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Split VAT - To Be Or Not To Be

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Romanian Government Ordinance no. 23/2017 regarding split VAT payment entered into force on October 1, with its provisions being optional until the end of 2017. On January 1, 2018, the Ordinance becomes mandatory.

According to the Ordinance, VAT payments to suppliers must be made directly to a special VAT account which each company is required to open. Similarly, VAT must be collected only in the special VAT account if the payer is a taxable entity. If the payer is not a taxable entity (e.g., if the payer is a natural person), the VAT collected by the company must be redirected to the special VAT account within seven business days.

Public institutions and all taxable entities are required to apply the split VAT scheme, including any entities carrying out an economic activity, whether or not registered for VAT purposes, and self-employed persons, if they are registered for VAT purposes.

The amounts in the special VAT account can be used to pay VAT to suppliers and the State budget VAT obligations. It can also be used to finance other taxpayer needs, but only after the tax administration's express authorization is obtained. The special VAT account can be foreclosed exclusively for the payment of VAT due to the State budget, as well as for the payment of other outstanding budgetary obligations.

As expected, severe punishments are provided for a number of infringements, such as fines of 50% of the amount paid to the wrong account of the supplier (i.e., an account other than the VAT account), if the error is not corrected within 30 days, as well as a fine of over 50% of the amount within the VAT account if it is used in a manner other than that provided for by the Ordinance.

To date very few companies have opted for the split VAT system. In addition, the Government has indicated that it may amend the Ordinance by making splitting mandatory only for public institutions, insolvent companies, and companies with a record of bad VAT behavior (e.g., making late or no payments).

These proposals are meant to temper the loud criticism of the business environment, which has objected strenuously to the short period before implementation and the additional costs required for implementation for both tax authorities and taxpayers, all required to adapt their IT systems and payment processes accordingly.

In this respect, it is worth recalling the evolution over time of two other fiscal measures adopted to combat VAT-related evasion. In their initial version, the measures were abused by the tax authorities, and eventually became the subject of an infringement procedure against Romania and significant litigation, including one case that reached the European Court of Justice.

The first of these measures concerned the cancellation of the right to deduct VAT in purchases from entities declared inactive. In order to conclude the infringement procedure, as of January 1, 2017, the tax authorities were required to replace the cancellation sanction with the suspension of the right of deduction for the period during which the supplier had the canceled VAT code, including as a consequence of its inactivity.

Another approach to tackling VAT evasion was a non-transparent and complicated methodology for VAT registration. This measure was amended several times and a positive turnaround was made in terms of transparency and reducing bureaucracy. As a result, registration for VAT purposes got easier for honest tax payers on October 1, 2017, following the implementation of the minimum score system, based on the assessment of the administrators/associates/shareholders' history in relation to tax authorities, as well as the analysis of certain company-specific criteria.

Hence, although it is clear at present that the tax authorities wish to maintain the split VAT system, the current version should be adjusted to ensure that its enforcement has only minimal effect on law abiding taxpayers. Once this goal is attained, undertakings should recognize the beneficial outcomes the fight against tax evasion may bring to the business environment.

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