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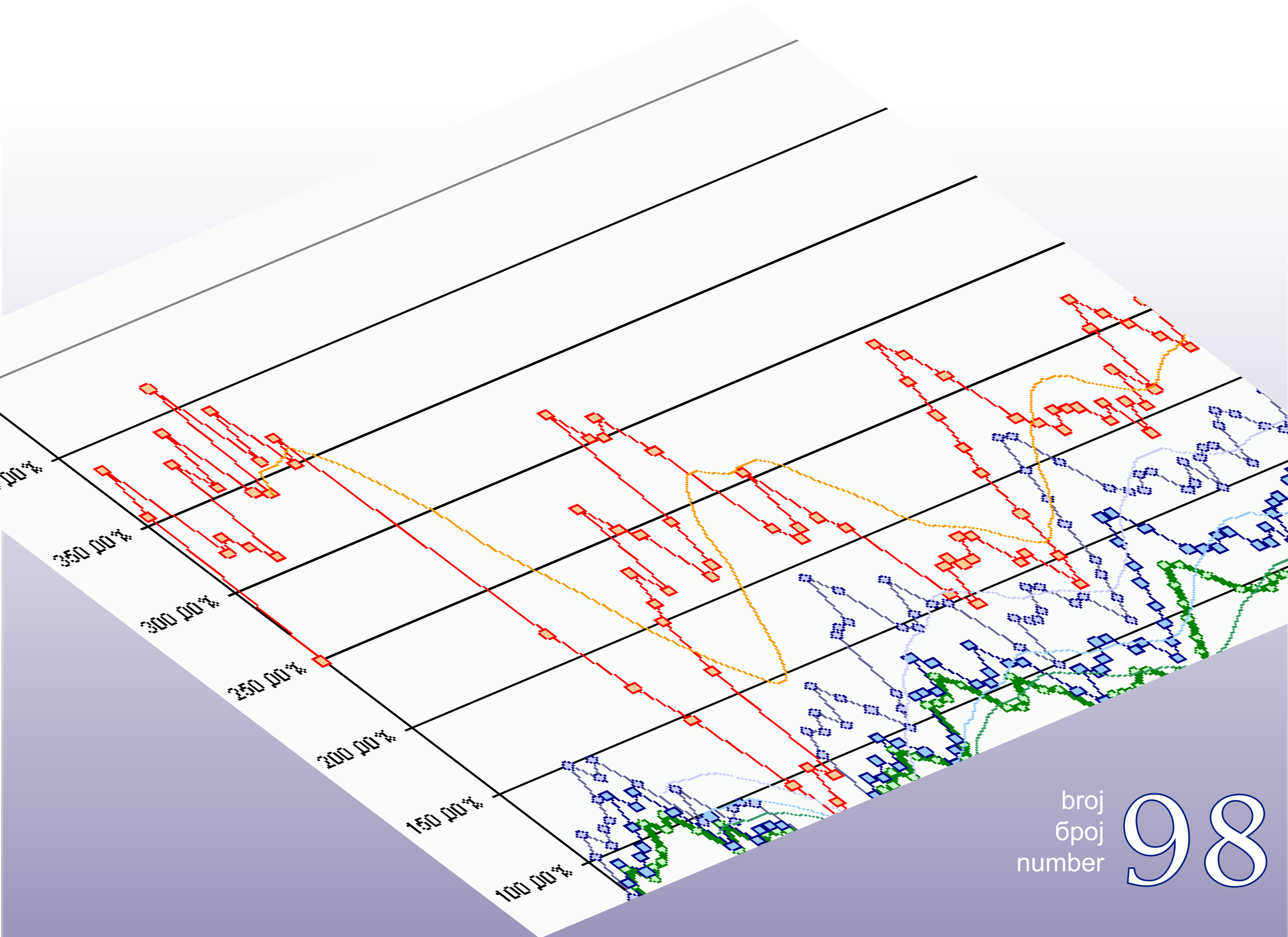
Macroeconomic Unit of the Governing Board of the Indirect Tax Authority

Oma Bilten



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With this issue

According to the preliminary report of the ITA the **net collection in August decreased by 9,4% in comparison with the same month of 2012.** Given that the refunds of indirect taxes in August increased by only 1 million KM, the main reason for the significant shortfall in August collection is in gross revenues.

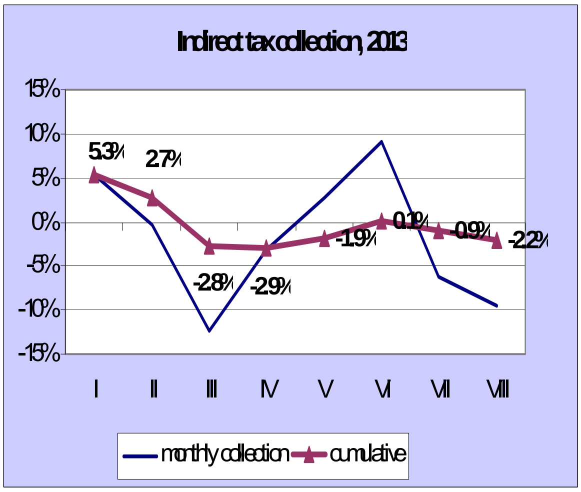

Chart 1

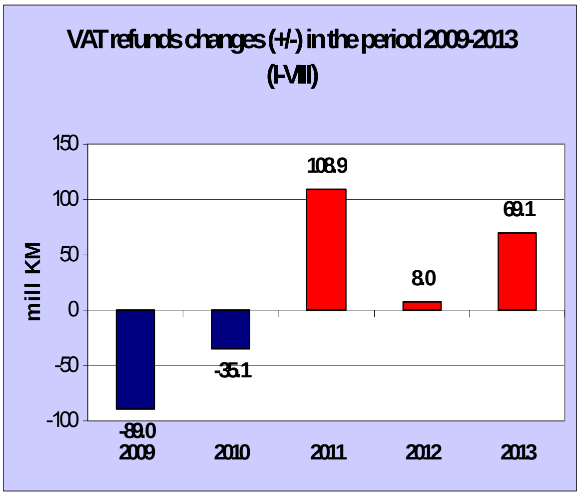

Chart 2

Extremely bad revenue collection of indirect taxes in August 2013 significantly deepened the negative trends which had already been manifested in July. At the level of eight months it was collected 3,195 billion KM of net revenues. In comparison with the same period of 2012, the collection decreased by 70,4 million or by 2,2%. The previous dynamics of cumulative collection of indirect taxes show the constant downward trend in the last six months, with the exception of month of June, when the cumulative collection moved into positive zone only thanks to huge withdrawal of excise stamps for cigarettes prior to accession of Croatia to the EU (Chart 1). Bad cumulative revenue collection is the result of stagnation in gross revenues and strong growth of refunds. The comparison of refunds growth in the period January-August over the past few years shows in the best way the increase of refunds in 2013. For the eight months of 2013 it was paid 69 million KM more refunds than in the same period of 2012 (Chart 2).

