

**ACCOUNTING AND FISCAL TREATMENT OF VALUE-ADDED TAX FOR CONSTRUCTION SERVICES****Dorel MATEȘ***West University of Timișoara, Romania***Daniela PORDEA***EVILANZ SRL, Romania**danapordea@gmail.com***Abstract**

*In this article we aim to approach the influence of the recent changes in the fiscal legislation regarding VAT on the accounting and taxing treatments of the construction contracts.*

*In the case studies, we are considering the application of the "VAT upon collection" system, as well as the split VAT payment mechanism, according to the Law 227/2015 regarding the Fiscal Code and the Law 275/2017 for the approval of Government Ordinance 23/2017.*

**Key words:** *collection; construction; guarantees; split payment; VAT*

**JEL Classification:** *M41, K34*

**I. GENERAL APPROACHES**

International Accounting Standard no. 11 "Construction contracts" defines the construction contracts as those contracts "specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use".

In the sense of the Romanian fiscal legislation, construction-assembly works represent service deliveries that result in successive settlements or payments, so they are considered performed at the date when the work progress reports are issued or, as the case may be, at the date of their acceptance by the beneficiaries, according to the contractual requirements<sup>8</sup>. The basis of value added tax is the counterparty obtained or to be obtained by the contractor from the beneficiary; performance guarantees do not constitute supplies of goods or services and are therefore not included in the taxable amount of VAT<sup>9</sup>.

Value-added tax becomes chargeable with the occurrence of the generator fact, but the entities can choose to apply the "VAT upon collection" system, under which VAT becomes chargeable at the date of total or partial collection of the invoices issued for the deliveries of goods or services. The tax legislation imposes a number of eligibility conditions for exercising this option. These are mainly related to the achieved turnover, but also to the place of economic activity - the registered office. According to Art. 297 par. (2) of the Fiscal Code, the right of an entity applying the "VAT upon collection" system to deduct the value-added tax on its acquisitions "is deferred until the date when the tax on the received goods or services was paid to their supplier".

One of the most recent Romanian fiscal policies on VAT concerns the split VAT payment mechanism according to which all the VAT registered entities (with the exception of public institutions) are required to pay the tax on their purchases of goods or services in a supplier's VAT account, if the supplier applies the split VAT payment mechanism. If the amounts are paid into a guarantee bank account at the supplier's disposal and this supplier applies the split VAT payment mechanism and only has access to the money after certain conditions have been fulfilled, when the money is released the supplier has the obligation to pay the tax into their own VAT account within 30 working days<sup>10</sup>.

<sup>8</sup> Law 227/2015 regarding the Fiscal Code published in the Official Gazette 88/10.09.2015 with subsequent amendments and completions, art. 281 par. (7)

<sup>9</sup> Ibidem, art. 286 par. (1) let. a)

<sup>10</sup> Law no. 275/2017 for the approval of Government Ordinance no. 23/2017 on split VAT payment mechanism, art. 3, par. (1)

**II. VAT ACCOUNTING TREATMENT FOR CONSTRUCTION WORKS AT ENTITIES APPLYING THE "VAT UPON COLLECTION" SYSTEM**

*Case study 1*

A VAT registered company carries out in 2018 some construction works (an industrial hall) for a beneficiary (also registered for VAT purposes). Both the contractor and the beneficiary apply the "VAT upon collection" system. The performance guarantees stipulated in the work contract represent 5% of the value of the executed works. The deadline for completion of works is the 31st of December 2018 and the warranty period is 5 years. The value of the contracted works is 15.017.547,21 lei + VAT 19%.

In April 2018, the beneficiary approved the first work progress report worth 504,575.10 lei (VAT 19%), and the contractor made the invoice.

