

ACCOUNTING TREATMENT OF TRANSACTIONS WITH PARTNERS WITH INVALID VAT CODE

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Abstract: *The value added tax is an indirect tax payable to the state budget. Its complexity lies in the application of rights and obligations regarding the exercise of the right of deduction or collection. The paper deals with practical aspects of tax deduction and collection in relation to the quality of trading partners, and the reflection of these transactions into accounting. The research method used is the case study. The aim of the research is to highlight the accounting treatments related to the peculiarities of the commercial transactions with partners with the cancelled VAT code.*

Keywords: *VAT, accounting treatment, tax treatment, deduction - collection, VAT code cancelled.*

1. Introduction

The value added tax is an indirect tax payable to the state budget resulting from economic transactions. The final customer bears this tax; the economic entities play an intermediary role only.

The value added tax appeared for the first time in France in 1954 as an alternative to the sales tax. In Romania, VAT was introduced in 1992 and aimed at replacing the tax on the movement of goods.

The Value Added Tax mechanism assumes the existence of transactions between commercial partners who hold the status of taxpayer.

Taxpayer means any person who independently carries out any business, whatever the purpose or results of that activity (Directive 112/2006). “Any person” means the individuals and legal entities, a group of people, public institutions that independently conduct any kind of business in any manner or purpose.

The activity of producers, traders or persons providing services, including mining and agricultural activities, and activities carried out in liberal professions are considered to be economic activity. The exploitation of tangible or intangible assets for the purpose of making continued income is also considered to be economic activity (Directive 112/2006).

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Transactions that fall within the scope of VAT are those that meet the following conditions: deliveries of products / provision of services against payment or similar operation, the place of delivery / provision is in Romania, are made by taxpayers and are the result of businesses. Imports of products, intra-Community acquisitions and similar operations fall within the scope of VAT (Law no. 227/2015 – Fiscal Code).

The value added tax instrumentation involves the deduction and collection of the tax and the generating factor, according to tax regulations.

We must remember that the generating factor represents the coordinates by which the legal conditions for tax chargeability are achieved. The chargeability outlines the nature of the obligation according to which the person has the obligation to pay the tax to the state budget (Law no. 227/2015 – Fiscal Code).

There are practical situations when transactions can be conducted between partners in which one of the participants may have the VAT code cancelled.

VAT code cancellation is made when the taxpayer (Law no. 227/2015 – Fiscal Code):

- has been declared inactive in terms of tax;
- the taxpayer, the shareholder or its associate have committed offenses or acts of an economic nature that have been entered in the tax record;
- no VAT return has been submitted during one calendar semester;
- the company is in temporary inactivity declared at the trade register;
- the VAT returns submitted for two consecutive fiscal periods do not contain purchases and sales of goods or services.

An entity with the cancelled VAT code has the obligation to collect the pay the entire tax to the state budget. On the other hand, customers of this entity are not entitled to deduct the tax paid for the assets and services purchased within the economic circuit.

In this context, the consequence for the client is the increase in the cost of purchasing goods and services with the VAT share, implicitly reflecting on performance (Baba, 2011).

2. Research Methodology

The study seeks to analyse the impact on the performance of an entity derived from transactions with suppliers with the cancelled VAT code. The main goals pursued are:

- ✓ identification of tax legislation;
- ✓ verifying the status of a taxpayer for the purposes of VAT of the trading partner;
- ✓ reflecting the accounting treatment applied to transactions between trading partners, one of which is a taxpayer with an invalid VAT code;
- ✓ Identifying the influence of the operation resulting from an operation with a partner with invalid VAT code;
- ✓ presentation of results in tabular form.

The research methodology used includes the study of specialized literature with tax incidence, the observation, comparison, and the case study. The case study is carried

out by examining the activity of an entity registered for VAT purposes and highlighting transactions relevant to the objectives pursued in the paper.

3. Research Results

The value added tax is the most difficult indirect tax to apply, the difficulties arise not because of the tax itself, but rather due to the complexity of the transactions carried out.

The value added tax mechanism involves the deduction right under the Directive 112 (EEC Directive 112/2006) is the right of the taxpayer to deduct from the payable VAT, the VAT due or paid for the assets purchased and for the services previously received by it.

This is a fundamental principle of the common VAT system established by European Union legislation transposed into the national regulations.

The national tax legislation punishes the conduct of taxpayers registered for VAT purposes with invalidation of the VAT code, so that the collected tax is fully transferred to the state budget. This also reflects on the partner purchasing goods and services with respect to deduction of the VAT related to the upstream transaction by not recognizing its right.

For study purposes, we have examined the transactions performed by **SUN SRL** in the situation where the partner has the VAT code invalidated compared to the case where the VAT code is valid.

Case A. The partner has the VAT code cancelled /invalidated

Over a management period the entity purchased a batch of goods for resale through the wholesale store, worth 8,500 lei and 19% VAT, based on the invoice issued by the supplier.

