



APPLICATION OF THE TAX CODE IN THE DEDUCTIBLE EXPENSES FIELD IN THE JUDICIAL PRACTICE OF ROMANIA

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Abstract Application of tax legislation in Romania, in the sense of determining what elements may not reduce the taxable base in determining corporation tax in the case, in which supporting documents shall give particulars incomplete or does not correspond to the facts, have generated various controversies. It was revealed that, in such situations the error operators beneficiaries is objective and cannot be attributed to them. Other views were expressed in the sense that it is prohibited to issue and use of invoices, considering that you can't deduct the value added tax, nor can reduce the taxable base at corporation tax setting, where supporting documents do not contain all the information required by the laws in force. Situation where fiscal inspection fails to establish the basis for imposing the obligation of tax payment, by using reasonable estimation process based on any evidence and means of proof provided for by law, whenever it cannot determine the correct fiscal situation.

Key words:

value added tax, corporation tax, supporting documents, inactive contributor invoice, Court, imposing base, highlights basic accounts, criminal sentence, the decision imposing, deductible expenses, taxable gross profits estimated, commercial environment, added surcharges and penalties for delay

JEL Codes:

M21, M41

1. Tax trap

A company from Pitesti, having as its main activity, the recovery of recyclable waste and scrap metal, CAEN code 3710, is bona fide buyer. Records under which registered the goods under management are evidence of the terms of the legislation in force on the date of supply of goods, since it was deducted value added tax only after the original invoices, which are filled with all the data required by the document have been posted to the General Ledger, and however, does not understand what this company has come the fact that suppliers who delivered goods in the period of 20.09.2002-10.03.2007 were declared inactive in 2006 or are subsequently prosecuted.

2. Administrative consequences

The supervisory body calculated an additional tax on the grounds that some of the suppliers of goods have been declared inactive, starting with 17.10.2006, no invoices have been registered in their financial and accounting records, do not have invoices from authorized suppliers, without taking into account the supporting documents (registration certificate, authorized by recyclable industrial waste collection from individuals, buy-sell agreements and criminal sentence).

3. Legal controversy

Records on which the company from Pitesti recorded as deductible expenditure on goods supplied from the inactive contributors, cannot be taken into consideration because it mentions¹: "after declaring as inactive, the taxpayer no longer has the right to use invoices, tax bills and other documents or special report forms".

In the text of the resolution it is claimed that the goods in question have been paid, were used for the production of taxable income and the company cannot be penalized for non-compliance with tax obligations by suppliers.

In law, the cause is solutioned according to legal provisions² as follows: "the purchases made by the company on the basis of the invoices issued by the companies after their declaration that inactive date no longer have legal effect from the tax point of view".

The motivation of the conclusions made by the inspection team has been taken into account the act³ which states the following:

The Attorney general's Office of the Embassy of the High Court of Cassation and Justice argued the appeal law, putting the conclusions of its admission in the sense of determining what elements may not reduce the taxable base in determining corporation tax in the

case, in which supporting documents shall give particulars incomplete or does not correspond to reality. In applying legal provisions⁴, courts do not have a unified point of view.

Thus, some courts have ruled that emergency may unavoidably surround the manifest, the applicants, beneficiaries of the goods or services supplied or rendered, have no legal possibility to verify that the companies which have submitted the appropriate justifications have been pre-printed on legal means or if I am correct the registration numbers at the trade registry office specified by the suppliers or service providers, nor verify the documents on which they have received from them have all the boxes filled in properly.

In motivating this view was held that economic operators are recipients of goods and services that cannot be liable for an offence culpable made by other legal entity because it would violate the principle of good faith in commercial relations. It was pointed out that in such situations the error operators beneficiaries is objective and cannot be attributed to them, unobserving form of invoices or other documents issued by suppliers of goods or service providers, nor their legal situation at the time of drawing up the supporting documents.

Other courts, however, have ruled that it is forbidden to issue and use of invoices that do not meet the requirements of supporting documents, in the meaning of the legal⁵ provisions, considering that you can't deduct the value added tax, nor can reduce the taxable base on profit tax setting where supporting documents do not contain all the information required by the laws in force on the date on which the operation is applied for deduction of value added tax.

