**RESEARCH ARTICLE:**

# *Analysis of the new regulations in the field of VAT from the legal and tax policy's perspectives*

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**ABSTRACT**

The new regulations in the Tax Code in force starting January 1st, 2016 in the field of VAT are mainly analysed from the rate perspective, as the standard rate is decreased from 24% to 20% and it will be further reduced to 19% starting January 1st, 2017. This reduction is considered to be in the category of "good measures" but it is important to evaluate its effects on the public budget.

The aim of this article is to explain the new regulations taking into consideration several legal arguments identified in the tax and budgetary policies of Romania.

**KEYWORDS:** *value added tax, tax-budgetary strategy, public budget, tax policy, budgetary policy, tax evasion, tax equity principle*

## 1.Introduction

Starting January 1st, 2016 a new Tax Code is in force in Romania approved by the Law no. 227 of 2015[1]. This new piece of legislation introduced a new standard VAT rate decreased from 24% to 20%. In addition, the area of products and services subject to a reduced VAT rate of 9% is broadened.

The relevance of the analysis of the impact of the new regulations in the field of value added tax is given by the fact that this tax represents one of the most important sources of public revenues. In any budget structure and in any tax-budgetary strategy it is necessary to take into consideration the manner of regulation of this tax as the impact of any amendment is important. From the historical perspective, value added tax is one of the taxes that have known the highest development in a short period of time as it was considered, and still is to be the solution for the increase of budgetary income.

The first regulation regarding value added tax was drawn up by Maurice Lauré, deputy manager of the General Directorate of Taxes from France in 1954[2], and was initially composed of two taxes, respectively a tax on production calculated at the sale price of the merchandises born by the last manufacturer and a turnover tax which applies to all the persons involved in the manufacturing of goods. Even if it was an innovative concept, the disadvantage of this system was the payment of this tax by each trader. This system was initially transposed in Romania in 1990[3]. Most of the EU countries adopted this tax in national legislation after 1970, as an accession condition in the European Union.

On the international level, VAT was introduced in 164 countries (out of 194 countries)[4] until 2014. US never introduced VAT but they have sales tax at federal level.

In the reports published by the European Commission after the economic crisis, it was shown that the level of the public revenue from VAT has significantly dropped. Starting 2009, in order to counter the effect of this decrease, the European Union member states have constantly increased rates, except for 4 states (Austria, Belgium, Bulgaria, and Denmark). From the analyses regarding the level of VAT receipts to the public budget carried out at the European Commission as well as at OECD level a difference ("gap") between the value of the VAT total tax liability and the value of the VAT actually collected has been found[5]. The biggest VAT gap was identified in Romania (2012 - 42.9%, and in 2013 – 41.1%), Slovakia (2012 – 38.6%, 2013 – 34.9%) and Lithuania (2012 – 36.5%, 2013 – 37.7%).

The analysis carried out at international level[6] by the Economic Organization for Cooperation and

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[1]Published in the Official Gazette of Romania, Part I, no. 688 of 10 September 2015.

[2]Embril, L., Keen, M. Bodin, J.P. and Summers,V. 2001. *The Modern VAT*, International Monetary Fund, p. 4.

[3]Government Decision no. 1109 of the 18th of October 1990 on the liberalization of prices and social protection measures, published in the Official Gazette no. 115 of 23.10.1990 in force on the 01st of November 1990; Government Decision no. 779 of the 15th of November 1991 on the tax on the circulation of merchandises and excises, published in the Official Gazette no. 244 din 30.11.1991 in force on the 01st of December 1991.

[4]OECD. 2014, *Consumption Tax Trends 2014: VAT/GST and excise rates, trends and policy issues*, OECD Publishing, Paris, p. 18.

[5]Study to quantify and analyse the VAT Gap in the EU Member States 2015 Report, TAXUD/2013/DE/321, p. 17. Previously, in Romania the level was 48% in 2011 according to TAXUD/2012/DE/316, *Study to quantify and analyse the VAT Gap in the EU-27 Member States*, Final Report, p. 21.

[6]OECD. 2014, *Consumption Tax Trends 2014: VAT/GST and excise rates, trends and policy issues*, OECD Publishing, Paris, p. 29.

Development has led to the conclusion that the voluntary degree of compliance of a person drops as the VAT rates increase, especially in those states that have a non-developed administrative apparatus and that do not face the tax payers' challenges.

Within this article we shall make a review of the tax and budgetary strategies published in Romania starting 2014 and a short analyse of the theoretical reasons based on which the VAT rates were modified.

