VAT CASH ACCOUNTING SCHEME IN ROMANIA

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Abstract:
VAT cash accounting enables the small enterprises to account for VAT on the basis of payments received and made, instead of on tax invoices issued and received. Accordingly, the VAT payable or repayable for each accounting period is the difference between the total amount of VAT included in payments received from the customers and the total amount of VAT included in payments made to the suppliers.
The VAT cash accounting scheme, recently introduced for the Romanian companies by Government Ordinance no. 15/2012, entered into force on January 1st, 2013.
This article reviews the basic principles of VAT cash accounting and highlights its benefits and disadvantages. It also discusses the impact and the challenges for the Romanian companies, due to the particularities of the system.

Key words*: VAT, VAT cash accounting scheme, VAT chargeability, date of payment*

JEL classification*: M41, M48*

1. Introduction

The VAT cash accounting scheme is a simplified optional tax scheme intended for small companies that do not qualify for tax exemption. It enables the eligible tax payers to apply a simple rule based on the date of payment for their input and output transactions, to determine at what point they must exercise their right to deduct VAT and pay the tax to the revenue authorities.

Generally, this scheme creates a cash-flow advantage in particular for those companies whose expenditure is mainly not liable to VAT, such as salaries, or for those that are subject to large delays in payment by their customers which they cannot impose on their suppliers [1]. The positive impact consists in maintaining an optional cash accounting scheme aiming to simplify the application of the VAT rules by small companies while improving their cash-flow situation.

2. VAT cash accounting scheme – the basics

Taxable person may opt for standard VAT scheme or simplified procedures. One of the simplified procedures is "VAT cash accounting scheme" based on which tax is accounted for on the basis of cash paid. A brief comparison between the standard VAT accounting and the VAT cash accounting emphasizes the following important differences:

- using standard VAT accounting scheme, on the accrual basis, the companies pay VAT on any invoice they have issued, even if the payment from the customer has not yet been received, and reclaim VAT on any invoice they have received, even if the supplier has not yet been paid;
- using the cash accounting scheme, the companies pay VAT on their sales when they receive the payments from their customers, and reclaim VAT on the purchases when they pay their suppliers [2].

VAT on sales (output tax) should be accounted for on the VAT return for the accounting period in which the company receives a payment from its customer. For the

purposes of the scheme, the date of the payment depends on the payment method. The rules are as follows:

- if the customer pays in cash, the date of the payment is the date that the company receives the amount;
- if the customer pays by bank transfers like giro, standing order or direct debit, the date of the payment is the date that the bank account is credited with the payment [3].

VAT on purchases and expenses (input tax) can be reclaimed on the VAT return for the tax period in which the company makes a payment to the supplier. The date of the payment depends on the payment method. The rules are as follows:

- if the company pays in cash, the date of the payment is the date that the company pays the amount; a receipted invoice is needed to claim back VAT on purchases that have been paid for in cash;
- if the company pays by bank transfers like giro, standing orders or direct debits, the date of the payment is the date that the bank account is debited with the payment [4].

In order to implement the VAT cash accounting scheme the company should be focused on:

- checking the eligibility for applying the scheme;
- evaluating the financial implications on the company's cash flow;
- tracking the cash (the date of the receipts, the payments and the related invoices);
- identifying the moment of VAT chargeability and when the VAT becomes deductible;
- identifying and fulfilling the VAT reporting obligations;
- adapting the accounting and information systems.

When the VAT cash accounting scheme is adopted, the company must adopt some special procedures for sales and purchases, in addition to all required VAT records and accounts for standard VAT. First of all, the company has to keep a record of its cash position. Furthermore, it must also keep track of debtors and creditors, to know the real position with regard to what it owes and is owed.

If the company cashes-in its invoices in cash, it must, if asked by its customer, endorse the customer's copy of the sales invoice with the amount and date paid. If the company pays invoices using cash, it must keep a copy of the purchase invoice endorsed with the amount and date paid.

Regarding the payment records, the company records must clearly cross-refer payments received or made to the corresponding sales or purchase invoices. It must also cross-refer these payments and receipts to evidence such as bank statements or cheque stubs [5].

Few European countries, EU members, apply the VAT cash accounting scheme as a measure derogating from Article 167 of EU VAT Directive (2006/112/EC): Sweden, United Kingdom, Estonia, Slovenia and Latvia.

Sweden and the United Kingdom have been authorised by European Council to introduce the VAT cash accounting as a special measure. The authorisation has enabled them to postpone the right of deduction of VAT until the date of the payment to the supplier in respect of taxable persons with an annual turnover which does not exceed SEK 3,000,000 for Sweden and GBP 1,500,000 for the United Kingdom, allowing them to benefit from the optional scheme of VAT cash accounting, according to which the VAT on their output transactions becomes chargeable when they receive the payment [6].

