

PRACE NAUKOWE

Uniwersytetu Ekonomicznego we Wrocławiu

RESEARCH PAPERS

of Wrocław University of Economics

Nr 375

Quantitative Methods in Accounting and Finance

edited by
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Publishing House of Wrocław University of Economics
Wrocław 2015

Copy-editing: Elżbieta i Tim Macauley

Layout: Barbara Łopusiewicz

Proof-reading: Barbara Cibis

Typesetting: Agata Wiszniowska

Cover design: Beata Dębska

This publication is available at www.ibuk.pl, www.ebscohost.com,
Lower Silesian Digital Library www.dbc.wroc.pl,
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www.wydawnictwo.ue.wroc.pl

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Wrocław 2015

ISSN 1899-3192

ISBN 978-83-7695-427-1

The original version: printed

Printing: EXPOL, P. Rybiński, J. Dąbek, sp.j.
ul. Brzeska 4, 87-800 Włocławek

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SPECIAL VAT SETTLEMENT PROCEDURES

Summary: The tax on values added to products and services (Value-Added Tax – VAT) is construed in accordance with the general taxation principles, to conform with such taxation postulates as universality, neutrality, multi-stage application, and the prevention of the restrictions and disturbances to competition. To ensure the proper application of those principles, the taxation authorities require the payers to settle their dues based on standard settlement procedures. The standard settlement mechanism involves the deduction of output tax collected at sale from the sum of the input tax on sales, and is used by all VAT payers. However, the tax obligations and other considerations resulting from VAT registration may generate an additional cost and a greater taxation risk for the taxpayer. The cost overhead and the extra risk may prove excessive for some entities, particularly SMEs. For this reason, general VAT rulings allow for the use of special procedures to limit the fiscal load (compliance cost) imposed on the entity. Taxpayers should consider using these procedures only after a careful examination of the potential benefits and costs involved. Those factors can only be analysed in the context of the entity's present economic condition and business model.

Keywords: value added tax, taxation risk, special procedures.

DOI: 10.15611/pn.2015.375.15

1. Introduction

The economic design of the value added tax mechanism can be described in simple terms. The compliance cost is carried by the consumer, since the price tag on products and services includes the VAT charge. At the same time, the consumer is not part of the formal settlement procedure. The tax settlement is performed by the seller, who is responsible for transferring (remitting) the collected VAT surcharge to the taxation authorities. However, the actual transfer of amounts due is done incrementally, on each individual item of the economic turnover. In line with the multi-stage application postulate, the input tax paid at sale is deducted from the sum of the output tax on sales. In effect, VAT settlement involves a simple calculation of the difference between input and output VAT. There are, however, certain formal complications involved, such as the duty to document all the transactions and keep evidence of the sales and purchases made.

For taxation to be effective and efficient, it must be based on a well-designed legal taxation framework. The legal construct should define both the object and the subject of the taxation procedure, as well as the principles for the calculation of amounts due and the settlement principles. The legal framework defines not only the mechanism of taxation (tax on sales, tax on property, tax on income), but also other elements, since tax duties may affect other areas, such as economic processes (e.g. investments, consumption rates), social processes (e.g. income distribution, satisfaction of needs), political processes, and so on. Thus, the legal design of tax must take into account not only the fiscal objective behind the decision to impose a given tax, but also a number of non-fiscal objectives (social, political, etc.). Moreover, the rules of taxation should be set in such a manner so as to reduce or eliminate certain negative side effects of the said taxation (such as taxation risk, compliance cost, or the risk of fraud). From the viewpoint of an economic entity, the tax imposed should not in any way disturb or restrict the competition (for instance, by satisfying the postulates of tax universality and equality), and the servicing of the tax settlement should not be too costly or too onerous.

The legal construct of VAT in Poland is defined in the Act of 11 March 2004 on Tax on Values Added to Products and Services (the unified text published in the Off.J. of 2011, No. 177 pos. 1054 with amendments). The legal provisions of the Act bring quite large complications into the apparently simple economic construct of the tax. The legislators were clearly intent on reaching the fiscal objective by widening the formal application of the tax and reducing the potential fraudulent abuse of the input tax deduction mechanism. In general, it may be concluded that both the present economic mechanism of the tax, and the legal limitations imposed by the legislators, have a negative impact on economic entities. The most notable economic effect of the present taxation mechanism is the appreciation of prices, and the resulting reduction in the demand for the products and services on offer. In addition, taxation negatively impacts such areas as liquidity management, settlement cost, and taxation risk.

The financial and organizational load associated with the tax is relatively higher for small and medium-sized entities compared to large enterprises. For this reason, the present VAT regulations include a number of solutions targeted for the SMEs, to help alleviate the negative effects of taxation in this particular sector of the economy. These so-called 'special VAT settlement procedures' are parametric, meaning that they can be applied, on a voluntary basis, by those entities that fulfil certain formal requirements. The choice should be made based on a careful examination of the potential benefits and risks involved (cost-benefit analysis), since special procedures may in some cases prove far more costly than the standard ones.