Through the fiscal frame⁶ it states that: *"the taxable profits are calculated as the difference between the income from any source and expenditure incurred for the purposes of revenue from tax year, minus non-taxable income and non-deductible expenses added"* and that: *"in determining the taxable profit shall be taken into account and other similar revenue and expenditure items according to the implementing rules"*.

The general rule is that the algorithm for calculating taxable profit, a deduction may be made for any identified proportion or part of an expense that is incurred entirely⁷.

The other legal notices⁸ it is stated that: *"revenue and expenditure to be taken into account in determining the taxable profit shall be those recorded in the accounts according to the accounting rules under the law on accountancy data, republished, with subsequent amendments and additions, as well as any other similar revenue and expenditure items, minus non-taxable income and non-deductible expenses are added."*

However, the meaning of provisions⁹ states: *"are treated as expenses deductible only expenditure incurred for the purposes of taxable income, including those regulated by normative acts in force"*.

In this regard, however, is to note that¹⁰ *"are not deductible, inter alia: the expenditure recorded in the accounts, which isn't based on a supporting document, according to the law, to make proof of the operation or management, as appropriate, in accordance with the rules"*.

As a result, according to these rules without quibble, cannot be diminished tax base the tax on profits if the documentary evidence does not contain or does not supply all the information required by the laws in force at the date of transactions.

Deducting tax is an issue from the point of view of fairness and morality of the taxpayer, because according to its application generates financial benefits disproportionately to the rich and strong¹¹.

4. The current law. Reasons for change

General Direction of Public Finances through the County Administration of Local Public Finances, Fiscal Inspection Service has forwarded an address to the Prosecutor of the County Court, the Criminal Division stating that as a result of checks, it says that the company from Pitesti compromised the State budget by the amount of 1.404.043 lei, and motivates. The basis for imposing the tax on the profit for the years 2006 and 2007 was modified, with the amounts arising from the entrance of goods origin documents from taxpayers declared inactive, such as other privately owned commercial companies considering a regulatory act that contains the list of inactive taxpayers¹². Thus infringed the legal framework¹³ which specifies that: *"shall not be taken into account by the tax authorities the transactions carried out with a taxpayer declared inactive by order of the President of the National Tax Administration Agency"*.

In turn, Prosecutor of the County Court, Criminal Division have send an address to the Ministry of Administration and Interior, by the County Police Inspectorate, which filed by Fraud Investigation Service a report with the proposal not to criminal proceed against the administrator of the company, the frame in question.

General Direction of Public Finances County, made an address to the local Tribunal in the form of complaint against the resolution given by the Prosecutor of the local Court in the criminal file which has ordered to confirm the police proposal not to bring prosecutions against the administrator of the company from Pitesti, researched in terms of crime and punished in legal framework¹⁴ not being met constituents, without intent as a form of guilt.

County Court Criminal Division, in public meeting, passed a criminal sentence¹⁵ arguing that in question are not met the constitutive elements of crime of tax evasion and the solution of the Prosecutor not to prosecute against an administrator is lawful and reasoned.

Those detained, in the sense that certain suppliers of intimate would be declared inactive because it does not have functioned on the premises stated or that have not submitted their balance sheets as provided by law, cannot be attributed to intimate.

In the report with the proposal not to prosecute, it follows that all the goods which were purchased by the intimate have been paid through promissory notes, bank documents, so all operations made by intimate were transparent operations.

In the preceding acts carried out in the question, it was noted correctly by the prosecution that the companies that held commercial relations with the company from Pitesti, in the period 2000-2006, for the purchase of ferrous materials, have issued invoices for tax collection, authorization certificates of registration and certificates of registration tax of those companies, merchandise being paid through money orders.

The intimate not concerned proceeded to highlight accounting acts and other legal documents of expenses based on actual operations or to highlight some fictionalized.