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Application of the cash accounting scheme in the VAT system

(Author: Dinka Antić, PhD)

As of 1 of January 2013 in the EU amendments to the Directive 2006/112/EC have entered into force by which the cash accounting option is introduced for the purpose of taxing by value added tax (VAT). The scheme, which is aimed to small enterprises, includes the possibility of calculating VAT at the time of collection of receivables, provided that the Member States may require that the right to deduct input VAT can be acquired by paying the vendor invoice. Upon the announcement of amendments to Directive there were discussions on the effectiveness of the scheme, particularly in terms of revenue collection from VAT in the period of crisis and preserving the neutrality of taxation, as the basic features of the VAT system.

APPLICATION OF CASH ACCOUNTING IN BUSINESS PRACTICE

The term "cash accounting" involves accounting method under which revenues are recorded at the time of receiving cash and expenditures at the time of payment of cash. The use of following synonyms is widespread: „cash basis accounting", „cash basis" or „cash method". The U.S. uses the term „cash receipts and disbursements method". Common accounting practice in the world supports the application of accrual accounting, under which revenues and expenditures are recorded at the time of the occurrence. Given that the focus of accounting includes the cash flows, cash accounting does not provide complete coverage of all financial and other resources in companies. However, due to the simplicity in the application the use of cash accounting is often allowed in small enterprises which their business transactions mainly carry out in cash.

Tax Authorities often allow the use of cash accounting when determining the taxable base only with taxation of income, but under certain conditions. Due to the negative sides Tax Authorities limit the use of cash accounting prescribing a category of taxpayers and the maximum amount of annual gross collection. The cash method of taxing income allows certain flexibility of tax planning in terms of managing the income tax. For example, the payment of expenditures can be accelerated at the end of the year to reduce the taxable base for the year or the collection of revenues at the end of the year can be transferred to the following year if higher costs are expected in the next year. Tax planning using cash basis is particularly attractive in the case of income tax rate scale where the balancing of receipts and payments can avoid paying taxes at a higher rate. However, the application of the cash basis in the tax records keeping requires certain modifications to items which are recorded on an accrual basis and it is necessary to perform certain adjustments.

Considering the widespread use of cash accounting for income taxation of small craftsmen it can be concluded that cash accounting is a standard concept of income taxation of certain categories of taxpayers. However, this statement cannot stand for the taxation of goods and services. Although the application of the cash basis for VAT calculation and payment was prescribed in 1977, a small number of Member States applied this benefit. Great Britain, Germany and Italy were among few Member States that allowed the application of the cash accounting scheme for VAT calculation. Germany was specific because it did not apply the scheme in a uniform manner throughout the country. Until 1 of July 2009 five federal states of Germany allowed the cash accounting for taxpayers (*Istbesteuerung*) whose annual turnover was up to EUR 500,000, while in other provinces threshold was EUR 250,000. In 2012, after the adoption of amendments to

Directive 2006/112/EC in the area of invoicing[1], only a few Member States of the EU-27 allow the application of the cash accounting for the calculation and payment of VAT[2], while the mass incorporation of new provisions of the Directive into national legislation in the field of VAT taxation occurred just before the amendments were to enter into force on 1 of January 2013.

THEORETICAL CONCEPT OF VAT

Application of cash accounting for VAT taxation delves into the basics of the concept of VAT taxation. Theoretical concept of a neutral system of VAT is based on the consumption type and the indirect method of calculation and payment.

Consumption-type VAT is a type of VAT where the deduction of input VAT is allowed from the tax payable on the purchase of all goods and services as a whole, including the purchase of capital goods. Tax base of consumption-type VAT corresponds to the value of consumption in the national economy. Being allowed to deduct the total cost of procurement of capital goods from the base there is no double taxation and cascading effects. The application of consumption-type VAT ensures the neutrality of taxation in relation to the economic decision-making of the undertakings and prevents the aggregation of taxes. Consumption-type VAT is a basic form of taxation in almost all countries today that moved to VAT. Still, many countries, including Bosnia and Herzegovina by various measures in the VAT system limit the right to deduct input VAT, not only in the sphere of taxation of non-business consumption of goods and services but also for administrative reasons, in order to combat the appearance of tax frauds.

Indirect method involves the application of VAT rate on individual elements of added value. In principle, similar to the direct method, using mathematical operations it is possible to get two versions of the indirect method, indirect method of addition and indirect method of subtraction. Indirect method of addition, which includes the application of the VAT rate to the components of value added, is not common in practice. On the other hand, indirect method of subtraction is the most popular method of determining VAT. It is the basis of the VAT system in the EU, and has being applied in many countries around the world. Since the basic technical requirement for the application of this method is the existence of an account (invoice) setting VAT, indirect method of subtraction is also called the account method. Given that a taxpayer has the possibility to compensate input tax from the purchases charged to the output VAT on sales, paying only the difference on account of the State Treasury, the method is also called the credit method. Credit method has several advantages over other methods of determining VAT. Since it is based on the invoice, opportunities for the development of VAT frauds are difficult. In addition, since the invoice includes individual items of turnover, the credit method facilitates the application of differentiated VAT rates on different goods or services, zero rates for exports or exemptions from VAT[3]. For more efficient use of the credit method, legislators prescribe the obligation for taxpayers to keep records of incoming and outgoing invoices.

VAT is also a self-controlling tax form. Tax Administration is not the only one interested in the accuracy of VAT invoices. Every taxpayer in the turnover chain is interested to receive the correct invoice from his supplier, since only under proper invoice the taxpayer may claim input VAT set on the invoice. For this reason, the taxpayer in addition of checking the identity of supplier (i.e. whether the tax code exists in the registry as the active number, and if so, whether a real

[1] Council Directive 2010/45/EU of 13 July 2010 amending Directive 2006/112/EC on the common system of value added tax as regards the rules on invoicing, OJ L 189, 22.7.2010.
[2] Source: Ernst&Young, The 2012 worldwide VAT,GST and sales tax guide, www.ey.com
[3] More in: Ebrill L., Keen M., Bodin J-P, Summers V., "The Modern VAT", IMF, Washington, 2001., pp. 20 – 22..; Tait A. A., "Value Added Tax, International Practice and Problems ", Washington, IMF, 1988; pp. 4 – 6.

company is registered under that number) needs to verify the accuracy of VAT calculation stated on the invoice.