The invoice for the executed works according to the work progress report accepted by the beneficiary was registered in April 2018:

<b>4111</b>	=	%	<u>600.444,37 lei</u>
"Customers"		<b>704</b>	504.575,10 lei
		"Services rendered"	
		<b>4428</b>	95.869,27 lei
		"VAT under settlement"	

The performance guarantee retained by the beneficiary was registered by diminishing the customer receivables value:

- the amount of the guarantee = 504.575,10 lei x 5% = 25.228,76 lei

<b>2678</b>	=	<b>4111</b>	25.228,76 lei
"Other long term receivables"		"Customers"	

The collection of the invoice, diminished by the amount of the performance guarantee:

- collected value = 600.444,37 lei – 25.228,76 lei = 575.215,61 lei

<b>5121</b>	=	<b>4111</b>	575.215,61 lei
"Cash at bank in lei"		"Customers"	

At the same time, output VAT was registered *for the collected amount*:

- output VAT value (applying reverse percentage method) = 575.215,61 lei x 19 : 119 = 91.841,15 lei

<b>4428</b>	=	<b>4427</b>	91.841,15 lei
"VAT under settlement"		"Output VAT"	

The accounting treatments related to the issued invoices for each work progress report during the contractual period will be similarly made.

Upon expiration of the warranty period, the performance guarantees will be released to the contractor:

- the total amount of the performance guarantees = 15.017.547,21 lei x 5% = 750.877,36 lei

The general contractor will issue an invoice to the beneficiary for the amount of the performance guarantees to be returned, without collecting VAT (the performance guarantees are not subject to VAT):

- the issued invoice for the return of the performance guarantees will be accounted:

<b>4111</b>	=	<b>2678</b>	750.877,36 lei
”Customers”		”Other long term receivables”	

- collection of the invoice:

<b>5121</b>	=	<b>4111</b>	750.877,36 lei
”Cash at bank in lei”		”Customers”	

At the same time, output VAT will be registered for the collected amount of the guarantees:

- output VAT value (applying reverse percentage method) = 750.877,36 lei x 19 : 119 = 119.887,98 lei

<b>4428</b>	=	<b>4427</b>	119.887,98 lei
”VAT under settlement”		”Output VAT”	

### III. PERFORMANCE GUARANTEES FOR CONSTRUCTION WORKS AND THE SPLIT VAT PAYMENT MECHANISM

#### *Case study 2*

The above mentioned company concluded with another entity (subcontractor) a subcontracting agreement for a part of the respective works. The subcontractor applies the split VAT payment mechanism. The value of these subcontracted works is 3.387.295,20 lei + VAT 19%, the performance guarantee is 5% of the works value. The deadline for completion of works is the 30st of November 2018.

In May 2018, the subcontractor issued the first work progress report worth 1.332.900,66 lei (TVA 19%), accepted by the entity.

The received invoice for the subcontractor's executed works was registered in May 2018:

<b>%</b>	=	<b>401</b>	<u>1.586.151,79</u> lei
<b>628</b>		”Suppliers”	1.332.900,66 lei
”Other third party services”			
<b>4426</b>			253.251,13 lei

”Input VAT”

The performance guarantee retained from the subcontractor's invoice was registered by reducing the debt:

- the amount of the guarantee = 1.332.900,66 lei x 5% = 66.645,03 lei

<b>401</b>	=	<b>167</b>	66.645,03 lei
”Suppliers”		”Other loans and similar debts”	

The entity accounted for the payment of the subcontractor's invoice less the value of the performance guarantee:

- the paid amount = 1.586.151,79 lei – 66.645,03 lei = 1.519.506,76 lei, of which:

- the VAT value (calculated by reverse percentage method) was paid *into the VAT account* opened by the subcontractor at a commercial bank or State Treasury:

VAT value = 1.519.506,76 lei x 19 : 119 = 242.610,32 lei

<b>401</b>	=	<b>5121</b>	242.610,32 lei
”Suppliers”		”Cash at bank in lei”	

- The difference was paid into the subcontractor's *current bank account*:

Difference value = 1.519.506,76 lei - 242.610,32 lei = 1.276.896,43 lei

<b>401</b>	=	<b>5121</b>	1.276.896,43 lei
”Suppliers”		”Cash at bank in lei”	

At the same time VAT was deducted for the paid amount:

<b>4426</b>	=	<b>4428</b>	242.610,32 lei
”Input VAT”		”VAT under settlement”	

Similarly, the accounting records of the received invoices for each of the subcontractor's work progress report will be made.