## 2.Tax-budgetary strategy concept and the analysis of Romania's strategies since 2014

### 2.1. Tax-budgetary strategy concept

In 2009, Romania requested to the European Commission, International Monetary Fund and World Bank support within the mechanism for payment balance. Following the analysis carried out by the European Commission, the European Union Council adopted Decision 2009/458/CE of the 6th of May 2009 for granting mutual assistance to Romania[7] and Decision 2009/459/CE of the 6th of May 2009 for granting community financial assistance to Romanian on medium term. One of the points undertaken by Romania within the economic program, and mentioned as a matter of fact in the Decision 2009/459/CE is the one to adopt a normative act that establishes "*medium term mandatory tax framework, set up of some limits regarding budgetary rectifications that can be performed throughout the year, including tax rules and the setup of a tax council that supplies independent and specialised analyses*"[8]. Given this engagement, the Romanian Government initiated and subsequently the Parliament adopted the Law no. 69 of the 16th of April 2010[9] on tax-budgetary responsibility. In the content of this law the tax-budgetary strategy concept appears for the first time, representing the "*public policy document that establishes the objectives and priorities in the tax-budgetary field, the targets of the income and expenses of the general consolidated budget and of the component budgets of the general consolidated budget, as well as the evolution of the general consolidated budget balance on a period of 3 years*".

Following the signature by Romania and subsequently to the ratification of the Treaty in the stability, coordination and governance within the economic and monetary union by the law no. 83/2012[10] the amendment of this normative act was necessary in order to include the obligations on the budgetary pact.

Consequently, until the 31st of July each year, the Ministry of Public Finance is bound to send the Government the tax-budgetary strategy for the next 3 years, which must comprise besides the statement on own liability, the macroeconomic framework on which the tax-budgetary policy is based, the tax-budgetary framework with the budgetary prognoses and the tax-budgetary policy. The Government has the obligation to submit the tax-budgetary strategy in the Parliament

[7] Published in the Official Gazette of the European Union, no. L150 of 13.06.2009.

[8] http://eur-lex.europa.eu/legal-content/RO/TXT/PDF/?uri=CELEX:32009D0459&qid=1443451155916&from=EN.

[9] Published in the Official Gazette of Romania, Part I, no. 252 of the 20th of April 2010, subsequently amended and republished in the Official Gazette of Romania, Part I, no. 330 of the 14th of May 2015.

[10] Law no. 83 of the 14th of June 2012 on the ratification of the Treaty regarding the stability, coordination and governance within the economic and monetary union between the Kingdom of Belgium, Republic of Bulgaria, Kingdom of Denmark, Federal Republic of Germany, Republic of Estonia, Ireland, Greek Republic, Kingdom of Spain, French Republic, Italian Republic, Cyprus Republic, Republic of Latvia, Republic of Lithuania, Grand Duchy of Luxemburg, Hungary, Malta, Netherlands Kingdom, Republic of Austria, Polish Republic, Portuguese Republic, Romania, Republic of Slovenia, Republic of Slovakia, Republic of Finland and Kingdom of Sweden, signed at Brussels on the 2nd of March 2012, published in the Official Gazette of Romania, Part I, no. 410 of the 20th of June 2012.

before the 15th of August each year and the breach of this legal obligation will not have a pecuniary impact on the members of the Government.

**2.2.Analysis of Romania's strategies**

The main objectives of the tax-budgetary policy synthesised within the tax-budgetary strategy 2014-2016 do not include any direct reference to the proposal of amendment of the VAT rates, but it can be supported as being a result of the objective regarding the "*carrying on of the tax consolidation process by […] creating a more effective and equitable system, but also a better administration of budgetary revenues*"[11], which also includes measures for fighting against tax evasion and gradual reduction of the value added tax as far as the collection of budgetary revenues gets improves. The tax-budgetary strategy for the period 2015-2017 envisages the reduction of the standard VAT rate[12], a table with the impact over the public budget in the next 3 years being also included.

In the tax-budgetary strategy for the period 2016-2018 published in December 2015[13] there are mentioned the new measures adopted starting 2014 regarding VAT, out of which it is relevant to include here:

(i) Starting January 1st, 2014, the optional application of VAT collection system by eligible persons, i.e. taxable persons with a turnover below the ceiling of 2,250,000.00 lei (equivalent of 500,000.00 euro).

(ii) Starting June 1st, 2015, the extension of the reduced rate of 9% for delivery of foodstuffs (including beverages but excluding alcoholic beverages) for human and animal consumption; live animals, seeds, plants and ingredients normally intended for use in the preparation of foodstuffs; products normally used to supplement foodstuffs or as a substitute for foodstuffs as well as restaurant and catering services, excluding the supply of alcoholic beverages.