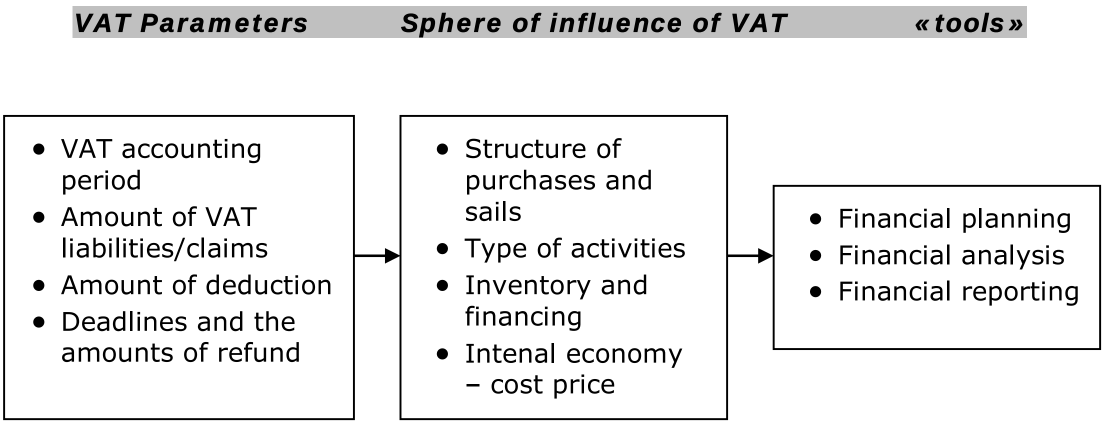
VAT AS LEVERAGE OF FINANCIAL MANAGEMENT

Characteristic of VAT to represent financial obligation if output VAT on sales is higher than the input VAT on purchases or financial claims if input VAT is higher than output VAT, allows VAT to become an important leverage of financial management of taxpayers.

Managing VAT implies (Box 1):

- Consideration of the basic parameters of the VAT system which are essential for financial management
- Consideration of segments and business functions in the company whose functioning exerts a positive or negative impact of VAT
- Consideration of possible directions of structural adjustments in company in order to:
  (i) Ensure better financial positions of the company in meeting financial obligations, including obligations for VAT, and
  (ii) Improve the business of the company as a whole.

Box 1: VAT Managing



VAT accounting period represents a fundamental determinant of VAT managing. All business transactions of the company, resulting in cash inflows and outflows, should be planned within the accounting period of VAT, in order for VAT liability to be paid to the period provided by law. It should be noted that the calculation period of one month is a big advantage of the VAT system in relation to the former sales tax system where taxpayers have to pay sales tax every seven days. Period of one month gives plenty of room for cash managing, receivables and payables. Liabilities for VAT, as the difference between total accrued receivables for input VAT shown in the vendor accounts and total accrued payables for output VAT shown on invoices issued to customers during the accounting period, are due to be settled not later then the tenth day after the end of each calendar month, regardless of whether accounts receivable are collected from customers and whether accounts payable are paid.

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It is possible that companies achieve the refund of input VAT (if the input VAT is higher than the output VAT) and positive financial effect, although accounts payable are not paid or it may happen that the company reports VAT refund on the accrued return of VAT and that at the same time the financial effect is negative since that in that month accounts receivable are not collected and accounts payable (which included VAT) are settled. Those companies that have a higher cash inflow will have favorable financial position i.e. regular and faster collection of payables which, on the other hand, postpone their financial obligations and receivables. However, a small number of companies are in such situation. In order to mitigate to some extent negative effects of VAT on the *cash flow* of business entities it is necessary to:

- Plan and monitor cash inflows and outflows daily,
- Include planned inflows based on VAT refunds in the monthly schedule of cash,
- Harmonize functioning of business functions (procurement, production, sales) so that in the long term cash inflows and outflows that they produce are balanced.

The amount of liability for VAT significantly affects the height of the tax deduction. The own consumption should be taken into account (delivery to employees, shareholders, the family of the owner), costs of representation and the use of fleet of company for private purposes. All these supplies are taxable in terms of VAT and companies do not have the right to deduct the input tax which is directly related to deliveries for non-business use of business assets or personal use, or is shown in the accounts for representation, accounts for maintenance, purchase or use of business assets for non-business purposes.

SCHEME OF CASH ACCOUNTING IN THE EU VAT SYSTEM

Elaboration of the basic elements of VAT theoretical concept which is the basis of VAT system in the EU and B&H indicates that the calculation of VAT, closely linked to the achievement of the right to deduct input VAT, is the main determinant of the VAT taxation. In other words, neutrality of the VAT taxation cannot be achieved if there is no mutual relationship between the right to deduct and the obligation to calculate VAT. Finally, expressing VAT on the invoice makes the invoice the most important value document on the basis of which the taxpayer can accomplish the deduction of input VAT. Invoice with reported VAT, with the auxiliary books, represents the basic mechanism for controlling the calculation and payment of VAT i.e. factor of combating tax evasion.

To understand the application of the concept of cash accounting for the calculation and payment of VAT in the Union it is necessary to analyze the moments of acquiring the right to deduct input VAT and moments of calculating VAT in the Directive 2006/112/EC, which represents the basic legal framework of the VAT taxation in the EU[4].

Legal framework

The use of special schemes of calculation and payment of VAT in the EU is enabled by the Sixth VAT Directive[5]. Members of the EC, and later the EU, from the very beginning of the establishment of harmonized system of VAT taxation, had the ability to grant small businesses a way of calculation and payment of VAT which would be more favorable compared to the standard regimen of calculation based on invoices issued and received. In addition, Members have the possibility of complete exemption from the payment of VAT prescribing a threshold for registration. At this point it should be noted that the moment of calculating VAT incurred at the time of delivery of goods and services, while the right to deduct input VAT is acquired at the time of calculation of VAT. Exempted

[4] Article 43-59 Directive 2006/112/EC.

[5] Sixth Council Directive of 17 May 1977 on the harmonization of the laws of the Member States relating to turnover taxes – Common system of value added tax: uniform basis of assessment - 77/388/EEC

from these rules is that VAT in certain cases and under certain categories of taxpayers can be calculated not later than the moment of receipt of payment by the customer.

At the beginning of 2013 amendments to the Directive in the area of invoicing entered into force. The use of cash accounting in the calculation and payment of VAT is specified by amendments to the Directive, popularly called „The Second Directive on Invoicing". Unlike current simplified scheme of calculation and payment of VAT, which referred only to the possibility of calculating VAT on a cash basis, a new scheme of cash accounting involves the obligation to deduct input VAT on a cash basis.

