

## **Analysis of the amendments from the Tax Code in the field of VAT in tax-budgetary terms**

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### **Abstract:**

*The amendments of the Tax Code related to the reduced rate of value added tax generated numerous comments by the media, specialists in public policies, tax scholars. It is considered a good measure but having important effects in the public budget. The analysis in this article explains several legal arguments that uphold the amendments.*

**Keywords:** *Value added tax, tax-budgetary strategy, public budget, tax policy, budgetary policy, tax evasion, tax equity principle*

### **1. Introductory issues**

Value added tax is one of the taxes that have known the highest development in a short period of time. The first theoretical paper regarding value added tax is considered to belong to the German economist, Wilhelm von Siemens, namely „Veredelte Umsatzsteuer” [1]. Apparently, one of the first authors that initially published in 1915 but subsequently became known for an article published in 1921 is Thomas S. Adams [2], American economist, who reflects the difficult situation of the budget of the United States of America after the first world war, due to the drop of the budgetary income from the income tax following the rate increase and considers that the introduction of a tax on expenses can be the solution for the increase of budgetary income.

The first normative act regarding value added tax was drawn up by Maurice Lauré, deputy manager of the General Directorate of Taxes from France in 1954, which was initially composed of two taxes, respectively a tax on production calculated at the sale price of the merchandises and which is 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 by each trader of this tax. This system was also initially transposed in Romania in 1990 [3].

Most of the countries adopted this tax in national legislation after 1970, being as a matter of fact an accession condition in the European Union. On the 1st of January 2014, VAT was introduced in 164 countries (out of 194 countries) of which 46 in Africa (out of 54), 15 in Central America and Caribbean (out of 34), 12 in South America (out of 14, but French Guyana is part of France and Falkland Islands of UK), 28 in Asia (out of 48), 51 in Europe, 8 in Oceania (out of 33) and Canada in North America [4]. USA never introduced VAT but they have sales tax at federal level.

The relevance of the analysis of the impact of the legislative amendments in the field of value added tax is given by the fact that this tax represents in the countries that newly acceded to the European Union, including in Romania, 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.

It is important to mention, that from the analyses carried out by the European Commission, after the economic crisis, the level of the receipts to the public budget from VAT has significantly dropped. Starting from 2009, in order to counter the effect of the receipts' drop effect, the European Union member states have constantly increased rates, except for 4 states (Austria, Belgium, Bulgaria, Denmark). Thus, the average at the level of the European Union increased from 19,5% in 2008 to 21,5% in 2014.

From the analyses regarding the level of receipts from VAT carried out both at the level of the European Commission as well as at OECD level a difference („gap”) between the value of the owed amounts from VAT according to legal provisions and the value of the actually received amounts has been found. Thus, the biggest differences on receipts from VAT [5], in relation to the value of the owed amounts according to the legal provisions are 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 Development has led to the fact 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 briefly present the provisions newly introduced by the Romanian Government starting from the 1st of June 2015 by Government Emergency Ordinance no. 6 of the 7th of April 2015 on the amendment and supplement of the law no. 571/2003 on tax code [7] and maintained in the future Tax Code, as well as a few tax-budgetary practical issues that have has an impact on the amendment in the field of value added tax and we shall particularly analyse a few of the theoretical reasons on which the explanation of the VAT rate amendments is based.

## **2. Analysis of the amendments brought by the Tax Code in the field of value added tax**

In 2013 the first measure for reducing value added tax rate was taken, 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 [8]. 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[9].” The argument of the Government in adopting this measure is supported, as mentioned, including by the studies carried out by the experts of OECD or of the European Commission. Thus, the tax bodies have 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 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. Yet another tax policy argument must be considered, relating to the one specific to the Romanian tax system, namely of the principles that apply to the Romanian tax system. In the tax Code in force at this moment as well as in the future one [10], one of the [principles that apply to the tax system is the taxation equity principle. In the applicable Tax Code, the taxation equity principle is very simply regulated as being „tax equity at the level of natural persons, by different taxation of income, according to their size”. It is necessary to mention that this principle was included in the Tax Code since 2004 when the taxation of the natural person was made by using the progressive rate system.

Even if at first sight it appears not to have a strict relation it is necessary to mention that at international level, the adoption of such principle applicable to the tax system presupposes that the entire legislation must observe it. Thus, in international doctrine it has been highlighted that the states that have adopted the taxation equity principle must also take into consideration that the legislation in the field of value added tax must also observe this principle.

### **2.1. Analysis of the legal provisions in force from the 1st of June 2015**

By the Government Emergency Ordinance no. 6 of the 7th of April 2015 on the amendment and supplement of the Law no. 571/2003 on tax code two important changes on the value added tax rate were carried out, even if the size of the concerned article is reduced. The normative act envisages just the fact that at article 140 paragraph (2), letter g) [11] is amended and letter h) [12] is introduced, the other articles from 1 to 5 comprising wholly other provisions.