This paper provides an analytical examination of selected special procedures of VAT settlement available for companies operating in Poland, with particular emphasis on the associated benefits and costs. The analysis addresses procedures available to applicable entities. Tax exemption is also presented here, as an alternative solution contrasting the principle of taxation universality. In addition, the study covers

some special procedures available for micro-entities (the cash register method), and for certain professions (farmers, cab drivers). The fundamental research problem addressed here is the evaluation of the prerequisites for the application of special settlement procedures against the potential risk of unprofitability.

2. VAT exemption for small entities

Universality is one of the central principles of VAT operation. Taxation, in principle, is obligatorily imposed on all economic entities, regardless of the results of their business activities. One of the important premise for the application of formal taxation duty is the notion that the essence of economic activity lies in the provision of certain services (mostly sales) which are subject to taxation. Thus, the legal construct of VAT implies that all economic entities are taxpayers. There are, however, two distinct exceptions to the universality principle. Firstly, taxation duty does not apply to those entities that deal exclusively in VAT-exempt goods and services, regardless of the notion that the sale – as an economic activity – should be subject to formal taxation. For instance, a company offering exclusively medical services is exempt from taxation based on the character of the services offered. In all such cases, the exemption from taxation is obligatory. Secondly, tax exemption may result from the application of a special settlement procedure.

Special settlement procedures (art. 113 of the Act) offer voluntary exemption from VAT for two groups of ‘small entities’. All start-up companies are considered small entities until their annual sales turnover is found to be in excess of 150,000 PLN. The threshold limit is recalculated proportionally for each consecutive year of business operation. In the same manner, companies with a continual history of operation may also be regarded as small entities if their annual sales for the previous reporting period had been below the 150,000 PLN limit. Tax-exempt goods and services are not included in the threshold calculations.

The provisions of the Act include a detailed list of VAT exemption requirements. Some of the regulations are of particular significance. Firstly, companies in their start-up phase are automatically exempted from VAT. Secondly, the exempt companies are free to waive their VAT exemption privilege (opt out) and adopt standard taxation procedures at any time (right from the onset, or at the start of any reporting month); in such cases, the assumed VAT obligation will be in force until the end of the next calendar year. Thirdly, some entities are excluded from the VAT exemption privilege based on the type of business activities (for instance, liquor sales), even if their annual turnover is within the limit of 150,000 PLN. Fourthly, both the loss of the exempt privilege and the voluntary opt-out decision will impose a number of formal obligations on the affected entity.

Analysis of the structure of VAT obligations of companies shows three distinct groups of entities. The first group represents companies subject to obligatory VAT taxation based on the type of business activities or based on the fact that their turnover

was in excess of the threshold limit. The second group represents companies that are obligatorily exempt from VAT based on the type of business activities. The third group represents those companies which are statutorily privileged to choose between general taxation and VAT exemption. With regard to the latter group, the rational approach would be to make an informed decision after the careful examination of the potential benefits and risks involved in each of the available settlement methods. Both the general taxation procedures and the VAT exemption may affect the entity's competitive position and its profitability [Owsiak 2013, pp. 503-504], since tax exemption is not necessarily the most profitable solution.

The evaluation of the profitability of VAT exemption must take into account the present economic situation of the entity and its turnover structure. For example, if the recipient of goods and services is a VAT-payer, then the supplying company should also be a VAT-payer. Only such a scenario will offer the supplier a chance to 'transfer' the cost of tax paid at purchase onto the recipient (consumer). However, if the recipient (customer) is exempt from VAT, the decision is not that simple anymore and requires a careful evaluation of both solutions (cost-benefit analysis).

Tax exemption offers a number of benefits, such as the elimination of evidencing and settlement costs, the elimination of the tax risk resulting from the application of taxation rules and regulations, and – most of all – exemption from the tax on added value, as reflected in the selling price. As a result, the VAT-exempt entities may call a lower selling price compared to their VAT-registered competitors, and benefit from higher sales volumes. Or, alternatively, they may adopt the same pricing schemes as their competitors, and benefit from higher sales margin. In this context, the benefits of VAT exemption can be simultaneously perceived as the drawbacks of the general taxation procedure.

However for VAT-exempt entities, the lack of an effective mechanism of reclaiming the input tax may prove disadvantageous. In addition it may seriously affect the entity's competitive position. Thus the drawbacks of VAT exemption can be seen as identical with the benefits of the general taxation method. In general, it may be concluded that VAT exemption is a profitable solution if the value of exemption benefits exceeds the cost of its drawbacks. Assuming that the decisive factor here is the VAT on sales and purchases, the following rule may be postulated: VAT exemption is a profitable solution if – within the tax exempt period – the total amount of output tax due based on the standard taxation procedure would exceed the sum of the input tax. An informed decision in this matter is largely determined by the entity's ability to plan the structure of its sales and purchases within the tax-exempt period. In addition, when the sales are subject to preferential taxation or when any investment-type purchases are being planned for the period in question, then the unprofitability of tax exemption will be more pronounced.