Under the new rules Member States have the option to require the delay of the moment of input VAT deduction until the moment of payment of VAT on goods and services to the vendor. This provision entails the obligation for VAT taxpayers selling goods and services of involving only VAT that is charged by the customer. Given the chain deduction of input VAT, enabling the use of mentioned option would not jeopardize the collection of public revenues in Member States.

The threshold for the scheme introduction

Amendments to the Directive provide that Member States which opt for the option of cash accounting have an obligation to prescribe the threshold for the use of the scheme. Threshold is determined similarly as the threshold for VAT registration. The threshold for eligibility of taxpayers for the use of cash accounting scheme should be based on the annual turnover of the taxpayer. Directive prescribes the upper limit of the annual turnover in the amount of 500,000 EUR. However, it leaves the possibility for Member States to introduce a higher upper limit for the use of the statutory scheme, up to even 2 million EUR, but only after consultation with the Committee for VAT. Also, it is obligatory for Member States to inform the Committee for VAT on the scheme implementation.

The amount of annual turnover for taxpayers who want to apply the cash accounting scheme should be calculated in accordance with Article 288 of the Directive. According to this Article annual turnover of the taxpayer, which is then compared with the upper limit of turnover set by the Member State, should include the following amounts, without VAT included:

- The value of taxable goods and services
- The value of exempt transactions with the possibility to deduct VAT from previous stages and transactions exempted in accordance with Articles 146-149, Articles 151, 152 or 153
- The value of transactions related to real estate, financial transactions and transactions in the insurance, if these transactions do not represent secondary transactions.

To calculate the threshold, the value of transaction related to material or non-material fixed assets of the company is not taken into account.

Other rules

In accordance with Article 226 of the Directive taxpayers engaged in the cash accounting scheme, who calculate VAT at the moment when it is charged, i.e. who acquire the right to deduct VAT at the time of payment of VAT, need to state on the invoice issuing to the customers that the "*cash accounting*" is applying.

PRACTICE OF MEMBER STATES

The existence of a certain mix between the standard mode of calculation and payment, based on the use of the invoice method of VAT calculation, and partial application of the cash basis has opened up an opportunity for revenue losses. Probably this was the main reason of sporadic application of the special scheme for small businesses. Only after the adoption of amendments to Directive 2006/112/EC relating invoicing for VAT Member States begin to consider introducing cash accounting for the purpose of calculation and payment of VAT.

According to recent data 23 Member States of the EU have incorporated new provisions on cash accounting in national VAT rules[6]. Analysis of the practice of several Member States of the EU showed various modalities of the scheme of cash accounting for VAT.

Italy[7] initially prescribed the threshold for the application of cash accounting in the amount of EUR 200,000 and then, after a few months, increased the threshold to 2 million EUR. Specificity of the Italian model lies in the fact that the scheme, according to the first approval, applies to three calendar years and after that applies year after year, depending on changes in annual turnover. According to the approved scheme, small and medium enterprises can charge VAT on their supplies at the moment of collection of receivables, and up to one year from delivery. On the other hand, taxpayers whom the scheme is concerned to may deduct VAT on purchases only at the moment of payment to suppliers. However, customers of the taxpayer who is in a cash accounting scheme may deduct VAT on their purchases in accordance with the standard rules of VAT deduction, regardless of paying the invoice to the supplier. It is interesting to present the way of including taxpayers in the scheme. It is enough to inform the tax authorities stating it on the annual VAT return. The same case is with the release of the taxpayer from the scheme. In any case, the taxpayer who is involved in the scheme each time needs to state it on the invoice issued. Missing to point out the use of the cash accounting scheme on the invoice represents a tax offense.

Latvia[8] has at the end of 2011 introduced a cash basis for the calculation of VAT and the realization of the right to deduct VAT for small businesses whose annual taxable income in the previous year did not exceed LVL 70,000. The scheme may include taxable persons engaged in agriculture and fishery, regardless of the amount of turnover in the previous year. However, this group of taxpayers is required to pay VAT liability not later than six months after the delivery of goods, regardless of whether the invoice was collected from customers.

Romania[9] applies the scheme from 1 of January 2013. Model of cash accounting for which this country has opted has several specifics:

- Unlike other States where the participation in the scheme is done on the voluntary principle, in the sense that the law allows the option to use the cash accounting under certain conditions, and small businesses that meet requirements are allowed to decide whether to join the scheme, Romania applies the principle of obligatory character. All VAT taxpayers whose annual turnover is below the proper threshold of EUR 500,000 are obliged to apply the cash accounting;
- With regard to the compulsory inclusion Tax Administration automatically registers taxpayers in the "Register of taxable persons who apply the system of cash accounting for VAT". Register is public and can be accessed through the web portal of the Tax Administration;

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[6] Annacondia F., Corput van der W., "Amendments to the VAT Systems of the EU Member States on 1 January 2013 (2)", International VAT Monitor Vol. 24, No. 1, IBFD, Amsterdam, January-February 2013, pp. 8-11.
[7] Source: Journals Issues "International VAT Monitor", IBFD, Amsterdam, issues for years 2012 and 2013.
[8] Ibid.
[9] Source: Deloitte, VAT Alert No. 6, 3 September 2012.

- Specificity of the scheme is its factual compulsory in the sense that every taxable person, who receives an invoice with no labels of applying the cash accounting, is obliged to check on the web page of the Tax Administration whether the supplier is involved in the cash accounting scheme;
- A taxpayer who is involved in the scheme acquires the right to deduct input VAT only at the time of payment of vendor invoice. In addition, the taxpayer is required when filling VAT return to submit evidence that he has fulfilled all payments to the vendors for which he reduces his VAT obligation;
- Buyer of the taxpayer who is involved in the scheme may not deduct VAT on his purchases until he pays the vendor invoice.

Cash accounting scheme in Romania does not apply to taxable persons who are part of the VAT group, persons who do not have established business in Romania and persons who have a permanent company in Romania, while their place of business is outside the country. However, if the customer has not paid the invoice taxable persons, regardless of their involvement in the scheme, must calculate VAT within 90 days from the day of issuing the invoice. But in this case also a buyer is not allowed to deduct input VAT until he pays the vendor invoice. Taxpayers involved in the scheme directly as users of the scheme or indirectly as customers of taxpayers involved in the scheme are obliged to keep separate records of transactions that are subject of the application of the cash accounting scheme.

