"Dimitrie Cantemir" Christian University
Knowledge Horizons - Economics
Volume 8, No. 4, pp. 81–88
P-ISSN: 2069-0932, E-ISSN: 2066-1061
© 2017 Pro Universitaria
www.orizonturi.ucdc.ro

CONSIDERATIONS ON VALUE ADDED TAX IMPLICATIONS ON THE ENTITY's PERFORMANCE

Victor MUNTEANU[1], Lavinia COPCINSCHI[2], Carmen LUSCHI[3] , Anda LACEANU[4]

[1]Professor PH.D., Christian University "Dimitrie Cantemir" Bucharest, E-mail a2c_vm@yahoo.com
[2]PhD.c., „Valahia" University Târgoviste, E-mail lavinia.copcinschi@gmail.com
[3]PhD.c., „Valahia" University Târgoviste, E-mail troteacarmenluiza@yahoo.com
[4]PhD.c., „Valahia" University Târgoviste, E-mail anda.laceanu@gmail.com

Abstract

Romania has done significant progress regarding implementing European Directives on Value Added Tax, although certain notions have been taken over without adapting them to the Romanian economic environment, as well as disconnecting fiscality from accounting. Yet, current fiscal regulations don't meet the requirements of an optimal fiscal system every time, as it is considered in economic theory. The principle of stability, for example, doesn't belong to Romanian fiscal system and as far as simplicity is concern there is none, especially regarding VAT. Furthermore, the definition of terms used in the legislation involves a critical appreciation, justified by the fact that in some cases, the attempt to define certain terms, entails the need to address other terms. This shortfall is the result of the hurried takeover of terms from the European legislation that are "indigestible" for an adaptation of the language and customs of national conditions in the field.

Key words:
value added tax, performance, cash flow, breakeven point, liquidity, solvency, rates of equilibrium.

JEL Codes:
M41

1. Introduction

VAT neutrality, which is the originality of this tax[1] is not necessarily observed in some cases. In relation to the management of the entity, the value added tax is neutral, provided we include it in the VAT payers' category according to the law. Otherwise, neutrality is no longer working and the fee affects earnings by increasing spending. Also neutrality of VAT no longer operates even if the operations of the entity are not fully taxable when deductibility is affected. For the entity *that is paying VAT*, performing taxable operations, the profit or loss account is not affected by paying VAT related to purchases, thus accounting and taxation remaining in a neutral report. For the entity that doesn't pay VAT, the deliveries made won't be taxed in VAT, *the amount related to purchased goods will be added to the cost of the purchased goods,* which will be leading to increasing the exploitation expenses. In this situation, we are facing an integrated report on the outcome, determined by the intersection of accounting interest with the fiscal one that requires conciliation when it comes to assessing the patrimony of the entity, determined by measuring the assets, liabilities and equity, income and expenditure. In this regard, if the entity, during the financial year moves from the category of non-VAT payer to that of VAT payer, we must bear in mind that the **principle of Consistency** requires that when methods change, to calculate the **influences** on the state of the entity and on the profit and loss account.

2. Research methodology

Considering the requirements imposed by the problem of research and the accounting and fiscal approaches at national and European level, as well as the global tendencies, we have used a number of tools and research techniques, as follows:

- **scientific analysis** regarding the factors that influence the unifying process and convergence of VAT, as well the necessity of this process;
- **diagnostic analysis** of the harmonization process, which followed the harmonization of national legislation with the EU acquis, in particular

[1] Collette Christine, *Fiscalité des entreprises en France et en Europe*, Editor Ellipses, Paris, 2004, pg. 65

through implementation of European directives in the field.

- **comparative studies** during which have been held:
    - identifying general principles concerning VAT;
    - The essential elements on VAT collected;
    - The essential elements on VAT deductible
    - Practical arrangements and specific field of value;
    - The accounting system of VAT;
- **impact analysis** on the implications of VAT on the entity's performance (on firm, cash flow, breakeven point and confidence interval, on liquidity, solvency and balance rates of the company).

The synthesis of the general issues of this study circumscribes to the report available between accounting and fiscality in terms of evolutions registered in these two areas, focusing on the influences of VAT on the entity's performance**.**

Therefore, although the principle of neutrality represents the originality of this tax, in some specific cases identified in the study it is not necessarily followed to the letter.