5. Case study

The National Agency for fiscal administration, through the General Directorate of public finance of the District issued a decision concerning the settlement of the appeal made by the company from Pitesti, whereby:

(a) dismissed as unfounded the appeal lodged against the decision imposing for the amount of 283875 lei (263335 lei profit tax and tax on the amount of 20540 lei added value tax);

(b) partial termination of the imposing decision, for the amount of 1115113 lei (lei 222067 value added tax, 167603 lei penalties of delay increases relating to value added tax, profit tax 289771 lei and 435672 lei increases and penalties for delay relating to corporation tax).

The National Agency for fiscal administration, through the General Directorate of Public Finance of the District has ordered another tax inspection, in which case his advisors have drawn up a tax inspection report and a decision to impose additional tax obligations relating to the payment of tax in the amount of inspection 85685 lei - rises and late penalties relating to corporation tax, 18459 lei increases of late - relating to value added tax and 1243 lei - penalties of delay relating to value added tax.

The company from Pitesti challenged these tax acts, at the County Court, Civil Division.

According to the law¹⁶, what specifies: *"The resolution of complaints, the settlement will have jurisdiction in relation to the surveys in question, in so far as they have implications for tax issues"*. In this sense the Comptroller responded to the following objectives formulated by the Court¹⁷:

Goal no. 1: the expert will rule if the amount of 6156 lei corresponding to tax invoice issued by a supplier from Galați was deductible for tax purposes.

In 2002 the company has deducted the value added tax in the amount of lei, corresponding to tax invoice dated 20.09.2002 issued by a trader from Galați, without requiring the supplier a copy of tax registration certificate¹⁸.

In this regard, the expert calculated: the increase for delay in amount of 9826 lei and penalties for delay in amount of 1243 lei.

Goal No. 2: the expert will rule whether the amount of 14384 lei - representing value added tax - has been deducted by the challenger from the original invoices, after observing data required by law.

The amount of 14384 lei, representing payable value added tax, fixed as flow for the company from Pitesti, on the basis of tax inspection report, has the following members:

(a) The wrong calculation of the commercial add for the amount of 36566 lei with a value added tax of 6948 lei, as a result of goods downloads for December 2004.

Against this finding of the supervisory body the expert has not identified violations of the legal provisions¹⁹.

(b) Taxpayer in Pitesti has not adjusted value added tax initially deducted related to the reduction of the value of the production hall inventory, as a result of the assessment report drawn up on the date of November 30, 2007 and, in accordance with the legal provisions²⁰, establishing for the petitioner a supplementary tax on added value, in amount of 7436 lei.

The expert took into account records: evaluation report to the fixed asset that is named "production Facility in the area of 1,507, 23 sqm." and the balance of fixed assets, which included: a the input value of a 67126 lei, a total depreciated value of 4812 lei and the remaining depreciation value of 62314 lei.

Towards these items was calculated the reconciled total value of 27991 lei = [67126 lei-(4812 lei + 112 lei/depreciation for the month in progress)]-[(67126 lei – 4812 lei – 112 lei) x 55%] = (62202 lei - 34211 lei), amount that corresponds with the one mentioned in the evaluation report.

So the value at which should have been calculated the additional value added tax was actually: 6500 lei lei = (34211 lei/the sum of the decrease value of the hall x

19%) and not 7436 lei = 39135 x 19%), mathematical error that stems from the fact that the supervisory body has taken into account the total amount written off in the amount of 4924 lei = (39135 lei - 34211 lei) = (4812 lei + 112 lei) which was operated on the intimate costs. The expert has computed the value of delay increases in amount of 1379 lei.

Objective No. 3: the expert will rule whether for the amount of 263225 lei, representing the profit tax, the challenger had the legal right to deduct profit expenses outlined in the remembered quantum, through the invoices issued by a trader from Ilfov, Romania.

Considering the procedural provisions of the estimate tax base (the estimated profit = estimated revenue – estimated expenses)²¹ stating: *"the tax organ establishes the tax base and the obligation of tax payment, by reasonable estimation of the tax base, using any evidence and evidence means provided by law, whenever it cannot determine the correct fiscal situation"*, in conjunction with²²: *"in situations where tax inspection found that accounting records or tax [...] or documents and information submitted in the course of tax inspection is incorrect, incomplete, [...]"*, in conjunction with²³: *"Estimation of the tax base will be held in situations such as the [...] do not permit the setting of correct tax bases"*.