Great Britain applies the rules of cash accounting for the purpose of VAT since 1995. Due to many years of use Great Britain has developed in details the cash accounting scheme[10]. Scheme can be applied by taxpayers with an annual turnover of over GBP 1,35 million. However, prior to inclusion in the scheme Tax Administration performs controls and will refuse the joining the scheme if a taxpayer does not submit regularly VAT returns, if there is a debt of VAT or other public income, if the taxpayer was sentenced to criminal or punitive measures in the previous year or if the taxpayer participated in tax frauds in the past years.

When assessing whether an annual turnover is below the prescribed threshold, the free trade and the value of expected sale of fixed assets are not included. Specificity of Great Britain is that the scheme cannot be used for all taxable transactions of turnover. Scheme does not include leasing, rental, conditional sales and sales on credit, advance sales of goods and services and sales in which the payment period is longer than 6 months after the issuance of the invoice. In the mentioned cases the taxpayer is required to apply the standard rules of calculation and payment of VAT. In the case of collection of sale in cash the taxpayer is obliged to submit copies of invoices issued to customers. Also, a small business must submit copies of vendor invoices when vendors pay in cash.

A small enterprise is obliged to regulate accounting system in a way to allow cross-checks to tax inspectors. It is necessary to cross-link the payment to the appropriate output invoices given to customers, payments with vendor invoices, as well as statements from the banks. Moment of calculation of output VAT and deduction of input VAT depends on the method of payment. If the sale is collected in cash VAT is calculated on the date of the money receipt. If the sale is charged over bank VAT is calculated on the date the payment was recorded in the bank. If the invoice is paid in cash to the vendor the right to deduct VAT occurs at the moment of giving the money, and if it is paid by the bank at the time when the payment is recorded in the bank. Given that payment of invoices becomes relevant for the calculation of VAT problems occur in a situation where the customer pays the invoice only partially, or if the customer pays the amount for several invoices by single payment. There are prescribed rules for both situations. If the buyer pays only part of the invoice a small enterprise is obliged to calculate only part of VAT which corresponds to the

[10] HMRC, Notice 731 Cash Accounting Scheme, January 2011.

paid section[11]. If the buyer pays the amount for multiple invoices and that cannot be distinguished to specific invoices in full then first VAT is calculated at the earliest invoices (as for example stock by FIFO method) and included in VAT return and the rest will be included on the next payment[12].

Fiscal authorities of Great Britain[13] in official documents emphasize both advantages and disadvantages of the scheme. As the benefits of the application of the cash accounting scheme for small business it is pointed out that the scheme has a positive effect on cash flow and liquidity of the company and that the scheme is particularly useful for sales on credit or in case of problems with liquidity for the customer. At the same time, fiscal authorities indicate that almost any use of the scheme cannot be achieved if the taxpayer is often in a position to obtain a VAT refund or tax credit, if the taxpayer has established a regular scheme of payments and collections, and if he continually provides services.

PROBLEMS IN USING THE SCHEME

Who benefits from the scheme?

The purpose of introducing the concept of cash accounting for VAT calculation was to help small and medium enterprises that are facing the problem of liquidity for payment of VAT liabilities before the collection of receivables from customers. On the other hand, fiscal authorities need to take measures that will not jeopardize filling the budget of the Member States and funding expenditures of the EU budget. The question is whether it is possible to adopt a measure that would simultaneously postpone payment of VAT to the moment of collection, and that will not jeopardize the budget financing.

The current application of cash accounting allowed benefits only to small enterprises in the form of postponing the calculation of VAT to the moment of the collection of receivables. At the same time, a small enterprise could deduct input VAT on purchases regardless of the fact that vendor invoices have not been paid. It is obvious that from the mentioned cash accounting scheme only small enterprises could have benefits, while the budget was jeopardized from the following reasons:

- Small taxpayers deducted input VAT from liability regardless of not paying the vendor invoices
- A customer deducted input VAT from purchases from small taxpayers regardless of whether he paid the invoice
- In the event of insolvency of the customer, calculated VAT on the sale of small enterprises would be irretrievably lost.

In the best case, due to the delay of VAT calculation for small entrepreneur to the moment of collection receivables there would be shifting the scheme of VAT collection and thus compromising the standard dynamics of filling.

Possibility of the occurrence of revenue erosion has been the reason for the sporadic use of cash accounting scheme in the EU over the past thirty years since the adoption of the Sixth VAT Directive.

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[11] For example, if VAT is 20%, and invoice to the customer is GBP 1,000, if the customer pays only GBP 600, small business is obliged to calculate VAT as follows: VAT = 600 / 1,000 * 1,000 * 20%.

[12] If, along with the invoice from the previous example (GBP 1,000), there is an invoice issued to the same customer of GBP 2,000, and the customer pays only 2,000 GBP. It is obvious that instead of 600 GBP ((1,000+2,000)*20%) it should be calculated only 400 GBP in a given tax period. Calculation of VAT for current tax period is done in the following way: Given that the invoice of GBP 1,000 was issued earlier, then VAT is first allocated to that invoice (1,000 * 20% = 200 GBP). The remaining of 200 GBP is allocated to another invoice, with still 200 GBP left to calculate in the accounting period when the customer pays the outstanding amount on the other invoice.

[13] HMRC, Notice 731 Cash Accounting Scheme, January 2011.

Experts believe that the standard VAT system which involves the VAT calculation at the time of delivery of goods/services or receipt of invoice is more favorable to the state than the cash accounting scheme[14]. By amendments to the Directive, the Member State which opts for the scheme may require from the small enterprise, if included in the cash accounting scheme, that input VAT on purchases may be deducted but only after the payment of vendor invoices. In this case, the benefits of the cash accounting scheme for small entrepreneurs are lost or significantly reduced. The final effects depend on dynamics of trade payables and liquidity of customers. If payables are due faster to the payment (for example if a small taxpayer procures from major suppliers and has no possibility to achieve more favorable conditions of purchase) than the collection of receivables (for example a small enterprise sells goods to a large shopping centre which can dictate the terms of payment) a small enterprise will, in periods until the collection of receivables, be eligible for a VAT refund. The final net effects are the difference between the amount of VAT and interest rate on short-term loans and borrowings to finance the costs of purchases from suppliers.

What is the position of the customer of a small enterprise?

Bearing in mind that VAT is calculated and levied at each stage of the turnover cycle of the value added of this phase (all phase form of VAT) as a key issue of the application of the cash accounting scheme becomes the position of the buyer of taxpayer who is involved in the scheme, i.e. the moment of realization of the right to deduct input VAT on purchases from suppliers included in the scheme.