The objectives of the tax policy in the VAT field continue to be in 2017 and 2018 improving VAT regulations in order to fight tax evasion.

**3.The evolution of the VAT reduced rates**

The first measure for introducing additional reduced value added tax rates was taken in 2013, namely the introduction in the special category of the 9% rate of all types of bread, bread manufacture specialties, wheat and rye flour, as well as raw materials triticum spelta, common wheat and meslin. The motivation that at the base of this measure has been "*the need to take some urgent measures in order to fight against tax evasion in the field of bread trade by the application of a VAT reduced rate of 9% for bread and on the entire bread production and distribution, respectively for wheat and flour*[14]." The argument of the Government in adopting this measure is supported, as mentioned before, including by the studies carried out by the experts of OECD or of the European Commission. Thus, the tax authority has accepted that in this specific field of bread manufacturing and distribution there is a high degree of tax evasion, it is not possible to fight against this evasion by administrative measures and the decision of

[11]Tax budgetary strategy for the period 2014-2016, p. 15 and p. 38.

[12]Tax budgetary strategy for the period 2015-2017, p. 39. http://discutii.mfinante.ro/static/10/Mfp/transparenta/Strategiafiscalbugetara2015_2017.pdf.

[13]Tax budgetary strategy for the period 2016-2018, p. 31.

[14]Substantiation note regarding the Government Ordinance no.16/2013 on the amendment and supplement of the Law no. 571/2003 on the tax code and regulation of certain tax-budgetary measures e: http://gov.ro/fisiere/subpagini_fisiere/nf-og-16-2013.pdf.

fighting against it by dropping the rate level so as to have no solid motivation to breach the value added tax condition has been made.

Subsequently, starting June 1st, 2015, two important changes on the VAT reduced rate were carried out, even if the size of the concerned article is reduced. The normative act[15] envisages just the fact that at article 140 paragraph (2), letter g)[16] is amended and letter h)[17] is introduced, the other articles from 1 to 5 comprising absolutely other provisions. For clarification it is necessary to mention that Article 140 paragraph (2) of the old Tax Code envisages reduced VAT rate of 9%. Thus, this VAT reduced rate applies to a larger number of categories of deliveries of goods and/or services starting from the June 1st, 2015.

The explanation of adopting this VAT reduced rate is to be found in the preamble of this emergency ordinance in which it is mentioned that the Romanian Government has taken these measures envisaging the following seven arguments:

(i) "*Tax budgetary strategy for the period 2014-2016 also envisages among other measures the gradual reduction of VAT in the next 4 years as far as the collection of budgetary revenues is improved*";

(ii) "*the VAT reduction measure is compliant with the European legislation and is likely to essentially contribute to the reduction of tax evasion*";

(iii) "*VAT reduction represents a particularly important instrument in terms of national economy development, by re-launching internal consumption, following the creation of necessary premises for dropping the prices if the goods and services in general*";

(iv) "*VAT level reduction contributes in the same time to the increase of productivity and implicitly to the increase of economic efficiency*";

(v) "*VAT rate reduction represents a measure that is likely to increase equity, by the improvement of income distribution or by the fact that certain goods become more accessible for the entire population*";

(vi) "*the extension of application of reduced VAT rate of 9% for the delivery of food products and restaurant and catering services represents a measure likely to essentially contribute to the reduction of tax evasion and to the creation of an appropriate competitive climate in this field, including in the tourism field*";

(vii) "*the extension of application of reduced VAT rate of 9% generates important positive effects on the business environment by the improvement of cash-flow flows too,*

[15]Government Emergency Ordinance no. 6/2015 was published in the Official Gazette of Romania, Part I, no. 250 of the 14th of April 2015 and was approved by the Law no. 187 of the 2nd of July 2015 on the approval of the Emergency Government Ordinance no. 6/2015 on the amendment an supplement of the Law no. 571/2003 of Tax Code, published in the Official Gazette of Romania, Part I, no. 499 of the 7th of July 2015.

[16]"g) delivery of the following goods: food including beverages, except for alcoholic beverages, destined to human and animal consumption, domestic live animals and poultries, seeds, plants and ingredients used in the preparation of the food, products used to supplement or replace food. The methodological norms establish the NC codes from annex I to the Regulation (CEE) no. 2.658/87 of the Council of the 23rd of July 1987 on the Tariff and statistical nomenclature and Common Customs Tariff, as amended by the application regulation (UE) no. 1.101/2014 of the Commission of the 16th of October 2014, corresponding to these goods".

