

FISCAL POLICIES: LAW VERSUS ABUSE

**POMANA (CARAUS) Madalina¹, SOGLU (CALUGAREANU) Mirela²,
BARTALIS Anne-Marie³, UNGUREANU Mihai Aristotel⁴**

Lucian Blaga University of Sibiu, Romania

Abstract

Creating a more efficient tax-collection system is a popular topic in the context of the public debate surrounding the revision of the Romanian Fiscal Code and the Romanian Fiscal Procedure Code.

One cannot reduce tax rates without improving the tax-collection system. This objective can be achieved through the modernization of the tax administration.

Proposed solutions involve a clear correlation between the Fiscal Procedure Code and Fiscal Code together with a harmonisation of the national law to the European Union law.

On condition that the NAFA's workforce will possess the required skills and the necessary procedures in place, the risk that the taxpayers acting in good faith will "vanish" can be reduced. The proposed procedures represent an effective solution to recover tax debts from the real debtors instead of imposing abusive measures against other trade partners purely because they are "within the reach" of the tax authorities.

Key words: *fiscal , collection , deduction , inactive , jurisprudence*

1. Introduction

In the context of the public debate surrounding two renewed codes (the Romanian Fiscal Code and the Romanian Fiscal Procedure Code), the creation a more efficient tax collection system for the general consolidated

¹ Ph.D. student, Faculty of Economics, Department Finance, madalina.caraus@bcr.ro

² Ph.D. student, Faculty of Economics, Department Finance, mirelascalugareanu@gmail.com

³ Ph.D. student, Faculty of Economics, Department Finance, bartalisa@yahoo.com

⁴ Professor, Faculty of Economics, Department Finance, m_a_ungureanu@yahoo.com

budget of Romania through fiscal relaxation measures has become a popular topic.

The popularization of the two normative acts (which are momentarily in the draft revision stage) caused numerous deliberations, but was generally well-received by the community.

Most of the debate concentrated on the draft revision of the Fiscal Code. This is due to the fact that the reduction of the tax rates and the reassessment of the tax base will both have a significant effect on fiscality, positively influencing the business environment.

Unfortunately though, the modification of the Fiscal Procedure Code hasn't attracted the same amount of public interest despite the fact that the tax collection method is equally as important as the way in which the taxes are calculated.

In our opinion, before deciding on whether to increase or diminish the tax rates, it is important to analyze the procedures by which the taxes are collected and whether the collection process can be improved by identifying the most efficient solutions and specific mechanisms. Creating a more efficient tax collection system to fuel the general consolidated budget in Romania represents a top-priority and an a vital requirement for the Romanian State. Thus, it entails the development of specific mechanisms with effects on short and medium-term.

Applying these perfectible and sometimes deficient fiscal procedures without identifying their weak points and fixing them accordingly can have negative consequences for the general consolidated budget of Romania. This issue needs to be addressed at the same time with conceptualizing a reduction in the VAT rate and other tax categories. Tax rates cannot be reduced without improving the tax collection procedures as there would otherwise be a real risk of a drop in revenues collected by the tax authorities for the general consolidated budget.

Improving the tax collection methods can be achieved by collecting as much as possible from the tax base with a direct effect of fighting the tax evasion. The State mustn't make claims on taxes it is not lawfully entitled to.

2. Argumentation

This objective can only be achieved by continuing the modernization of the tax administration and by accelerating the rate of advancement.

National Agency for Fiscal Administration (NAFA) is in dire need of:

- IT infrastructure;
- employee training and development programs;
- revised tax administration work procedures;
- a change in the organizational culture.

NAFA current requirements' prioritization indicates that the human resources factor deserves more focus than the working procedures due to its higher impact and the comparatively lower investment the development of the human resources would require. Investing in the improvement of the human resources and work procedures will directly benefit the organizational culture.

NAFA has already initiated, with the joint support of the World Bank, a project aimed at developing the IT infrastructure with expected benefits on both the medium and long-term, benefits which surpass its considerable costs. Such a project is essential for the modernization process of the institution.