A raising issue is also the range of cash accounting scheme for the purpose of VAT having in mind that a small enterprise is just one link in the turnover chain. While some focus on the new rules, others, however, believe that for the acquisition of the right to deduct input VAT is still relevant the provision under which the right to deduct input VAT is acquired at the time of VAT calculation. If the supplier charges VAT at the time of the invoice payment by the customer it is logical that the customer acquires the right to deduct VAT in the same moment. From this observation it follows the obligation of all buyers of goods or services of small enterprises to adjust their accounting systems and records to ensure a different accounting treatment of purchases from small enterprises in relation to purchases from standard VAT taxpayers who charge VAT as received and issued invoices[15]. Since the additional obligations in terms of VAT administering require additional funds final consequences of the application of this cash accounting model can be twofold: :

- Large VAT taxpayers can avoid procurement from small companies involved in the scheme, much like as taxpayers avoid to purchase from persons who are not VAT taxpayers because they cannot exercise the right to deduct VAT paid in previous phases which is transferred via a cascading procurement to costs of the firm which is not VAT taxpayer,
- If the business of small enterprise depends on large buyers, the small enterprise may, under their pressure, abandon the use of the scheme.

The purpose of the scheme is to improve the financial position of small enterprises. However, the above elaboration shows that the target group is expanded because the application of the scheme affects also customers of small enterprises. VAT is a financial liability or account receivables, by which the taxpayer may operate as part of financial management. Analysis of the VAT management as the leverage of financial management has shown that standard regimen of calculation and payment of VAT on the basis of invoices may favor certain categories of taxpayers. Therefore, there is a reasonable question why the buyer would bear consequences of introducing the scheme for VAT payment which aims to help small enterprises. Consistent application of the

[14] Wohlfahrt B., "The Future of the European VAT System", International VAT Monitor No 6/2011, IBFD, Amsterdam, November/December 2011, pp. 387-395.
[15] Više: Desmeytere I., „The Hidden Features of EU Invoicing Directive 2010/45", International VAT Monitor No 6/2011, IBFD, Amsterdam, November/December 2012, pp. 174-175.

rules of cash accounting scheme and limitation of effects to only the position of small enterprise would mean that all other taxpayers doing business with small enterprises should implement the standard rules of calculation and payment of VAT. Assessments of experts suggest that in the event that the buyer deducts VAT before paying the invoice to small entrepreneur it should not lead to more serious threat of VAT collection bearing in mind the proportion of sales of small taxpayers with other taxpayers in total turnover[16].

Analysts have already pointed out to some confusion which will produce stating the use of the cash accounting scheme on the invoice[17]. Taxpayers who would follow the standard scheme of taxation (credit method) may be in dilemma when they receive an invoice from the supplier who is involved in the cash accounting scheme whether they should show VAT from the received invoice as input VAT on the return or they should first pay the invoice to their supplier including VAT as well. Given that according to the new rules deduction of input VAT is linked with the VAT payment from the vendor invoice standard VAT taxpayer should ignore the "cash accounting" label on the vendor invoice. Therefore, the question is why put that label on the invoice if the Tax Administration has already approved status of small taxpayers to a particular taxpayer and if that status does not affect the VAT liability payment method of his buyers and suppliers.

Can it come to a tax evasion?

Exposed doubts of the Member States regarding the potential negative effects of introducing the cash accounting scheme to the collection of VAT revenues contributed to a scheme modeling in Member States. Analysis of the practice in Member States shows different modalities of the scheme.

Some Member States are trying to prevent the erosion of revenues from VAT after the entry into force of the cash accounting scheme by limiting the period to which the VAT calculation on sales of small taxpayers can be delayed. There may be a situation of insolvency or bankruptcy of taxpayers who have obligations to small VAT taxpayers. To prevent the possibility that the VAT calculation and therefore the payment of small taxpayers at the expense of the budget, is *de facto* indefinitely postponing until the moment of payment of the invoice by the customer, some Member States prescribe deadlines for postponing the VAT calculation. The ultimate deadline for the VAT payment should be harmonized with the regulations governing the designation of insolvency and bankruptcy laws.

The practice of Member States indicates the limitation of the scope of the scheme application to certain activities and groups of taxpayers. In some Member State the scheme is limited to retail sales, agriculture, professional services and delivery of building and construction services. Choice of activity is not surprising given that it was the last link in the turnover chain, in which sales are made mainly to the final consumer. In this way a problem of special regulation of acquiring the right of the customer of small enterpriser to deduct VAT is avoided. On the other hand, these are activities that are liquid, i.e. having mainly cash sales, so there is no significant delay of the calculation and payment of VAT. Bearing in mind that the scheme is introduced to help taxpayers to maintain the liquidity the question is what benefits from the cash accounting scheme are given to the mentioned small taxpayers who mostly have cash sales.

Is the VAT concept endangered?

In theoretical terms VAT is the tax payable on each phase of turnover with mechanisms that allow deduction of VAT paid on purchased goods or services from tax payable on goods or services sold.

[16] Ibid.

[17] Više: Swinkels J.J.P., „Confusing EU VAT Invoices from 2013", International VAT Monitor No 3/2012, IBFD, Amsterdam, May/June 2012, pp. 174-175.

The theoretical concept of VAT is based on the "value added", which is defined as the value that each participant in production chain (manufacturer, distributor, retailer, etc) added to inputs of certain phases before the sale of new or improved products and services.

Realistic models of VAT are to some extent different from the theoretical concept. Emphasis in taxation is not in the value added but in the taxation of consumption. Moreover, the right to deduct input tax and scope of goods and services that are taxed by VAT cannot be understood in an absolute sense, that the taxpayer is entitled to deduct input tax on all goods and services, i.e. that all activities and all goods and services are subject to VAT taxation. Although VAT is levied at each stage of the turnover cycle, all the way to the retail stage, the mechanism of compensation of input tax on purchases is *de facto* transforming VAT from theoretical concept of tax on intermediate phases of the production cycle in the real concept of the consumption tax. Given that all participants in the production cycle had the opportunity to compensate for input tax VAT is ultimately collected at the stage of final consumption. This is an important fact for drafting projections of revenues from VAT, as the amount of collected revenues from VAT depends on trends in consumption, elasticity of demand and market trends.