For scientific clarification we mention that Article 140 par. (2) of the 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 1st of June 2015.

The explanation of adopting this VAT reduced rate is to be found again 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 of 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, diminishing thus a series of difficulties the economic operators face in this respect”.

Obviously, within this article the above mentioned arguments cannot be all analysed, some of them being probably proven only by economic methods, therefore we will focus on three arguments, respectively the first two arguments and the fifth one. It must be underlined that the amendment of 2013 envisaged only one argument respectively the one of reduction of tax evasion in a specific field.

## *2.2. Tax-budgetary strategy concept and the analysis of Romania's strategies in the period 2014-2016 and 2015-2017*

### *2.2.1. 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 [13] 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 set up of a tax council that supplies independent and specialised analyses”[14]. Given this engagement, the Romanian Government initiated and subsequently the Parliament adopted the tax-budgetary responsibility the Law no. 69 of the 16th of April

2010 [15]. 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 [16] 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 com[ri]se besides the statement on own liability:

- (i) macroeconomic framework on which the tax-budgetary policy is based,
- (ii) the tax-budgetary framework with the budgetary prognoses and
- (iii) the tax-budgetary policy.

The Government has the obligation to submit the tax-budgetary strategy in the Parliament before the 15th of August each year.

#### 2.2.2. Analysis of Romania's strategies in the period 2014-2016 and 2015-2017

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 value added tax rate, 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” [17], 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 [18], a table with the impact over the public budget in the next 3 years being also included.

Therefore, at the Government level the idea of amendment of the standard VAT rate as well as the amendment of certain rates according to certain strategies for the fight against tax evasion existed.

### 2.3. *Motivation of reduction of value added tax rate*

As previously mentioned, in supporting the reduction of the rate from 24% to 9% for certain products and services starting from the 1st of June 2015 several arguments have been considered but in our opinion two of them can lead to legal debates namely:

- (i) „VAT reduction measure is compliant with the European legislation and is likely to essentially contribute to the reduction of tax evasion”;
- (ii) „the reduction of VAT rate represents a measure likely to 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 reduction 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 have no well set 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 identification of some economic activities generating tax evasion and application of a reduced VAT rate can involve on medium and long term a gain 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 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 fact that the reduction of the rate represents an equity measure, by the improvement of the distribution of personal income or by the fact that certain goods become more accessible for the entire population, 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”). Unlike Italy, for example whose Constitution at article 53 envisages that any person contributes to the public expenses according to its ability, in Romania there is no such provision, except for the provision of art. 3 lit. c) of the current tax code, on tax equity. Unfortunately, the current text refers only to the principle of equitable taxation of the natural person's income („direct taxes”), according to their size, principle that finds a partial application in the legislation in force. It is true, by the new tax code that will be effective on the 1st of January 2016 such provision has been also included, 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 future Tax code is important when we envisage what is called in doctrine „indirect taxes”, whose specificity consists in the fact that the tax load is not borne by the payer of the tax but by the end consumer. 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 rate for the deliveries of food 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, 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 and impositions [20]. 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.



### 3. Conclusions

From tax policy perspective, the introduction of a value added tax reduced rate can be supported on the one hand by the need of fighting against tax evasion in the specific field of delivery of food and restaurant and catering services, the actions of the investigation bodies in these areas being notorious. On the other hand, this value added tax reduced rate can be construed as a tax measure that applies the tax equity principle which provides thus 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 beginning of next year, based on the actual and clear data of the budgetary execution account.

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- [8] The full text introduced by item 8 of art. 1 of the Government Ordinance no. 16/2013 on the amendment and supplement of the law no. 571/2003 on Tax code and the regulation of some tax-budgetary measures, adopted on the grounds of art. 1 item I.3 and 6 of the law no. 182/2013 on the authorization of the Government to issue ordinances, and published in the Official Gazette of Romania, Part I, no. 490 of the 2nd of August 2013 envisages:
- "g) the delivery of the following goods:
1. all sorts of bread as well as the following bread manufacture specialties: croissants, buns, batons, pretzels mini baguettes, ,mini French bread and twisters, that fall under the group of bakery products at NACE /CPSA code 1071;
  2. white wheat flour, semi white wheat flour, black wheat flour and rye flour, which fall under NACE/CPSA code 1061;
  3. triticum spelta, common wheat and meslin, which fall under NC code 1001 99 00, and rye, which falls under NC code 1002 90 00 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 (EU), no. 927/2012 of the Commission of the 9th of October 2012."

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[10] Art. 3 letter c) of the Tax Code approved by the Law no. 227 of the 8th of September 2015 published in the Official Gazette of Romania, Part I, no. 688 of the 10th of September 2015 establishes as one of the taxation principles: „the justness of taxation or tax equity makes sure that the tax burden of each taxpayer is established based on contribution power, respectively according to the size of his/her income or properties”.

[11] „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;”

[12] „h) restaurant and catering services, except for alcoholic drinks.”

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

[15] 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

[16] 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

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