Towards these legal provisions, the expert calculated an additional profit tax of 17314 lei = (108213 lei x 16%), following the registration of invoices issued by an inactive contributor for the period 19.10.2006 – 22.12.2006, in value of 532359 lei. The commercial entity from Pitești added a commercial average of 20,327% in 2005, for the management of account 3711 – ferrous. For estimated incomes of 640572 lei = (532359 lei x 120,327%) involves expenditure of goods estimated at the value of 532359 lei and a taxable gross profit estimated by 108213 lei = (640572 lei – 532359 lei). The expert calculated the delay increase in amount of 9021 lei.

Towards these legal provisions, the expert calculated an additional profit tax of 30841 lei = (192756 lei x 16%), following the registration of invoices issued by an inactive contributor for the period 02.01.2007 – 10.03.2007, in value of 1113489 lei. The commercial entity from Pitești added a commercial average of 17,311% in 2006, for the management of account 3711 – ferrous. For estimated incomes of 1306245 lei = (1113489 lei x 117,311%) involves expenditure of goods estimated at the value of 1113489 lei and a taxable gross profit estimated by 192756 lei = (1306245 lei – 1113489 lei). The expert calculated the delay increase in amount of 12828 lei.

Goal No. 4: the expert will rule if the record in the accounting of the invoices issued by the operator of Ilfov, to the company from Pitesti, had legal basis.

The expert analysed the original invoices issued by the company from Ilfov for the contributor from Ploiesti for the period 19.10.2006 – 10.03.2007 in total value of 1645848 lei. The invoices are corresponding to the legal model²⁴ and are fulfilled with all requested data²⁵.

The commercial entity from Pitesti issued entrance reception notes for every good purchased. The goods purchased with the bills in question were paid with money orders through the Bank.

Goal No. 5: The expert will rule if during 2002 – 2008 the challenger company asked and cashed refunds of value added tax. To determine whether the invoices for which has not been granted the right to deduct value added tax by the tax inspection body shall constitute supporting documents.

According to the correspondence from 20.11.2008 send by the The County Public Finance Administration to which reference is made in the criminal sentence dated 06.09.2011, it is stated that: *"in the period 2000-2008 taxpayer in Pitesti has not requested refunds of value added tax"*, which is also confirmed by the financial-accounting records provided by the respondent's expert.

According to the law²⁶, the invoices issued by the contributor from Ilfov during 19.10.2006 – 10.03.2007, in total value of 1645848 lei, are supporting documents for the company from Pitesti.

Goal No. 6: The expert should determine whether the bills for which no deduction was granted legal have been paid through the Bank.

Goods purchased from the society of the Ilfov County based on 35 invoices issued during 19.10.2006-10.03.2007, worth a total of 1645848 lei had been paid with money orders through the Bank.

The report looks at the content of the proposal dated 18.08.2009 with proposal for not prosecution issued by the fraud investigation service of the County Police Inspectorate framework, it appears that all the goods which were purchased by the intimate, have been paid through promissory notes, bank documents, so all transactions made by the company from Pitești were transparent operations, according to the criminal sentence 06.09.2011.

Goal no. 7: the wizard to establish with respect to income taxes and increases delay, which is the source of them, calculating the income tax each year separately.

Accessories for payment (and increases penalties for delay) relating to income tax debts have been calculated on the basis of legal provisions²⁷.

The expert calculated the associated increases for delay in amount of 9021 lei for an additional profit tax in amount of 17314 lei, for the year 2006, stating that tax accessories were calculated during 25.01.2007-30.06.2008.

The expert calculated the associated increases for delay in amount of 12828 lei for an additional profit tax in amount of 30841 lei, for the year 2007, stating that tax accessories were calculated during 25.04.2007-30.06.2008.