Improving the revenue collection rate for the general consolidated budget of Romania (which represents the objective of the Fiscal Code revision) will be difficult to achieve without crystal-clear procedures and skilled tax authority employees. To this end we would like to propose a working hypothesis depicting a situation in which the taxation authorities can close down a company.

Our case study company is defined as a taxable person – a Romanian legal entity – organized as a stock company with a fully-private share capital. This specific business entity (founded in the year 2012) is a retail trader in a fast-moving consumer goods industry. On top of that, it provides transport, repair & maintenance services for the traded goods.

Company facts:

Registered office: located on a premise owned by the company.

Subscribed share capital: 5 million Romanian lei.

Average annual revenue for the past five years: 50 million Romanian lei.

Average net profit: 4 million Romanian lei.

Average number of employees: 42 members.

The company has no financial obligations towards tax authorities, suppliers, banks and shareholders.

As a result of a tax inspection, the Company was notified it owes an additional 4 million Romanian lei as a VAT tax liability and 2 million

Romanian lei as late-payments penalty/interest accrual for the four years audited. The VAT liability mentioned in the audit report is in fact deductible VAT connected to acquisitions of goods from several suppliers, deductible VAT which was refused by the fiscal inspectors. The refusal of the deductible VAT was based on the following considerations communicated in the audit report:

- An inadequate fiscal behavior of the Company's suppliers highlighted by their failure to meet the fiscal obligations as regards declaration and payment of VAT and the irregularities connected to the intra-community transactions carried out by the suppliers;

- One of the suppliers was declared inactive and the had its VAT registration canceled as a result of this. It is important to note that this event occurred after the transaction involving the company in our case study as the supplier was declared inactive two years after the transaction mentioned in the audit report took place.

By analyzing the inspection report it becomes clear we are facing a refusal to grant the deductible VAT sum pertaining to the acquisition of goods. This refusal is in contradiction with Romanian Fiscal Code and the EU legislation.

In accordance with the articles 145 and 146 of the Romanian Fiscal Code, in order to exercise the right of deduction of the tax, the taxable person must satisfy the following conditions:

a) for the tax paid or payable for the delivery of goods or the supply of services made or to be made to him, hold an invoice that satisfies the requirements provided in art. 155 par. (19);

b) the goods or services acquired are intended to be used for taxable operations.

The invoice shall, in accordance with art. 155 par. (19), compulsory include the following details:

a) a sequential number, based on one or more series, which uniquely identifies the invoice;

b) date of issue of the invoice;

c) the date on which the supply of goods or services was made or completed or the date on which the payment on account was made, in so far as that date can be determined and differs from the date of issue of the invoice;

d) name, address and the registration code under which the taxable person supplied the goods or services;

e) name of the service provider/supplier of goods which is not registered for tax purposes in Romania and which has designated a VAT representative, together with the name, address and registration code of the tax representative;

f) name, address and the customer's VAT identification number, under which the customer received a supply of goods or services or the registration code of the customer for the non-taxable legal persons;

g) name of the customer which is not registered for tax purposes in Romania and which has designated a VAT representative, together with the name, address and registration code of the tax representative;

h) the quantity and nature of the goods supplied or the extent and nature of the services rendered and the details provided in the art. 125¹ par. 3 regarding the conditions for the intra-communitary supply of new means of transport;

i) the taxable amount per rate or exemption, the unit price exclusive of VAT and any discounts or rebates if they are not included in the unit price;

j) the VAT rate applied and the collected VAT, expressed in Lei;

k) where the customer prepares the supplier's invoice, the detail "self-billing" should be written on the invoice;

l) in the case of an exemption, the reference to the applicable provisions of the Directive 112/2006 or any other reference indicating that the supply of goods or services is exempt;

m) in the case the customer is liable to pay the tax, the reference "reverse charge";

n) where the margin scheme for travel agents is applied, a reference indicating that the margin scheme has been applied;

o) where one of the special arrangements applicable to second-hand goods, works of art, collectors' items and antiques is applied, a reference indicating that one of those arrangements has been applied;

p) in the case where the exigibility of the VAT occurs on the date the full or partial delivery of goods or the rendering of services, a reference indicating this scheme has been applied;

q) a reference to previously issued invoices and documents, in the case where multiple invoices and documents are generated for the same transaction.

