it. The research method consisted in reviewing approaches made in the literature, articles and specialized studies in national and international journals. We followed a detailed approach of the effects generated by the VAT collection system among companies acting in the construction field and we made a case study based on the activity of the construction companies before applying the system and their option to stay or exit the VAT collection system.

Key words: *VAT, collection system, construction sector, deductible VAT*

JEL CODE: *H71, H25*

1. Introduction

The most important indirect tax is the value-added tax (VAT), which was introduced in Romania under the conditions of transition to the market economy, and apply throughout the economy to the end user, only the value added at each stage of this circuit.

Entities are obligated to collect the tax on behalf of taxation and to pay the difference between the VAT collected and deductible VAT to the State budget.

In economic terms, the added value is an indicator that allows the measurement of the newly created value of an entity as a result of its work and has implications regarding the profitability of the entity.

In 2013 taxpayers who had a business in Romania under Article 125¹ paragraph (2), lit. of Law no. 571/2003 regarding the Fiscal Code as amended and supplemented and whose turnover for the period October 1, 2011 - September 30, 2012 did not exceed the sum of 2.250.000 lei applied a VAT collection system referred to in Article 134², paragraph (3) of Law. 571/2003 as amended and supplemented beginning with January 1, 2013.

Provisions of the Tax Code and norms on VAT collection system application provide that where persons obliged to apply this system and who have not received full or partial value of the supply of goods or the provision of services within 90 days from the date of invoice calculated in accordance with the Civil Procedure Code, the liability for unpaid tax intervenes in the 90th calendar day after the date of invoice.

Under the current legislative provisions the right of deduction of VAT on sales made by a taxable person is deferred until the tax on the goods and services that have been delivered or rendered was paid to the supplier / provider even if some of the operations of the taxpayer are excluded from the VAT collection system. In other words the legislative provisions of the Tax Code defer tax deduction for purchases of a taxpayer applying VAT collection system until the total or partial invoice payment to the supplier / provider.

Applying this system was supposed to lead to economic growth, to a reduced unemployment rate and to increase Romania's competitiveness in attracting foreign investment and in ensuring a fiscal framework to support SMEs with the main aim of increasing the velocity of money in the economy and efficient collection of VAT .

However after one year from its implementation in January 2014 major changes have taken place in the application of VAT collection system in Romania. Thus according to Government Emergency Ordinance no. 111/2013 published in the Official Gazette on December 19, 2013 regarding the tax measures to amend certain acts, the system becomes optional for taxpayers whose turnover in the previous calendar year does not exceed the threshold of 2.250.000 lei .

According to NAFA taxable persons who on January 1, 2014 apply VAT collection system have the following possibilities:

* Whether they continue the application of the system: without filing any notice provided they are eligible for applying the system;

* Whether they require removal from the register of taxable persons applying VAT collection system by sending a notification to the competent tax authorities at any time during the year 2014. This provision shall not apply to taxable persons who are registered for VAT in the year 2014 and opting for application of the VAT receipts which are required to operate the system until at least the end of 2014 unless they exceed the sum of 2.250.000 lei.

In case of taxpayers who continue applying the VAT collection system and those leaving the system for the operations whose chargeable event occurred until December, 31, 2013 and for the invoices issued before that date where the 90th calendar day after the invoice date or deadline required by law to issue the invoice is after December 31, 2013 the chargeability of tax occurs on full or partial consideration receipt of the goods delivered / services.

2. The VAT collection system applied in the construction sector

To reflect from practical point of view at the application of the VAT collection system in the construction field we conducted a case study based on data from a construction company that performed work replacing the water pipe in a village of Timis County. The analysis reflects the situation of the company:

* before applying the VAT collection system;

* input in the VAT collection system;

* option to cancel or continue the application of the VAT collection system.

From the data provided by the company to carry out the work of replacement of water pipe, direct expenditures are presented in the table below:

Table no.1 The amount of direct costs- partial data

| Nr.crt | Direct costs | Value: lei |
|--------------|--------------|-------------------|
| 1. | Materials | 335.423,38 |
| 2. | Labour | 157.638,95 |
| 3. | Machinery | 74.431,23 |
| 4. | Transport | 12.375,00 |
| TOTAL | | 579.868,56 |

Source: own interpretation after the estimate

At these direct expenditures, specifically at labour costs, we add the contribution due by the company to the State Budget and in this way we achieve a complete picture of the direct costs necessary for carrying out the work.