Considering all those metodological and legal issues, the amounts calculated by the expert are: delay increases in amount of 21849 lei and supplementary tax on profit in amount of 48155 lei.

Goal No. 8: The expert should to determine whether the disputed invoices shall include the particulars required according to legislation – being supporting documents.

The expert will analyse whether the goods purchased from the intimate from the trader in Ilfov, on the basis of those 35 invoices, during the period 19.10.2006-10.03.2007, totalling 1645848 lei, fulfil the conditions for being regarded as documentary evidence.

The company owns the original invoices in accordance with the legal provisions²⁸, and from the analysis of each of the Bills has been found:

- 1) This includes all mandatory elements of the legal framework²⁹;
- 2) goods entered into the management of the company and in this case, there are entrance-reception notes;
- 3) such purchases are linked to taxable transactions.

Goal No. 9: The expert should analyze whether the goods were recorded in the accounts of the company from Pitesti.

The goods supplied by the company of Ilfov, on the basis of 11 tax invoices, during 19.10.2006-22.12.2006 period, totalling 532359 lei, have been recorded in the financial-accounting records of the company from Pitesti, in this regard have been issued entry notes-reception for each invoice individually.

The goods supplied by the company of Ilfov, on the basis of tax invoices for the period 24 02.01.2007-10.03.2007, totalling 1113489 lei, have been recorded in the financial-accounting records of the company from Pitesti, in this regard have been issued entry notes-reception for each invoice individually.

Goal No. 10: the expert should to analyze whether the expenses incurred with the goods are joined to the earnings of the same period. For each invoice in part will examine whether they are deductible from legally.

The goods supplied by the company of Ilfov, on the basis of 11 tax invoices, during 19.10.2006-22.12.2006 period, totalling 532359 lei, have been sold to various customers in Romania, documents that were included in the monthly sales journals.

The goods supplied by the company in Ilfov, based on the 24 tax invoice, during 02.01.2007-10.03.2007,

totalling 1113489 lei, have been sold to various customers in Romania, invoices were included in monthly sales journals.

Goal No. 11: the expert should to determine whether the goods purchased by the company can be found in the products sold.

Goods supplied from the trader in Ilfov are found in products sold to commercial companies with private capital in our country. These acquisitions have been associated with the development of taxable operations³⁰,

because the company has issued and recorded in the accounts of subsequent sales invoices with these goods according to market prices, invoices entered in the journals for sale.

Compared to the total flow in amount of 389262 lei County Administration of Public Finances calculated and recorded in the evidence of the National Tax Administration Agency, Regional General Directorate for Public Finance Ploiesti through technical expertise-specialty accounting, legal, arrived at the following result, totalling 95108 lei, of which 48155 lei: income tax, tax on the value of 12656 lei added to 21849 lei rises, the delay incurred in additional corporation tax, price increases of late 11205 lei relating to value added tax and penalties of 1243 lei delay relating to payable value added tax.

6. Conclusions. Proposals

With regard to profits tax, the amount calculated by the Comptroller is different taking into account the fact that, in the determination of financial results and income tax determined that additional tax payable has not taken account of the second element of calculation, namely the supply of goods.

Objectively, without spending income cannot be achieved. It should have used the procedure to estimate the tax base³¹, (profit = revenue + expenses), in force at that time: *"If the tax body cannot determine the size of the tax, it must consider"*.

As a result, technical-legal expertise in the field of accounting³², determined the estimated profit (tax base for corporation tax) on the basis of the average margin of the company from Pitesti, in the previous year for the year concerned.

According to the law³³, referring to the opposition of the intimate in administrative field, stated: *"the object of the appeal is only the amounts and measures established by the tax in inscribed the title of the administrative act, or claim tax attacked"*.

The claim title is defined³⁴ as: *"the Act by which the law is established and individualizes the obligation to pay the tax claims, drawn up by the competent authorities or other persons holding entitlement under the law "*. Such titles may be assimilated to: *"order,*

conclusion of the Prosecutor or the Court judgment [...], a prosecutor or court".

Using the principle of repair, in the American jurisprudence, has led to sharp disagreements between the federal courts and in respect of the proportion of deduction of certain expenses for the purpose of fixing net profit³⁵.