Moreover, in accordance with the provisions laid down in art. 11 par 1¹:

(1¹) “The taxable persons established in Romania and deemed inactive (in accordance with the art. 78¹ of the Government Ordinance no. 92/2003 regarding the Fiscal Procedure Code, republished, as subsequently amended and supplemented), which carry out economic activities in the period they are inactive, must obey the tax obligations laid out by the provisions of the current law but cannot, during the inactivity period, benefit from the right of deduction for the VAT and expenses connected with the acquisitions made. “

(1²) “Customers acquiring goods or/and services from inactive taxpayers established in Romania, after these taxpayers are deemed as inactive by the Trade Register (in accordance with the art. 78¹ of the Government Ordinance no. 92/2003 regarding the Fiscal Procedure Code, republished, as subsequently amended and supplemented), cannot benefit from VAT and expenses exemptions for the acquired goods, with the exception of the goods acquired from suppliers in the forced execution procedure or/and the acquisition of goods/services from taxable persons undergoing a bankruptcy procedure (as laid down by the Law no. 85/2006 regarding the procedure on insolvency procedure, as subsequently amended and supplemented).

The right of VAT deduction is clearly regulated by the European Law and is further supported by the Court of Justice of the European Union (CJEU) jurisprudence.

For example, Judgement of the Court 29 April 2004 in the Case C-152/02, Terra Baubedarf-Handel GmbH versus Finanzamt Osterholz-Scharmbeck ruled that: “the deduction referred to in Article 17(2) thereof must be made in respect of the tax period in which the two conditions required under the first subparagraph of Article 18(2) are satisfied. In other words, the goods must have been delivered or the services performed and the taxable person must be in possession of the invoice or the document which, under the criteria determined by the Member State in question, may be considered to serve as an invoice.”

As a consequence, on the basis of the provisions laid above, it follows that the taxable person has the right of deduction for the VAT directly borne by the acquisition of goods from the supplier deemed inactive, provided that the goods are intended to be used for taxable operations and the invoices includes all the compulsory details. Moreover, the suppliers was deemed inactive after the goods were physically delivered, and thus the taxable person

from the case study cannot be held jointly and severally liable for the tax obligations of the supplier.

To this end, the Court of Justice of the European Union (CJEU), in the Case C-384/04, Commissioners of Customs & Excise and Attorney General v. Federation of Technological Industries and Others, ruled that:

“Article 21(3) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the harmonisation of the laws of the Member States relating to turnover taxes — Common system of value added tax: uniform basis of assessment, as amended by Council Directives 2000/65/EC of 17 October 2000 and 2001/115/EC of 20 December 2001, is to be interpreted as allowing a Member State to enact legislation, such as that in issue in the main proceedings, which provides that a taxable person, to whom a supply of goods or services has been made and who knew, or had reasonable grounds to suspect, that some or all of the value added tax payable in respect of that supply, or of any previous or subsequent supply, would go unpaid, may be made jointly and severally liable, with the person who is liable, for payment of that tax.

Article 21(3) of the Sixth Directive permits Member States to adopt legislation which provides that a person may be made jointly and severally liable for payment of VAT, with any person who is so liable, only in the situations referred to in Article 21(1)(a), second subparagraph, Article 21(1)(c), Article 21(2)(a) or Article 21(2)(b). The imposition of such joint and several liability is subject to the general principles of Community law.”

Tax audit authorities base their findings on irregularities committed by the supplier, aspects which were not known or which could not have been known by the customer. Furthermore, the time the customer gained knowledge of the fact that the supplier was deemed inactive was the moment the information become public by being published on the NAFA website, an action which occurred two years after the transaction in discussion took place.

In fact, by refusing the right to deduct in the above-mentioned conditions, the tax authority was transferring its own investigative tasks to taxable persons.