In order to translate the transaction into accounting, the following working methodology is performed (Andone et al., 2011):

- ✓ the analysis of accounting documents in terms of substance and form or content;
- ✓ verifying the supplier's status in the Taxpayers Records registered for tax purposes;
- ✓ establishing the accounting and tax treatment of the transaction in relation to the supplier's status;
- ✓ recording the operation in the accounting.

According to the analysis carried out, the transaction complies with the substantive form requirements necessary for exercising the right of deduction (Law no. 227/2015–Fiscal Code), although the results of the check in the Taxpayers Register indicate that the partner's VAT code is cancelled, suggestively reflected below (Bâtcă-Dumitru, 2017).

Taxpayers Register registered for VAT purposes

Table 1

Ref. no.	Previous date of registration for VAT purposes	Date of cancellation of registration for VAT purposes	Invalidation of registration for VAT purposes was performed on	The legal basis for the cancellation of registration for VAT purposes
1	27/10/2008	01.11.2018	01.11.2018	Cancellation of VAT registration ex officio, according to Art. 316 para. 11 (d)

Source: <https://www.anaf.ro/RegistruTVA/searchVAT>

The acquisition accounting treatment is technically explained as follows (OMFP Guide 1802/2014):

%	=	401 "Suppliers"	10,115
371 "Goods purchased for resale"			8,500
4426 "Input VAT"			1,615

The tax treatment of value added tax that became non-deductible is:

371 "Goods purchased for resale"	=	4426 "Input VAT"	1,615
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The sale of commodities to customers at the value of 14,000 lei and 19% VAT is reflected in this way:

4111 "Customers"	=	%	17,850
		707 "Sale of goods purchased for resale"	15,000
		4427 "Output VAT"	2,850

At the same time, decommissioning of the commodity stock:

607 "Goods for resale"	=	371 "Goods purchased for resale"	10,115
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Implications on value added tax

4427 "Output VAT"	=	4423 "VAT payable"	2,850
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The study shows the increase in the cost of purchasing the goods with the value of 1,615 lei representing the VAT deductible paid to the supplier with the VAT code invalidated - non-deductible VAT - and the payment to the state budget of the tax in the amount collected.

Case B. The partner has the VAT code valid

In this situation, the resumption of operations in the entity's accounting is set out below:

Purchase of commodities in the amount of 8,500 lei and 19% VAT, according to the

invoice:

%	=	401 "Suppliers"	10,115
371 "Goods purchased for resale"			8,500
4426 "Input VAT"			1,615

The sale of commodities to customers at the value of 14,000 lei and 19% VAT is reflected in this way:

4111 "Customers"	=	%	17,850
		707 "Sale of goods purchased for resale"	15,000
		4427 "Output VAT"	2,850

At the same time, decommissioning of the commodity stock:

607 "Goods for resale"	=	371 "Goods purchased for resale"	8,500
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Implications on value added tax

4427 "Output VAT"	=	4423 "VAT payable"	1,235
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The study reveals a decrease in the expenses on commodities and, implicitly, the VAT due to the state budget. Accurate reflection of the results of the research carried out is shown in the table below:

The impact of the VAT code invalidation on the result Table 2

Ratios (LEI)	Case A - VAT code invalid	Case B - VAT code valid
Turnover	15,000	15,000
Goods for resale	10,115	8,500
Other operating expenses	2,000	2,000
Result	2,885	4,500

The analysis carried out, shows, in the case of A compared to the case B, the increase in the cost of purchasing commodities with the value of 1,615 lei, representing the VAT deductible paid to the supplier with the invalid VAT code. Under such conditions, the transaction leads to the payment to the state budget of the tax in the amount collected with impact on the liquidities and, on the other hand, the decrease of the result of the entity (Baba, 2001).

4. Conclusions

Invalidation of the VAT code of a taxpayer is essentially a sanction imposed by the authorities as a result of inappropriate tax behaviour with implications for tax deduction operations. The complexity of applying the right of deduction has given rise to a series of disputes between taxpayers or between taxpayers and the tax authorities (Anton, 2018).

As a harmonized tax at European level, the Court of Justice of the European Union

(CJEU) resolves the issue regarding the rights of taxpayers. It is called upon to rule on the way in which national VAT regulations converge with EEC Directive 112/2006 on the common system of value added tax. Through a constant case-law, the Court holds that the right to deduct VAT is an essential one for taxpayers (C.J.U.E. C101/16).

The study shows that transactions made with partners with invalid VAT code influence the cost policy and, implicitly, the performance of the entity. The fee paid becomes an unpredictable cost with implications for the result of the activity. In these circumstances, a rigorous selection of suppliers is required so that the fee is not part of the acquisition cost. The non-recognition of the right of deduction, with implications for the performance and flow of liquidity, has determined the national regulator to align with the case law of the European Court of Justice.

Hence, entities that had their VAT code invalidated ex officio, when they recover the VAT code or eliminate invalidation, are entitled to VAT deduction from the period their code was invalidated. The supplier will communicate to the partner, reversal and correction invoices for VAT deduction.

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