Estonia and Slovenia, by way of derogation from Article 167 of EU VAT Directive 2006/112/EC, are also authorised to postpone the right of deduction of the VAT of the taxable persons until the date of the payment to the suppliers. The taxable persons concerned must have opted for the scheme under which the VAT on their supplies of goods and services becomes chargeable on receipt of the payment. Under this scheme, their annual turnover must not exceed EUR 400,000 in the case of Slovenia and the equivalent in national currency of EUR 208,646 in the case of Estonia (as of 1st of January 2011) [7]. In Estonia, until this date, cash basis accounting was only allowed for VAT registered sole proprietors.

In Latvia a special VAT payment and input tax reporting procedure (the "cash register principle") may be applied to taxable persons whose taxable transactions do not exceed LVL 70,000 and to suppliers of agricultural produce; tax is paid for the tax period when payment is received for goods supplied and services provided, whilst input tax may be deducted in the tax period when goods and services received are paid for [8].

Issues to consider before opting for VAT cash accounting

VAT cash accounting may improve the company cash flow if its customers are slow payers. The company doesn't need to pay VAT until receiving the payment from the customers. Accordingly, if the customer never pays, the supplier doesn't have to pay VAT on that bad receivable as long as it continues to use the cash accounting scheme.

Still, before opting for VAT cash accounting, the company has to consider if there are any financial benefits, as the scheme is more suitable for those businesses that have to wait the longest for the receipts from their customers. Conversely, those businesses that receive instant payments for goods or services could actually find themselves worse off under this scheme as they would no longer be able to reclaim VAT before they settle purchase invoices [1].

The fact that VAT on purchases can't be reclaimed until the payments to the suppliers are done may be a disadvantage for those who buy most of their goods and services on credit. Also the companies that regularly reclaim more VAT than VAT payable will usually receive the repayment later under cash accounting than under standard VAT, unless they pays for everything at the time of purchase.

In the special circumstances of a company that starts using cash accounting VAT when it starts trading, this cannot reclaim VAT on most start up expenditure (like as initial stock, tools or machinery), until it actually pays for these items.

Besides the financial benefits, a considerable advantage is the simplified record keeping. If a manual record system is used, VAT may be accounted simply through a cash book, without the need for a separate sales/purchase day book. Thus, small business owners and sole proprietors lacking accounting experience may find easier to account for VAT using the cash basis accounting than the accrual system.

3. The VAT cash accounting scheme in Romania

In Romania, the VAT cash accounting scheme has entered into force on the 1st of January 2013. The Government Ordinance no. 15 dated 23 August 2012 has amended and complemented Law no. 571/2003 regarding the Fiscal Code [10].

The system was promoted as a support for small companies, but its implications need to be assessed also by large companies that don't apply it.

The scheme is applied by those taxpayers with an annual turnover less than RON 2,250,000 (the equivalent of EUR 500,000 at an exchange rate of RON 4.50 to EURO). The turnover valid for the computation includes the value of taxable supplies of goods and services and exempted with credit, as well as the value of the operations for which the place of supply is considered to be in another country.

The Romanian legal provisions are compliant with the basic principles of the scheme but some specific rules are imposed by the Fiscal Code.

• While the VAT Directive provided for an optional scheme, its implementation into Romanian legislation has made the scheme mandatory for a large number of companies (estimated at roughly 90%) [2].

• The most important aspect worth mentioning is that if the invoices for goods sold are not cashed in within 90 days, then the chargeability of the VAT occurs in the 90th day since the date when the invoice has been issued. Thus, the companies that apply the system have to implement a complicated process for checking if this deadline is not exceeded. Tax effects are: (i) for the customer, input VAT deduction is blocked for an indefinite period (that is until the payment is performed); (ii) for the supplier, output VAT chargeability is only deferred for a period that doesn't exceed 90 days; after this period VAT becomes chargeable and it has to be paid even if the customer didn't pay his debt. This scenario is possible as in practice the payments are made even with delays higher than 90 days. Thus, "VAT cash accounting scheme" is misleading, being in fact "VAT deferment scheme", as the encashment moment does not always correspond to the VAT chargeability.

The implications for the book-keeping records are illustrated with the following example. On 7 February, Company A purchases goods from Company B. The total amount of the invoice is RON 1,240 referring to standard-rated goods valuing RON 1,000 and VAT rate 24% that is RON 240.