The approach in which the tax authority handled the tax audit of the company in the case study violated several general principles of the EU law: fiscal neutrality, proportionality, indiscriminate treatment, equal treatment of the taxpayers and legal certainty. Thus, the fiscal inspection findings were based upon abusive practices.

3. Conclusions

Analyzing the case study, one can infer that the audit report written by the tax authorities violated the principles of the European Union Law, as settled by the jurisprudence of the Court of Justice of the European Union. It remains unclear whether the audit authorities had no prior knowledge of the fact that the taxpayer can make use of the provisions laid out the European Union Directives to claim its right of deduction in any Member State.

On the other hand, the absence of a Fiscal Procedure Code which is clearly correlated to the European Union Law, we can witness an increasingly abusive tax collection process which will deny the lawful rights to the Romanian taxpayers.

In the current context surrounding the reduction of the tax rates, it is essential for the Fiscal Procedure Code and the Fiscal Code to comply with the relevant European Union law. Fiscal relaxation measures represent a facility aimed at nurturing the business environment in Romania and must be offered to each taxable person investing capital and hiring labor force. However such measures need to be backed in the near future by procedures designed to provide a more efficient tax collection system. In this context the role of the fiscal procedures becomes vital in order to ensure an accurate and fair tax collection system.

Tax administration must not turn into a repressive authority in regards to the taxpayer, but must instead seek to bring balance in the business environment.

Returning to our case study, one can conclude that as a result of the fiscal inspection, the audited taxpayer will cease to function as it does not possess the necessary financial resources to pay off the taxes imposed without any objective basis by the tax authority. The audit authorities have levied the sum of 6 million lei upon the taxpayer as VAT to be paid due to the taxpayer's transaction with a supplier which had its VAT registration canceled. As a result, the solvency and liquidity of the company are severely affected, forcing the company into judiciary reorganization, a measure which will most likely lead to lay-offs.

What was the positive return to the State Budget following these measures? On top of the fact that no VAT to be paid was collected in this case, the tax administration's image and public trust have been negatively impacted.

Our case study evidences a good support for Radu Colban's assertion that "the current fiscal system has stepped away from the economic

principles” expressed in his article “Fiscal system: a holistic view”. We adhere to the view that the Romanian fiscal system needs a comprehensive vision for the upcoming years.

In the case in question there is a fine line dividing applying law from outright abuse. There are surely more efficient solutions to prevent the bankruptcy of the taxable persons. Such solutions involve a clear correlation between the Fiscal Procedure Code and Fiscal Code together with a higher adaptation of the national law to the relevant European Union law in the fiscal administration domain.

Specifically, the fiscal legislation needs to clearly regulate the obligation of the tax authority to carry out a real-time risk-analysis as a basis for tax collection in the case of third-party traders which fail to declare and pay their tax obligations (e.g. the case of the supplier presented by us). Such a measure is possible through the following steps:

- using an advanced information exchange system to check the data sent by the trader acting upstream or downstream in the chain of supply;
- internal and external data collection from tax statements, creditors, National Trade Register Office, National Agency for Cadastre and Real Estate Publicity, Romanian Police authority;
- initiating swift “receivables recovery” procedures by using precautionary measures against the debtor's assets, forced execution and by enforcing joint-liability for the involved parties.

In essence, the development and implementation of such procedures represents an effective solution to recover tax debts from the real debtors instead of imposing abusive measures against other trade partners purely because they are “within the reach” of the tax authorities. The state should aim to impose the tax liability on the business entities directly responsible for the fraud/irregularities and should not attempt to collect the taxes to be paid from the trade partners without that authority establishing, on the basis of objective evidence, that the taxable person concerned knew, or ought to have known, that the transaction relied on as a basis for the right to deduct was connected with fraud committed by the issuer of the invoice or by another trader acting earlier in the chain of supply. Such procedures will ensure an equitable tax collection process.

On condition that the NAFA’s workforce will possess the required skills set and the necessary procedures in place, the risk that the taxpayers acting in good faith will “vanish” can be reduced.

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