Member States have already in the introduction of the cash accounting scheme for small taxpayers been aware of the danger that by giving up the basic features of the VAT concept, such as the right to deduct VAT, it undermines its neutrality and reduces benefits compared to the sales tax system. In essence, postponing the right to deduct and calculate VAT led to the interruption of the VAT calculation chain in which the output VAT of one taxpayer in one tax period is the input VAT of another taxpayer in the same period. A similar situation was also with strong requirements of Member States that the application of the reverse charge mechanism, which basically means transferring VAT liability from the seller to the buyer, should extend to all stages of the turnover chain, or at least to a greater number of activities (excluding construction works and turnover of waste). In addition to the right to deduct, by the use of the cash accounting scheme VAT as a system losses its other features as well: administrative simplicity, all phase and self controlling character.

Postponing the calculation of VAT until the moment of collection of claims and postponing the deduction of VAT until the moment of the payment of the liability to the supplier VAT ceases to be all phase tax. The practice of some Member States indicates that the postponing is tolerating up to a year.

VAT is characterized by administrative simplicity. Basic records that the taxpayer has to keep and which are the subject of controls are the books of incoming and outgoing invoices. Chain frauds can be detected by electronic cross-records of more taxpayers. Administering the cash accounting scheme is more complex given that it is necessary to connect invoices of both banking and treasury records. A particular problem for tax administration is monitoring the subsequent collection/payment by invoices issued/received prior to the introduction of the scheme. There is a real danger of double tax relief, at the time of the invoice receipt (before the introduction of the scheme) and the time of payment (after the introduction of the scheme). Tax administration objectively has no resources in any country to control a large number of small taxpayers in a given period.

The scheme downgrades the significance of the invoice, as the valued document, and emphasizes the importance of financial documents. To relativize the significance of the invoice and emphasizing the moment of payment/collection, especially if it is also related to the customer of small taxpayer, VAT ceases to be self-controlling tax.

INSTEAD OF CONCLUSION: RECOMMENDATIONS FOR IMPROVING THE POSITION OF SMALL VAT TAXPAYERS

Analysis of the EU practice shows that the cash accounting scheme for the purpose of the VAT taxation of small taxpayers until 2013 sporadically applied in only a few Member States. European Commission in its documents (see Box 2) recommended to the Member States the application of cash accounting for taxation of small enterprises. Mass application of the scheme begins on 1 of January 2013 by entering into force of so called The Second Invoicing Directive so it is too early for analyses of the effects of the scheme in terms of improving of liquidity and economic position of small taxpayers and taxpayers who are associated with them in the turnover chain, but also of implications of the scheme to the inflow of revenues from VAT.

Framework 2: Recommendations of the European Commission for SMEs

In cases where the company is small or very small the use of cash accounting can be regarded as adequate. In this case accounting and financial reports are prepared on a cash basis. Cash basis means that the costs or revenues are stated on a cash basis. Cash basis means that the costs or revenues are calculated in the amount equivalent to the amount paid or received. Some Member States use a cash accounting basis for the taxation of small businesses and some of them consider it sufficient for external reporting of small enterprises to national accounting standards (GAAP).

Izvor: European Commission, Enterprise and Industry Directorate-General, Final Report of the Expert Group, "Accounting Systems for Small Enterprises – Recommendations and Good Practices", November 2008.

It can be concluded that **the main advantage of the cash accounting scheme lies in the fact that by paying VAT at the time of collection of receivables a small taxpayer does not have to hire his own funds for the payment of VAT liability or to pay expenses of interest to loans from which he would pay taxes. Savings on expenditures or potential revenues from hiring their own funds for other purposes have a positive impact on costs and profits of small taxpayers, with all the positive implications that lower selling prices may have to economic position of taxpayers in the market.**

Associations of small entrepreneurs indicate the advantages of the application of cash accounting for the tax purposes[18], and recommend that cash accounting schemes for taxation of income should be consistent to the cash scheme of VAT taxation. As advantages they stated the following:

- Easier understanding of bookkeeping and administration of taxes for owners and other employees who are not accountants
- Facilitated preparation of reports, without the need for annual adjustments
- Payment of taxes only on the achieved realization.

Experiences of Great Britain are significant for States that have not adopted the option offered by the Second Invoicing Directive but also for those that have just included the scheme in the national VAT systems. Detailed rules for the scheme prescribed by Great Britain are the product of different circumstances and situations occurring in recent years and that could not be identified at the start and legally standardized. Legal regulation and perennial practice of Great Britain, which applies the cash accounting scheme for almost 20 years, however, points to the paradox – although the scheme is introduced in order to simplify the administration of VAT for a group of taxpayers whom the costs of tax administration are larger burden than to large taxpayers,

[18] Office of Tax Simplification, "A simpler income tax for the smallest businesses: a discussion paper", London, July 2011, p. 11.

administering of the scheme becomes extremely complex, not only for small VAT taxpayers, but also for the tax administration.

OECD experts in the detailed study regarding the taxation of small and medium enterprises state that the use of the cash accounting scheme can significantly reduce the cost of compliance with tax regulations, but also warn that in the practice different degrees of complexity of the scheme administering may appear, depending on supporting documents and records that taxpayers have to keep, including other financial documents as well[19]. Given the different levels of the scheme complexity, while keeping in mind the differences that exist between companies in the group of small and medium enterprises, it is possible to divide all models of cash accounting into three groups of models:

i. model which implies keeping cashbook based on daily inflows and payments;
ii. model which implies keeping cashbook and records of sales and purchase, as well as financial records (bank statements);
iii. model based on the cashbook, books of incoming and outgoing invoices and shortened financial reports[20].

Since the application of the cash accounting scheme is still associated with the increased complexity of administering and growing uncertainty regarding the revenue collection, when considering the introduction of the scheme, especially at a time of global economic crisis, it is necessary to consider other modes of favorable taxation of small taxpayers. There are several schemes of taxation applied by modern states in the world, some of which require systemic interventions in the law (tax policy), and the other on operational measures in the form of simplifying administration (accounting, collection, return filing, reporting). Each of the measure bears benefits to taxpayers and tax administration, but it also requires certain costs and losses. A certain *trade-off* is needed, to sacrifice the maximum possible benefits to achieve the optimal result for both sides.

Given that small taxpayers are not a homogenous group, in terms of economic and financial position, the position in the turnover chain, etc. the effects of each of these measures may manifest differently in each group of small taxpayers, and even lead them in a worse position than before the modification of the VAT taxation system.

Regardless of the choice of measures for which the fiscal authorities decide to improve the economic and financial position of small taxpayers, **the most important is that the measures are not mandatory but to be offered as an option which small taxpayers may choose if they estimate that they can benefit from the proposed taxation schemes.**

[19] OECD, Taxation of SMEs: Key issues and policy considerations, OECD tax policy studies no. 18" (2009).
[20] IFC, "Designing a Tax System for Micro and Small Businesses: *Guide for Practitioners*", The World Bank Group (in collaboration with DFID), December 2007., p. 51.