3. The value added tax in relation to the entity's results

As a collector, for the entity, VAT is generating direct costs, management costs and cash flow costs.

Direct costs, intervene if VAT is not fully deductible and the non-deductible part of the goods consumed in the interest of its work must be included in the acquisition cost of the asset in question**.** *Increasing acquisition cost by including non- deductible tax leads to increasing operating costs and thus decrease the accounting result.* The decision to allow non-taxable status of VAT must be made depending on the type of activity and the market position of the entity in competition with a payer of VAT, who has the right to deduct VAT[2], because it will be in a disadvantage towards the latter.

An example of this is the current Fiscal Code regulations restricting the right of deduction of VAT for certain purchases.

Management costs are generated by the tax collector position of the company, to that purpose it must organize its accounting information systems, personnel involved, document system used, each of which influence growth by category of expenditure corresponding costs**. Treasury costs** are determined by immobilizing resources of the entity within the time following payment of the fee at suppliers to date fixed for the regularization of the payment obligation when it can result in a difference to be paid or refunded from the state budget**.** In case that from the settlement results an amount representing VAT to be refunded that implies a higher treasury cost, because of the higher period of time (30 days or more) the refund of the tax is made.

If they receive advances and intermediate consumption isn't made to alleviate the obligation to pay VAT deductible, then the tax collected must be transferred to the state budget, with the consequence of decreasing cash flow to the treasury.

There is the possibility that the operations for which the advances were cashed no longer be achieved, as a result the advance will be returned in full to the client, so even though the operation is reversed VAT obligation affected treasury until at least next VAT regulation occurs the following month.

Also, a significant unbalance appears in the treasury of the entity and if the deliveries bearing of tax are not collected in time, after the specific term for paying the tax. The impact of VAT becomes obvious on the financial-patrimonial statement, on the treasury flows and on the financial equilibrium indicators, when these costs categories appear.

Regarding the operations generated by special limitations on the right of deduction for the purchase of vehicles, according to the current tax code, VAT related to purchases of motorized road vehicles that are intended exclusively for passenger transportation, with maximum authorized weight of up to 3,500 kg and not more than 9 seats, including the driver, are not deducted.

Exceptions to the limitation on the right of deduction of VAT are:

- vehicles used exclusively for: emergency services, security and protection services, courier services, vehicles used by sales agents and acquisition;
- -vehicles used to transport passengers with pay, including taxi services;
- vehicles used for rendering paid services, including training by driving schools;

[2] Ana Morariu, M. Paunescu, G. Radu, *Accounting and fiscality in the development of a company*, Editura Expronto, București, 2005.

- vehicles used for hire or whose use is submitted pursuant of a financial or operational lease;
- vehicles used as commodities for trading purposes.

Accounting records arising from the application of special limitations of deduction for purchasing vehicles referred to in art. 298 index 1 of the Fiscal Code, are as follows[3]*: (in case of intra-Community acquisitions of vehicles if VAT is fully deductible then this is totally unrecoverable fee and becomes part of the acquisition cost.)*

a) if VAT becomes chargeable in the same month of performing and receiving vehicle:

- VAT is registered as tax collected and tax deductible:

4426 „VAT deductible”	**=**	**4427 „VAT collected”**

- irrecoverable VAT shall be recorded in cost of acquisition of the vehicle at the time of its reception:

213 „ Technical equipment and means of transport”	**=**	**4426 „ VAT deductible”**

b) if chargeability of VAT on intra-Community acquisition and delivery of the vehicle occurring in different months:

b1) records that are carried in the month the chargeability of intra-Community acquisition intervened:

- we will register VAT as tax collected and tax deductible:

4426 „ VAT deductible”	**=**	**4427 „ VAT collected”**

and at the same time,,

- irrecoverable VAT is registered in the acquisition cost of the vehicle:

231 „Tangible assets undergoing completion”	**=**	**4426 „ VAT deductible”**

b2) registration in the month in which the reception of the goods take place (later declared the month of intra-Community acquisition), in the cost of acquisition of the amount previously registered in account 231 "Tangible assets undergoing completion”:

213 „ Technical equipment and means of transport”	**=**	**231 „Tangible assets undergoing completion”**

In case of vehicles being imported, if VAT is entirely not- deductible then this is a totally unrecoverable fee and becomes part of the acquisition cost. To reflect this in accounting we will make the following accounting entries:

- payment of VAT:

4426 „ VAT deductible”	**=**	**512 „ Current bank accounts”**

and at the same time:

% 213 - „ Technical equipment and means of transport” 4426 - „ VAT deductible”	**=**	**404 „ Suppliers of fixed assets**

For vehicle purchased in the country, VAT will be part of the cost of acquisition only if the tax was deductible in full. For leases, given the fiscal treatment on VAT that is different from the accounting treatment and the income tax treatment, shall be deemed that for assets acquired under a lease contract VAT has not been fully deductible and will not be part of the cost of acquisition of the vehicle.

4. The influence of VAT on cash flow

Any movement of cash flow in or out has an effect on the entity's treasury flow. VAT

[3] Munteanu Victor (coordinator), *Financial accounting of enterprise*, Publishing House Universitară, Bucharest, 2015.

deductible for acquisition of tangible assets can have a positive impact on treasury, but can also generate treasury costs. VAT impact on the financial and treasury flows statement is emphasized in the next case:

If an entity has to pay VAT to the state budget, the tax must be transferred until the 25th of the next month. If the tax related to deliveries was cashed before this date, until the actual payment, a surplus of treasury appears that depends entirely on the receivables collection period. The more this is farthest upstream of the legal deadline for payment of VAT to the state budget the more the entity benefits from a Treasury surplus. To this regard are favored the activities of entities collecting the money for goods sold immediately or at least within the month for which the payment of VAT has to be made, VAT resulting from monthly regularization in which case the entity can benefit from Treasury surplus for periods even higher than 25 days. For the entity that does not collect deliveries for the month for which the adjustment and payment of VAT is made, they face an outflow of cash equivalent to the amounts that were not collected and were the object of determining VAT to be paid.

If the company Alfa purchased during January year N goods in value of 24. 000lei of which:

- acquisition cost 20.000 lei
- deductible VAT 4.000 lei

During the same month, the company sold goods in value of 36. 000 lei for which collected VAT is 6.000 lei. Thus, the company has VAT to be paid in amount of 2.000 lei, meaning a treasury net flow of 2.000 lei for those 25 days until payment is made. The evolution of treasury flow and treasury cost is presented as follows:

Days	VAT to be paid		% corresponding to the period of collection	Cash flows	
	collected	Not collected		Positive	Negative
-	2.000		25/25=1	-	-
1	-		24/25	1.920	80
2	-		23/25	1.840	160
…	…		…	…	…
10	-		15/25	1.200	800
…	…		…	…	…
25	-		-	…	2.000

If clients pay the invoice after 10 days from maturity date, treasury flows decrease with 800 lei. If the invoice is not paid by the client then the company has to fill up the gap in treasury by taking a loan or to seize some payments to other creditors in order to pay VAT owed to the state budget.

If sales remain stable and the maturity date is fulfilled then the company benefits from a loan from the state to constant value of 2.000 lei per month, making a profit by not hiring a loan and thus loan expenses.

Changes occurring in the structure of the company can be summarized as follows, taking into account the company's following financial structure:

Balance sheet items	31.01.N	01.02.N	10.02.N	25.02.N
Fixed assets Current assets of which: Receivables T.V.A. to recuperate Available in monetary	240.000 130.000 20.000 - 110.000	240.000 130.000 - - 130.000	240.000 130.000 - -	240.000 125.600 - - 125.600
TOTAL ASSETS	370.000	370.000	370.000	365.600
Equity Loans Other debts of which: VAT to be paid	240.000 - 130.000 2.000	240.000 - 130.000 2.000	240.000 - 130.000 2.000	240.000 - 125.600 -

Other liabilities	128.000	128.000	128.000	125.600
TOTAL EQUITY AND LIABILITIES	370.000	370.000	370.000	365.600

In the event that the company would have to collect VAT from the state budget, then it will face the need for liquidity, and in a hypothetical case changes that occur in the evolution of the treasury flow can be summarized as follows:

Days	VAT to be collected	Number of days
3I.0I.N	2.000	-
01.02-25.02.N	2.000	25
25.01-25.03.N	2.000	90
Total	2.000	115

In this case the company has to cover the treasury gap of 2.000 lei, by taking a loan from a bank which means that the income will be low and treasury flows will be negative, VAT impact will be as follows:

Balance sheet items	31.12.N-1	25.01.N	25.02.N
Fixed assets Current assets of which: Inventory Receivables VAT to recuperate	240.000 130.000 100.000 20.000 2.000	240.000 132.000 100.000 30.000 2.000	240.000 130.000 108.000 20.000 2.000
TOTAL ASSETS			
Equity Loans Other debts of which: VAT to be paid Other liabilities	240.000 - 130.000 - 130.000	240.000 2.000 130.000 - 130.000	240.000 - 130.000 - 130.000
TOTAL EQUITY AND LIABILITIES	370.000	372.000	370.000

From the financial structure presented we can say that between 01.01.N and 25.06.N, the company is forced to adopt one of the following strategies:
• to hire a loan from a bank ;
• to decrease inventory by accelerating their rotation speed;
•to reduce the volume of credit to customers by accelerating the collection of receivables from customers.

Also, another situation is where the VAT deductible exceeds the VAT collected. This situation is due mainly to the following causes[4] :

- circumstantial reasons - when the entity performs an investment the amount of VAT is important;

4 Collette Christine, 2004, *Fiscalité des entreprises en France et en Europe*, Editor Ellipses, Paris, pg. 65

- Structural causes - the case with application of multiple VAT rates for exports.

To remedy this situation the Finance Administration provided the refund procedure for VAT.

In fact, delays in VAT reimbursement are variable and affect the financing needs of the entity. In reality, however, many entities prefer to give up this right, preferring to wait for temporary carts adjustment to be reabsorbed in the coming months that have income from investments, because the reimbursement procedure is cumbersome and sometimes takes a long time. In conclusion, we can say that through the costs and imbalances that are generated by VAT in treasury flows, poor management implications of this position can create unstable situations and could cause disruption to the life company.

5. The influence of VAT on the breakeven point and on the confidence interval

In practice, knowledge of the breakeven point and confidence interval gives the opportunity to make decisions that minimize the possible influences of certain factors. The relationship measuring the breakeven point has the following form:

$$Q = \frac{F}{1 - \frac{V}{F}}$$

Where:
Q – Breakeven point
F – the amount of fixed costs
V – the amount of variable costs

To determine the confidence interval we will use:

$$Is = \left(1 - \frac{Q}{CA}\right) \times 100$$

Where:
Is – confidence interval
CA - turnover

The more the confidence level is higher the more the company will take less risks. If the company is registered as a VAT payer and will benefit from the right to deduct according to all its activity, VAT will be neutral and the breakeven point and confidence interval will not change.

If the entity must include VAT that is not deductible, in the exploitation costs, management costs and treasury costs then the breakeven point and the confidence interval will change according to expenses variations.

6. The influence of VAT on liquidity, solvency and balance rates of the entity

For entities that are not registered as payers of VAT and are not entitled to deduct, or are registered as paying VAT, but the deduction of VAT using a pro rata below 100%, the acquisition cost of goods used in operating activities simultaneously increases and at the same time by the same amount the result.
As we previously stated, payment of VAT if the value of VAT related to deliveries was not collected until the maturity date of VAT owed to the state budget every month, then an outflow of cash is going to happen that will decrease the treasury flow or the enterprise is forced to hire a loan. All of these influence the liquidity, solvency indicators and implicitly the financial equilibrium and efficiency rates.

1. The general level of liquidity = (Cash / Total assets) x 100
Optimal level 1, 5 -2 %.

2. Net liquidity level = (Cash / Total current assets) x **100**
Optimal values must be between 3 and 5 percent

3. Overall solvency = (Active / total debt) x **100**
Overall solvency must be higher than 100%

4. General solvency = (Current Assets / Current Liabilities) x **100**
General solvency must be between 1, 6 and 1, 8 percent.