How is the controversial case since 1993, the U.S. Supreme Court has imposed some difficult requirements for general expenses deductions. This decision was not without controversy, by limiting expenditure, it has been concluded that: *"this solution limiting the category of deductible expenses can be a trap or a discrimination against tax professionals?"*. In accordance with the specific legal framework (Internal Revenue Code), taxpayers have traditionally able to deduct all expenses "ordinary and necessary" and to conduct a trade or business from the proceeds of the economic operator concerned³⁶.

In conclusion the authors considered that both the solution when the expert calculate the tax due to flow through the application of process assessment³⁷, and the solution of the annulment by the Court of the whole control act taking into account the elements identified by the expert, and later with a new tax act taking into account the favourable points to which he made reference³⁸, are valid.

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- ²⁰ According to art.149, paragraph (4), lit.b) from Law nr.571 from 22.12.2003, republished, regarding The Fiscal Code, The Official Journal no.92 from 23.12.2003.
- ²¹ According to art.67, paragraph (1) from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.
- ²² According to art.67, paragraph (2), lit.b) from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.
- ²³ According to art.65, pct.65.1, lit.a) from Decision nr.1050 from 01.07.2004 for approving The methodological norms for applying the Ordinance nr. 92/2003 regarding The Fiscal Procedure Code, The Official Journal no.651 from 20.07.2004.
- ²⁴ Provided by the Decision nr. 831 from 1997, The Official Journal no.368 from 19.12.1997.
- ²⁵ According to art.155, paragraph (5) from Law nr.571 from 22.12.2003, The Official Journal no.92 from 23.12.2003, with subsequent amendments.
- ²⁶ According to art.6, paragraph (1) from The accounting law nr.82 from 1991, republicat, The Official Journal no. 454 from 18.06.2008.
- ²⁷ According to art.1, art.3, paragraph (1) from Decision nr.1513 from 18.12.2002, The Official Journal no.959 from 28.12.2002; art.24 from Law nr.414 from 26.06.2002, The Official Journal no.456 from 27.06.2002; art.12, art.14, paragraph (1) from Ordinance nr.61 nr.29.08.2002, republished, The Official Journal no.582 from 14.08.2003; art.119 and 120, paragraph (7) from Ordinance nr.92 from 24.12.2003, republished, The Official Journal no.580 from 05.07.2005; pct.15⁶, art.3, paragraph (5) from Law nr.210 from 04.07.2005, The Official Journal no.580 from 05.07.2005.

- ²⁸ Provided by pct.46, paragraph 1 from The methodological norms for applying the art.146 from The Fiscal Code, approved through Decision nr.44 from 2004, The Official Journal no.575 from 04.07.2005, with subsequent amendments.
- ²⁹ Provided by art.155, paragraph (5) from The Fiscal Code, Law nr.571 from 22.12.2003, The Official Journal no.92 from 23.12.2003.
- ³⁰ According to the provisions of art.145, paragraph (2), lit.a) from The Fiscal Code, Law nr.571 from 22.12.2003, The Official Journal no.92 from 23.12.2003.
- ³¹ Provided by art.67, paragraph (1) from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.
- ³² Nr.1169 from 15.01.2014.
- ³³ Art.206, paragraph (2) from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.
- ³⁴ Art.107, paragraph (1), lit.g) from Decision nr.1050 from 2004, The Official Journal no.651 from 20.07.2004.
- ³⁵ Kenneth E. Burdon (2007), „Accounting for profits in a copyright infringement action: a restitutionary perspective”, vol. 87, No: 255-288.
- ³⁶ Banatte, Jean-Marie & Damtew, Desta (2008), “ Entrepreneurial Executive Publisher: The Dream Catchers Group”, vol. 13, No:1-6.
- ³⁷ According to art.67, paragraph (1) from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.
- ³⁸ Art.216, paragraph (3) “Solutions for litigation” from Ordinance nr.92 from 2003 regarding The Fiscal Procedure Code, republished, The Official Journal no.580 from 05.07.2005.