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Consolidated reports

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Table 1 (Consolidated report: B&H institutions, entities, SA)

The preliminary consolidated report includes

- revenues from indirect taxes collected by the Indirect Tax Authority on the Single Account,
- transfers from the ITA Single Account,
- revenues and expenditures of the institutions of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Federation of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Republika Srpska.*

Report doesn’t include unadjusted revenues collected on ITA SA.

Table 2 (Consolidated report: General Government)

Preliminary consolidated report includes:

- revenues and expenditures of the budget of Institutions of Bosnia and Herzegovina,
- revenues and expenditures of the budget of the Federation of Bosnia and Herzegovina, cantons, municipalities and funds,
- revenues and expenditures of the budget of the Republika Srpska*,municipalities and funds,
- revenues and expenditures of the budget of Brčko District and funds.

**Includes: (A) Budget of the Republic and extra-budgetary funds recorded in Treasury General Ledger of the RS, (B) total foreign debt for the projects realized through municipalities and companies, and (C) Budget users who have their own bank accounts (including some foreign project implementation units established by ministries)*

Preliminary report: B&H Institutions, entities and SA, I-VII 2013

	I	II	III	IV	V	VI	VII	Total
Revenue	434,7	382,4	446,3	489,5	554,8	560,3	549,8	3.417,7
Taxes	409,4	348,7	402,9	424,1	477,1	478,0	473,9	3.014,1
Direct taxes	22,7	29,7	53,5	45,4	27,0	31,6	39,1	248,9
Taxes on income, profits and capital gains	22,0	29,0	52,5	44,3	25,9	30,6	37,9	242,3
Taxes on property	0,6	0,7	0,9	1,1	1,0	0,9	1,2	6,5
Indirect taxes (net)	386,7	318,9	349,4	378,3	450,1	445,9	434,5	2.763,8
VAT	240,7	210,2	227,6	243,4	274,7	254,2	291,5	1.742,3
Excises	112,0	76,4	82,4	93,0	129,9	150,3	99,2	743,2
Road fee	20,3	16,8	18,9	22,5	26,6	23,9	25,6	154,5
Customs	12,6	14,5	18,9	18,2	17,4	16,2	16,8	114,5
Other indirect taxes	1,0	1,0	1,7	1,3	1,5	1,3	1,5	9,4
Other taxes	0,0	0,0	0,1	0,4	0,0	0,5	0,3	1,4
Social security contributions	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Foreign grants	1,4	0,7	1,8	2,4	0,8	2,9	3,5	13,6
Other (non-tax) revenue	23,9	33,0	40,2	64,3	76,6	79,4	72,2	389,6
Transfers from other general government units	0,0	0,0	1,4	-1,4	0,2	0,0	0,1	0,4

	I	II	III	IV	V	VI	VII	Total
Expenditure	411,9	400,9	410,4	416,0	459,3	478,3	531,6	3.108,5
Expense	407,5	397,9	402,9	411,1	455,9	468,9	514,7	3.059,0
Compensation of employees	123,1	124,7	126,9	124,2	125,0	128,9	131,2	883,9
Use of goods and services	14,6	24,1	28,3	24,7	24,6	37,9	25,3	179,6
Social benefits	52,6	54,4	53,4	53,3	51,7	57,4	55,3	378,0
Interest	4,2	7,1	18,9	8,7	13,7	23,1	5,4	81,2
Interest payments to non-residents	2,3	5,5	10,1	6,0	6,2	14,1	3,1	47,4
Interest payments to residents	2,0	1,6	8,8	2,7	7,5	9,0	2,3	33,8
Subsidies	2,2	2,4	6,0	3,7	8,3	19,3	19,2	61,2
Grants (to non-residents)	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
Transfers to other general government units	40,3	42,2	41,5	37,8	42,4	49,5	59,8	313,6
Transfers from SA (BD, cantons, municip, funds, road f.)	165,4	134,4	119,1	153,2	184,6	144,8	197,2	1.098,6
Other expense	5,1	8,6	8,9	5,4	5,6	8,0	21,3	62,8
Net acquisition of nonfinancial assets	4,4	3,0	7,5	4,9	3,4	9,5	16,9	49,6
Acquisition of nonfinancial assets	4,6	3,3	8,2	5,6	3,9	10,1	17,4	53,0
Disposal of nonfinancial assets	0,2	0,2	0,7	0,7	0,5	0,6	0,4	3,5
Gross/Net operating balance (revenue minus expense)	27,1	-15,5	43,3	78,4	98,9	91,4	35,1	358,7
Net lending /borrowing (revenue minus expenditures)	22,8	-18,5	35,9	73,5	95,4	81,9	18,2	309,2
Net financing = (Minus) Net lending /borrowing	-22,8	18,5	-35,9	-73,5	-95,4	-81,9	-18,2	-309,2

Table 1

Preliminary report: General Government, I-VI 2013

	Q1	Q2	Total
Revenue	2.445,9	2.894,0	5.339,8
Taxes	1.247,7	1.476,9	2.724,7
Direct taxes	235,9	242,2	478,1
Taxes on income, profits and capital gains	205,9	211,1	417,0
Taxes on payroll and workforce	3,9	3,9	7,9
Taxes on property	26,1	27,1	53,2
Indirect taxes	1.010,8	1.232,6	2.243,4
Other taxes	1,0	2,2	3,2
Social security contributions	930,6	1.011,1	1.941,8
Foreign grants	6,3	10,0	16,4
Other (non-tax) revenue	258,3	393,6	652,0
Transfers from other general government units	2,8	2,2	5,1
Expenditure	2.470,9	2.709,9	5.180,8
Expense	2.431,8	2.648,5	5.080,2
Compensation of employees	785,8	804,6	1.590,4
Use of goods and services	443,9	492,8	936,7
Social benefits	1.053,2	1.088,7	2.142,0
Interest	37,5	54,3	91,8
Interest payments to non-residents	19,1	27,2	46,3
Interest payments to residents	18,4	27,1	45,4
Subsidies	32,3	61,0	93,3
Grants	0,9	5,2	6,0
Transfers to other general government units	7,6	48,3	55,9
Other expense	70,5	93,6	164,1
Net acquisition of nonfinancial assets	39,2	61,4	100,6
Acquisition of nonfinancial assets	44,7	67,8	112,4
Disposal of nonfinancial assets	5,5	6,4	11,9
Gross/Net operating balance (revenue minus expense)	14,1	245,5	259,6
Net lending /borrowing (revenue minus expenditures)	-25,0	184,1	159,0

Table 2