5. Immediate solvency = (Current Assets - Inventories) / Current Liabilities
Immediate solvency must be between 0, 6 and 1.

6. Financial autonomy rate = Equity / (Equity + Capital borrowed)

7. Financing rate of inventory= Working capital / Inventory

The full report of VAT rates does not generate value movement of solvency and liquidity, but influence VAT rates on liquidity and solvency their upside occurs when the economic agent has to pay VAT to the state budget, benefiting from a surplus of treasury.
If sales remain constant and due date is not changed, the company benefits from the state from a constant loan, which enables it to achieve an additional profit, determined by the interest that would have been paid to financial institutions borrowers, for purchasing available funds.
If the company has to recover VAT, then will face the need of liquidity, being in a position to take out a bank loan, and reduce inventory by accelerating the speed of rotation or reduce the volume of credit to customers by speeding up procedures collection of receivables from business partners. These measures will lead to reduced liquidity and solvency ratios.

Financial equilibrium rates are as follows:

8. The rate of self-financing assets = Equity / (Fixed + Current assets)

9. Debt ratio = 1 - self-financing rate of assets

If the company has to pay VAT that means that it will be able to use created liquidity and give up loans. This will lead to increasing the financial autonomy rate, of inventory financing rate and decrease liability rate. Otherwise a decrease in these rates takes place.

Rates of return correspond to following relations:

10. Economic rate of return = (Profit / Total assets) x 100

11. Return on equity = (Net profit / Turnover) x 100

The neutral report of VAT if the economic agent is paying VAT and performs operations with 100% pro rata will not change the return rates.

In case VAT is not fully deductible, because the economic agent performs operations which are exempt, or doesn't have 100% prorate, costs entailed will lead to the decrease of economic profitability and of the rate of financial return[5].

7. Conclusions

In relation to the management of the entity, the value added tax is neutral, provided the enrollment in the category classification and registration as payers of VAT as required by law. Otherwise, neutrality no longer works and the **fee affects the result by increasing spending**.

Furthermore, any movement of cash entering or leaving has an effect on the treasury flow of the entity. VAT deduction for the acquisition of assets can have a positive effect on treasury, **but can also generate Treasury costs**. This aspect was analyzed in this study, emphasizing that delays in reimbursement of VAT are variable and affect the financing needs of the entity.

Also it was highlighted **the influence that VAT exerts on breakeven point and on the confidence interval of the entity.** An entity will be subject to less risk as the confidence interval is greater. If the entity will be registered as VAT payer and will be entitled to deduct in respect of all activities, VAT will have a neutral character and the breakeven point and confidence interval, will not change. If the entity is put in a position to include exploitation costs, management costs and treasury costs, then VAT which is not entitled to deduct will lead to breakeven point and confidence interval to change, depending on changes in spending.

Another issue identified in the study captured the influence of value added tax on liquidity, solvency and balance rates of the entity. As we reported previously, the payment of value added tax while the value of VAT relating to supplies was not collected until at least the term of payment of VAT payable monthly to the state budget, an outflow of liquidity takes place, which diminishes treasury flow or the entity is forced to resort to loans. All these have influence **on indicators of liquidity, solvency and implicitly on rates of return and financial equilibrium.**

[5] Ana Morariu, M. Paunescu, G. Radu, *Accounting and fiscality in the development of a company*, Publishing House EXPONTO, Constanţa, 2005.

8. Bibliography

1. Collette Christine, *Fiscalite des enterprises en France et en Europe*, Editura Ellipses, Paris, 2004.

2. Ana Morariu, M. Paunescu, G. Radu, *Accounting and fiscality in the development of a company*, Editura Expronto, Bucharest, 2005.

3. Munteanu Victor (coordinator), *Financial accounting of enterprise*, Publishing House Universitară, Bucharest, 2015.

4. Tirard J.M., La *fiscalité des sociétés dans l'Union Européenne, 8-eme Edition*, Groupe Revue Fiduciaire, Paris, 2010.

5. Law no.227 / 2015 regarding the Fiscal Code, published in M.O. of Romania no. 688 from 09/10/2015.

6. Order M.F.P. 1802/2014 for the approval of accounting regulations on the annual individual and consolidated financial statements.