(1) contribution to the social insurances:

157.638,95 lei * 0,20800 = 32.788,90 lei

(2) the social insurance contribution of unemployment:

157.638,95 lei * 0,00500 = 788,19 lei

(3) the contribution to the guarantee fund:

157.638,95 lei * 0,00250 = 394,10 lei

(4) contribution to social health insurance:

157.638,95 lei * 0,05200 = 8.197,23 lei

(5) the contribution of risk and accident insurances:

157.638,95 lei * 0,00306 = 482,38 lei

(6) the contribution for medical holidays:

157.638,95 lei * 0,00850 = 1.339,93 lei

(1) + (2) + (3) + (4) + (5) + (6) = 43.990,73 lei

If we add the amount of 43.990,73 lei to the labour costs, the total direct expenditure is shown in the following table:

Table no.2 The amount of direct costs – final data

| Nr.crt | Direct costs | Value: | lei |
|--------------|--------------|-------------------------|-------------------|
| 1. | Materials | | 335.423,38 |
| 2. | Labour | 157.638,95 + 43.990,73= | 201.629,68 |
| 3. | Machinery | | 74.431,23 |
| 4. | Transport | | 12.375,00 |
| TOTAL | | | 623.859,29 |

Source: own interpretation after the estimate

Graphic, the structure of the direct expenditure is reflected in the following chart:

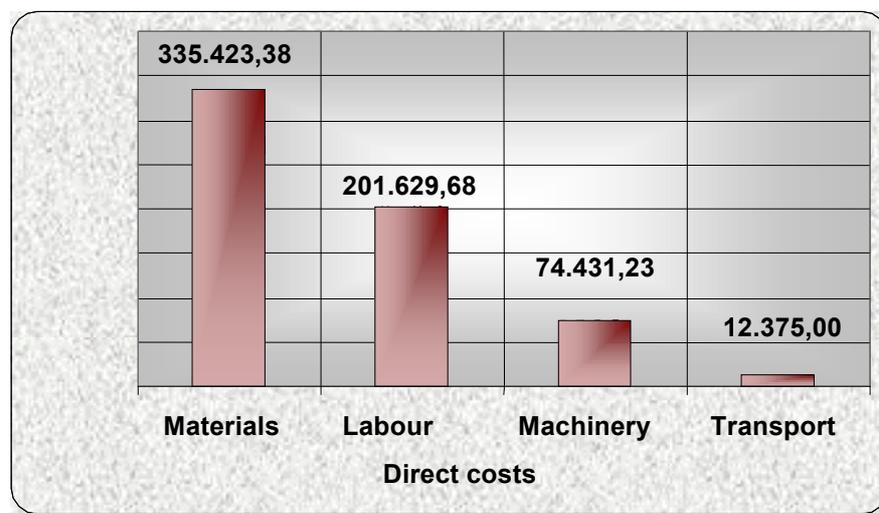


Figure no.1 The structure of direct costs

Source: own interpretation after the estimate

As can be seen from the figure, the materials used to carry out the replacement of water pipe have the highest value, respectively 335.423,38 lei, from the total of direct expenditure, namely 623.859, 29 lei. As a percentage, the value of materials in the total of direct expenditure is 54%. The costs of Labour rises to the level of 201.629,68 lei and represent 32% of the total direct expenditure. The cost of the machinery used in production has a value of 74.431,23 lei, and as percentage in the total costs represent 12%. The costs of transport represents 2% of total direct costs, namely 12.375 lei.

To calculate the indirect costs, on the total of direct expenditures the company applies a percentage set at 6% to carry out the work of replacement of the water pipe.

By multiplying the direct expenditures with 6%, we will find the value of the indirect expenditures:

$$\begin{aligned} \text{Direct expenditures} * 6\% &= \text{indirect expenditures} \\ 623.859,29 * 0,06 &= \mathbf{37.431,56 \text{ lei}} \end{aligned}$$

The sum of direct and indirect expenditures is:

$$\begin{aligned} \text{Direct expenditures} + \text{indirect expenditures} &: \\ 623.859,29 + 37.431,56 &= \mathbf{661.290,85 \text{ lei}} \end{aligned}$$

The company's profit is calculated by applying a percentage, in this case, 4% over the amount of direct and indirect expenditures:

$$\begin{aligned} \text{Company's profit} &= (\text{direct expenditures} + \text{indirect expenditures}) \\ &= 0,04 * 661.290,85 \\ &= \mathbf{26.451,63 \text{ lei}} \end{aligned}$$

For services carried out for the customer the company collects VAT in a percentage of 24%. This rate applies to the total cost of the order and is calculated according to the following formula:

Total cost of the order:

$$\begin{aligned} \text{VAT} &= 24\% * (\text{direct expenditures} + \text{indirect expenditures} + \text{profit}) \\ &= 0,24 * 687.742,48 \\ &= 165.058,20 \text{ lei} \end{aligned}$$

Having the value of the direct and indirect expenditures and the calculated profit, we can build the estimate for the replacement of water pipe.