Considering that Company A is eligible for VAT cash accounting, the book-keeping records for this company – the customer – are as follows:

(i) February 7: accounting for the invoice; VAT on purchasing goods is not chargeable:

Merchandise inventory *1,000*
VAT not chargeable *240*
Account payable *1,240*

(ii) March 15: accounting for the payment, based on the payment order:

Account payable *1,240*
Bank account *1,240*

(iii) March 15: VAT becomes deductible for Company A:

VAT deductible *240*
VAT not chargeable *240*

Few considerations regarding specific circumstances that may occur in practice:

• If Company A reports VAT on monthly basis, the tax is not deducted on February (when the invoice was issued) but on March (when the invoice was paid). If Company A reports VAT on quarterly basis, the tax is deducted at the end of the 1st quarter.

• If Company A doesn't pay the debt to Company B (eligible or not) in 90 days or more cannot deduct VAT.

• If Company A is not eligible for the VAT cash accounting scheme and purchases the goods from Company B, which is eligible, than Company A deducts VAT at the date of the payment. In case that nor Company B is eligible, both companies apply standard VAT, so Company A deducts VAT at the date that the invoiced was issued.

Based on the same example, the book-keeping records for Company B – the supplier – are illustrated as follows:

(i) February 7: accounting for the invoice; VAT on selling goods is not chargeable:

Account receivable *1,240*

Sales *1,000*
VAT not chargeable *240*

(ii) March 15: accounting for the encashment, based on the payment order:
Bank account *1,240*
Account receivable *1,240*

(iii) March 15: VAT becomes chargeable for Company B:
VAT not chargeable *240*
VAT payable *240*

Few considerations regarding particular circumstances which might occur in practice:

- If Company B reports VAT on monthly basis, VAT is not reported on February (when the invoice was issued) but on March (when the invoice was cashed). If Company B reports VAT on quarterly basis, the tax is reported at the end of the 1st quarter. The above mentioned are valid if Company A is eligible for the VAT cash accounting scheme, no matter Company B is eligible or not.
- If Company B, eligible for the scheme, doesn't receive the payment from the customer (eligible or not) in 3 months, it has to collect VAT on selling after 90 days from the date that the invoice was issued.
- If Company B is not eligible and sells goods to Company A (eligible or not), Company B collects VAT at the date that the invoice was issued.

In the particular case that the two companies decide to settle the transaction in cash, Company A deducts VAT and Company B collects VAT at the date that the invoice was issued. If Company B is eligible, it doesn't mention "VAT when cash-in" on the invoice issued.

4. Conclusions

VAT cash accounting scheme is conceived as a simplification measure in particular for those undertakings experiencing difficulty in determining, under the normal rules, the date of chargeability for their input and output transactions, and for those that do not maintain an accrual basis of accounting.

The application of the scheme in Romania is based on some specific provisions that could hold back its practical implementation. An important concern is related to the compatibility of these provisions with the VAT neutrality principle: the supplier has to pay VAT after 90 days regardless of encashment, while the customer cannot deduct VAT until payment date.

For a real improvement of business environment and for being helpful for small companies, the new regulation should set the VAT chargeability on the encashment of the receivables, regardless the date. Actually, there is only a deferment of the VAT chargeability if small companies fail to collect the outstanding debts in 90 days. Consequently, the situation is solved in practice in the same way as in the previous legal framework, and the small companies are still facing the risk of not collecting the bills. In this case, cash flow is affected by the fact that the price of goods sold is not recovered and, additionally, by losing the amounts for the VAT payments with whom the state budget is credited.

Another concern is that the short transition period to the new system has entailed huge administrative efforts and notable costs for companies. In order to be compliant with the new rules, transactions had to be mapped for assessing the future treatment and the accounting and tax software had to be reconfigured (with additional costs). These entailed additional workload and increased risk of errors [3].

The new system also requires changes in the accounting and reporting procedures for those companies that are not eligible, having the obligation to deduct

VAT on purchases from eligible taxpayers on the date of the payment. The most important implications are: adapting the accounting and reporting system; checking which suppliers apply the VAT cash accounting; keeping a separate evidence for the suppliers that apply the system [4]. In order to avoid the administrative burden, the larger companies are likely to avoid doing business with those who apply the simplified scheme.

The conclusion is that, at the first glance, the new VAT cash accounting scheme seemed to be a measure meant to support companies. At a closer look, it has increased the average time spent for operating the invoices, complicating the accounting process [5]. For each invoice, the accountant has to check if the supplier that issued the document applies the VAT cash accounting system, then a copy of this result should be filed. For each invoice issued under the new scheme, the accountant needs to check if the payment was made and the amount paid, then the evidence of the payment has also to be filed. Additionally, specific aspects should be managed: partial payments, cash payments, payments in advance, compensated invoices, assignment of receivable.

Still, beyond the increased bureaucracy and complexity of the accounting operations related to the new system, the higher risk is that large companies could avoid transactions with those companies forced by the law to apply it. Therefore, applying VAT cash accounting according with the existing legal framework – that imposes certain rules which are not found in the legislation of other European countries that apply this system - could have rather negative effects on the business environment in Romania.

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