Upon expiration of the warranty period, the performance guarantees will be released (paid) to the subcontractor:

- the total amount of the performance guarantees to be released = 3.387.295,20 lei x 5% = 169.364,76 lei

The subcontractor will issue an invoice to the general contractor for the amount representing the performance guarantees to be returned, without collecting VAT:

- the received invoice for the return of the performance guarantees will be accounted for:

<b>167</b>	=	<b>401</b>	169.364,76 lei
"Other loans and similar debts"		"Suppliers"	

- payment of the invoice:

- the VAT value (calculated by reverse percentage method) will be paid *into the VAT account* opened by the subcontractor at a commercial bank or State Treasury:

VAT value = 169.364,76 lei x 19 : 119 = 27.041,73 lei

<b>401</b>	=	<b>5121</b>	27.041,73 lei
"Suppliers"		"Cash at bank in lei"	

- The difference will be paid into the subcontractor's *current bank account*:

Difference value = 169.364,76 lei - 27.041,73 lei = 142.323,33 lei

<b>401</b>	=	<b>5121</b>	142.323,33 lei
"Suppliers"		"Cash at bank in lei"	

At the same time VAT will be deducted for the paid amount:

<b>4426</b>	=	<b>4428</b>	27.041,73 lei
"Input VAT"		"VAT under settlement"	

The above presented Case studies approach the accounting and fiscal instrumentation of construction contracts that provide for the performance guarantees to be constituted by retaining their value from the issued invoices. In the case where the guarantees are to be immobilized into a contractor's distinct bank account, the treatments are different: the amount of each issued invoice will be collected in full, but into separate bank accounts - the performance guarantee will be collected into the guarantee bank account and the difference will credit the current account of the contractor, highlighting the separate amounts in the entity's accounting registers.

Based on the data from Case study 1 (entity applying the "VAT upon collection" system), we performed a comparative analysis of VAT accounting and fiscal treatments for the two methods of providing the performance guarantees:

**Table 1 - Comparative analysis**

Specification	Performance guarantees deducted from the invoices	Performance guarantees immobilized into a distinct bank account
Total invoiced amount on contract completion (VAT included), out of which:	17.870.881,18 lei	17.870.881,18 lei
Work progress reports value	15.017.547,21 lei	15.017.547,21 lei
Invoiced VAT (19%)	2.853.333,97 lei	2.853.333,97 lei
Performance guarantees value (5%)	750.877,36 lei	750.877,36 lei
<i>Collected amounts - total</i>	<i>17.120.003,82 lei</i>	<i>17.870.881,18 lei</i>
<i>Output VAT upon collection</i>	<i>2.733.445,99 lei</i>	<i>2.853.333,97 lei</i>

#### IV. FINAL CONCLUSIONS AND OWN CONTRIBUTIONS

As the performed analysis shows, in the case of the immobilized guarantees into a distinct bank account, the difference in the output VAT is **119.887,98 lei**. The contractor (who applies the "VAT upon collection" system) can not use the blocked amounts until the expiration of the contractual warranty period (which in our case reaches **up to 5 years**). However, he will have to register the output VAT on the guarantees and pay it to the state budget in full, as the guarantee amounts are considered to be collected: "For the purpose of art. 282 par. (3) of the Law 227/2015 regarding the Fiscal Code, collecting the value of the delivered goods or services means any method by which the supplier obtains the counterparty for these operations from his beneficiary or from a third party: payment in cash or in kind, compensation, cession of credit, use of payment instruments"<sup>11</sup>.

We consider that the legislator should review these fiscal statements on the application of the "VAT upon collection" system and distinguish between the *collection* of the performance guarantees amounts and the *access* to them, so that VAT due to the state becomes chargeable only when the entity can use the previously collected guarantees. Such a measure would entail an increase in the role of the banking system in collecting taxes and contributions, a role that banks have performed over several periods throughout history and which in other countries is more pronounced (for example in the UK, where some taxes are calculated, retained and transferred to the state budget directly by the banks).

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<sup>11</sup> Government Decision 1/2016 for the approval of the Methodological Norms for the application of Law 227/2015 regarding the Fiscal Code, Title VII, pt. 25 par 7