Table no. 3 The estimate of the work

| Nr.crt | Specification: | Value: | lei |
|--------|------------------------------|--------|------------|
| 1. | Total direct expenditures | | 623.859,29 |
| 2. | Total indirect expenditures | | 37.431,56 |
| 3. | Profit | | 26.451,63 |
| 4. | TOTAL ESTIMATE (1+2+3) | | 687.742,48 |
| 5. | VAT | | 165.058,20 |
| 6. | TOTAL ESTIMATE + VAT (4 + 5) | | 852.800,68 |

Source: own interpretation after the estimate

Graphic, the estimate is reflected in the following chart: chart no.2

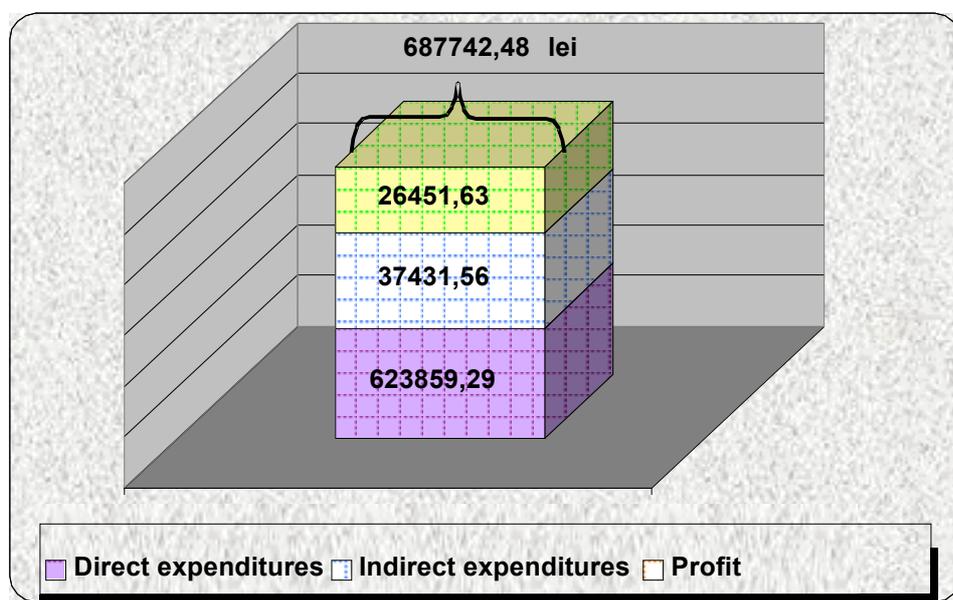


Figure no.2 The estimate of the order

Source: own interpretation after the estimate

As can be seen from the figure no. 2, the direct expenditures used to carry out the replacement of water pipe have the highest value, respectively 623.859,29 lei, from the total of the order, namely 687.742,48 lei. As a percentage, the value of direct expenditures in the total of the order is 91%. The indirect expenditures rise to the level of 37.431,56 lei. The company's profit has a value of 26.451,63 lei, and as percentage in the total order represents 4%.

I. Before the entry into the VAT system

Before the application of the VAT receipts when purchasing materials on the invoice issued by the supplier, the VAT registered in those documents represented the deductible VAT of the construction company whether such purchase invoices were paid or not. The VAT highlighted on the construction company invoice emitted for work represented the VAT collected whether or not the invoice was paid by the beneficiaries.

Applying this mechanism and on the estimation previously given at the end of the reporting period, the construction company registered the following results:

Table no. 4 VAT calculation:

| Nr.crt | Specification: | Value: | lei |
|--------|---------------------------------------|--------|------------|
| 1. | Collected VAT | | 165.058,20 |
| 2. | Deductible VAT (335.423,38lei*24/124) | | 64.920,65 |
| 3. | Payable VAT | | 100.137,55 |

Source (own interpretation after the estimate)

As we can see from the calculations, the VAT collected by the company exceeds the amount of VAT to be deducted by the State, which is why the company has to pay the difference between the two values to the State Budget.