[17]"h) restaurant and catering services, except for alcoholic drinks".

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*diminishing thus a series of difficulties the economic operators face in this respect*".

Basically, from legal perspective, two arguments analysed in this article are relevant, the one related to the compliance with the European legislation and to its contribution to the reduction of tax evasion and the other one regarding the tax equity principle, as this measure will improve income distribution and certain goods will become more accessible for the entire population.

**4.Arguments for the decrease of VAT standard rate and reduced rate**

Further to the analysis of the explanations provided in the preamble to the piece of legislation mentioned above and the content of the tax and budgetary strategies, two legal arguments for supporting the decrease of the standard VAT rate and the enlargement of the area of the reduced rate can be taken into consideration are:

(i) the new measures in the VAT area are compliant with the European legislation[18] and will essentially contribute to the reduction of tax evasion;

(ii) the decrease of standard VAT rate will increase equity "*by the improvement of the distribution of income or by the fact that certain goods become more accessible for the entire population*".

The argument that the decrease of VAT rate essentially contributes to the reduction of tax evasion in this field can be at first sight a sentence without much substance. But, actually, in relation to the studies performed at the request of the European Commission[19], it has been highlighted that the existence of high rates of value added tax does not automatically mean higher budgetary revenues. On the contrary, with regard to those states of the European Union that did not develop a proper administrative system, the increased rates draw the breach of the applicable tax legislation. As a matter of fact, this is highlighted in the mentioned studies by the high value of the gap between the amounts owed from VAT according to the legal provisions and the actually received amounts, Romania occupying the first place. The application of a decreased standard VAT rate can involve on medium and long term again as it increases the voluntary compliance degree. If at the level of the European Union measures for fighting against tax evasion of the "carousel" type can be taken, at national level each state has the obligation to analyse those sectors of its economy and apply all the methods allowed by the legislation of the European Union for the fight against tax evasion. These methods do not involve only the increase of the number of "nocturnal raids" in the vegetables-fruit warehouses but can also involve the amendment of the tax legislation by reducing the rate. Another method promoted at the level of the European Union is the one of inversed taxation mechanism for certain categories of services and goods.

The second analysed argument regarding the equity principle applied to the VAT field means that a lower VAT rate and reduced rates for foodstuffs will improve the distribution of personal income and certain goods become more accessible for the entire population. This

[18]According to Article 99 paragraph (1) of the Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, "The reduced rates shall be fixed as a percentage of the taxable amount, which may not be less than 5%".

[19]Study to quantify and analyse the VAT Gap in the EU-27 Member States, published 2013 http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf and Study to quantify and analyse the VAT Gap in the EU Member States, 2015 Report, published in May 2015, http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_gap2013.pdf.

argument is very interesting and often considered in carrying out tax policy by any state that considers the principle of the person's ability to pay ("ability to pay"). In the new Tax Code the principle of equity is included[20], lodged maybe in a defective manner but particularly useful in the legal supporting of such measures. The relevance of a text as the one introduced by the Tax Code is important when we envisage what is called in doctrine "indirect taxes", whose specificity consists in the fact that the tax burdened is not borne by the taxpayer but by the final purchasers. Thus any increase of the indirect taxation level impacts consumption, namely the ability of a person to purchase certain goods and services. The reduction of VAT represents perhaps a populist measure but certainly is a measure used by the European states that have the obligation to observe the constitutional principle of the person's ability to pay taxes[21]. Obviously this measure is also beneficial to the persons with high income who will benefit thus from a wide range of consumer goods at a lower price.

**5.Conclusions**

From tax policy perspective, the introduction of the decreased standard value added tax rate and the additional reduced rates can be supported on the one hand by the need of the authorities for fighting against tax evasion in the specific fields of economic activities (such as delivery of foodstuffs and restaurant and catering services), in which the actions of the investigation bodies are notorious. On the other hand, this tax measure applies the tax equity principle which provides the consistency of the tax system. Obviously, the effects in budgetary terms, respectively of the budgetary income level, can be only estimated at this moment, being subsequently analysed at the end of next year, based on the actual and clear data of the budgetary execution account.



[20]Article 3 letter c) of the new Tax Code "the justness of taxation or tax equity ensures that the tax burden of each taxpayer to be established on the basis of the contribution, i.e. depending on the amount of revenue or its properties".
[21]Auerbach, A. J. *Public Finance in Practice and Theory*, Musgrave R. May 25, 2009 *Lecture*, *CESifo*, Munich.

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