II. The activity during the application system

Since the turnover recorded by the company was below the threshold of 2.250.000 lei, in 2013 the analyzed company mandatory follows the VAT collection system and therefore we can observe the following:

* Provided that the company has negotiated flexible payment terms with suppliers and has collected bills charged to beneficiaries, the company was in a position where it had to pay the VAT collected directly to the state budget without having the right to deduct VAT on purchases without paying the suppliers' invoices.

Given that the company does not charge for services rendered to beneficiaries, in 90 days from the date of issue of the invoice the chargeability tax intervenes. This aspect generates:

* on the one hand the lack of funds necessary to pay the bills to suppliers – mandatory condition for deduction of VAT on purchases;

* and on the other hand the obligation to pay VAT on invoices issued after the expiry of 90 calendar days although the bill was not paid by the beneficiaries.

As far as we can see from the foregoing facts the VAT collection system hampered the running of the business creating a need for additional short-term financing to pay maturing obligations. The implementation of the system from administrative point of view produced among others changes in the accounting program; has been added to invoices the mention "VAT receipts" and it was necessary to establish an additional declaration in order to enter the system.

Designed to release liquidity into the market and to help companies in difficult economical times the system has proven to be a deferred payment until the 90th day from receiving the invoice which does not bring significant benefits to taxpayers. Thus in 2014 an EO regulation no.111/2013 stipulates that the chargeability of tax occurs in full or partial consideration of the goods delivered or services rendered and not after 90 days from the issuance of the invoice; the system also becomes optional for taxable persons whose annual turnover does not exceed the threshold of 2.250.000 lei.

III. Abandon or continue to apply the VAT collection system?

Being able to choose and considering the events in 2013, beginning with 2014 the company decided to abandon the implementation of this system. This decision was made because in 2013 the company has encountered difficulties in cashing services and this aspect has led to delays in paying suppliers and state obligations.

3. Conclusions

After studying current legislation and the survey we concluded that the application of VAT collection system has advantages, but also a number of disadvantages.

Among the advantages of applying VAT collection system are included:

- easing short-term cash-flow for entities who collect with delay their issued invoices
- helps to combat tax evasion
- advantage to work with customers like public institutions and entities providing services is the fact that VAT is deferred for 90 days, but in practice it translates differently not only by the activity, but also in the economic sector in working on supplies and purchases, the time of collection / payment of customers / suppliers, mode of financing.

Among the disadvantage of VAT collection system we mention:

➤ tax inequities:

This system does not applies to all entities, only those with turnover of less than £ 2,250,000, with negative effects on entities that exceed this limit in terms of how the deduction of VAT; If the invoice is not received in full within 90 days of issue, the seller is obliged to collect VAT on the 90th day of issue. This violates a balance that was set so far and allowed VAT to be neutral: the relationship between trading partners, the client deduct the date on which a provider collect and owed the state budget and the tax becomes payable on the merits of the final consumer, only its value is sometimes distributed between two or more links into a "market chain" the merchant producer-consumer relationship.

➤ violation of the Tax Code:

Taxes and fees regulated by tax code are based on the following principles:

* neutral fiscal measures in relation to various categories of investors and shareholders with ownership, ensuring equal conditions Romanian capital and foreign investors;

* certainty of taxation, by developing clear legal rules that do not lead to arbitrary interpretation and timing, manner and amount of payment to be precisely set for each payer that they can follow and understand the tax burden they bear and be able to determine financial management influence their decisions on their tax burden;

➤ technical problems:

Technical problems in achieving financial and accounting records are found especially in the small entities that do not have high performance software for personal or domestic service. These entities have opted for outsourcing to external providers to reduce costs, and they will practice an increase in tariffs, the cost to taxpayers, because they have to keep records on the timing and amount of revenue analytical and VAT on the way separately for each transaction. Formats Journals for purchases and sales, according to the tax code will be more complicated.

In its first form the VAT collection system caused difficulties in the activity of the analyzed company taking into account the fact that the construction field is still vulnerable to the economic crisis. Investments in this sector dropped considerably and the contracted value of the works has not been paid in full and in due time by the beneficiaries which has led to chain negative effects:

1. the construction company has not received invoices but the VAT written on the invoice had to be paid on the chargeability of 90 days,
2. providers were not paid on time due to lack of money and VAT could not be deducted,
3. VAT invoices issued by the manufacturer had to be paid to the State Budget in order to avoid injunctions, enforcement and garnishment of bank accounts.

The new form of the VAT collection system eliminates bottlenecks in the construction companies so that the VAT collected is paid to the State Budget when it collects the invoices and not at the chargeability of 90 days; thus VAT is deducted when the payment is made to suppliers.

4. References

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