Analysis of the VAT taxation/exemption dilemma offers some important conclusions. Firstly, for entities selling products and services to VAT-registered companies, the choice is obvious – they should select the general taxation solution.

Secondly, if the sales are made (in part or in full) to VAT-exempt recipients, it is necessary to compare the projected values of input and output VAT. This, however, introduces the risk of making an unprofitable decision. Thirdly, based on the analysis of various scenarios, it may be observed that the probability of general taxation being more profitable than tax exemption is markedly higher. Thus, the general taxation method can be seen as the default solution, whereas tax exemption should only be adopted when justified by tangible and undebatable benefits. Fourthly, the main source of taxation risk lies in the VAT mechanism itself (enforcing the continuity of deductions), and not in any specific legal provisions. The use of the VAT exemption option should always be based on a careful examination of the taxpayer's economic situation.

3. Special settlement procedures for small taxpayers

Small taxpayers are entities with annual sales for the previous reporting year not higher than the equivalent of 1,200,000 euro. The applicable entities may choose their tax settlement method on a voluntary basis. Special provisions [Litwińczuk (red.), 2013, p. 505] for small taxpayers include settlement in quarterly reporting periods (as opposed to the standard per-month approach) and the use of the cash register method.

Per-quarter settlement (art. 99 of the Act) is typically interpreted as a tax-optimization instrument [Szlęzak-Matusiewicz 2013, p. 356]. One of the positive effects of the extended settlement period is the postponed payment of tax dues, which may improve the entity's liquidity and allow for a potential reduction of the tax settlement workload. Eligible entities may simultaneously opt for per-quarter settlement of the income tax, to magnify the scale of such benefits. However, the per-quarter settlement of VAT may have some negative effects, e.g. by affecting the payer's rights to tax returns. Thus, the per-quarter method may be unprofitable for entities reporting a steady excess of input VAT over their output VAT, for instance – due to the use of preferential tax rates on sales. Using this method for the purpose of improving company liquidity may require the careful management of the sales/purchase windows, which is an extra burden for the taxpayer. Moreover, as a result of the reduced number of settlement operations, the sum of dues per settlement operation is proportionally higher – this burden should be reflected and anticipated for in the structure of company expenses. In general, it may be observed that using the per-quarter method as a way to improve company financial standing enforces certain financial discipline and planning. In fact, the tax becomes an additional factor to be included in the planning process. This form of tax settlement requires strict financial and organizational discipline and should be based on rational analyses, since it cannot be opted out of before the end of the next reporting year. It must be noted that per-quarter settlement can also be used by other economic entities (large companies), but the respective provisions drastically limit the extent of the potential financial benefits.

The cash register method is another instrument with the potential for reducing the burden of accrual VAT settlement (art. 21 of the Act). This method offers the adjournment of the tax payment by relating tax dues to the date of payment received. In the case of VAT-exempt customers, the tax is accounted for within 180 days from the date of the goods/service provision. At the same time, however, the input tax may be deducted, but only for payments registered on the supplier's account. The deferment effects are magnified by the per-quarter settlement procedure, which is obligatory in this method. The potential benefits of tax deferment should be examined against the cost of evidencing and monitoring of the payment maturities. To maximize the financial benefits, the users of this method should also adopt some form of control over the sale/purchase terms and payments. For instance, at the turn of the settlement periods it may be advisable to precipitate the settlement of purchases and to extend the maturity of receivables.

The use of the cash register method may negatively affect the competitiveness of small taxpayers, since the recipients of goods/services may reclaim the input VAT stated on the 'cash register' earmarked invoice only after the payment has been made. In the case of longer grace periods, the VAT return may be postponed beyond the recipient's 'comfort zone', or perceived as a limitation of rights, leading to their discontinuance.

When evaluating the profitability of the cash register method, one should remember that it allows for deferment, i.e. a temporary decrease of tax payment. Incidentally, this is also a form of limiting the payment gridlock [Wyciślok 2013, p. 322]. The cash register method is a clear departure from the accrual method and yet another proof that special VAT settlement procedures may be unprofitable for some entities. In this context, the benefits of small taxpayers correspond to an additional cost for their contractors. From the viewpoint of the tax authorities, tax deferments are principally neutral. In view of the above, and taking into account the additional cost of the procedural character, the cash register method may be seen as a source of potential risk for the taxpayer, in the form of reduced competitiveness and reduced effectiveness.

4. Flat-rate schemes for selected taxpayers

The Act provides for other special settlement procedures for selected groups of entities based on the type of business activities involved. Special procedures may be used by farmers providing agricultural goods and services, by cab drivers, by providers of tourist services, as well as entities dealing in used goods, antiquities, art and investment gold. Extra provisions apply to farmers and cab drivers – those groups of taxpayers may choose between standard settlement procedures and flat-rate settlement schemes.

The flat-rate settlement of VAT may be used in the taxation of cab services for personal transport only (art. 114 of the Act). In essence, this form of settlement is based on a flat tax rate of 4% with no option to reclaim the input VAT. The flat rate scheme

must be used for at least 12 consecutive months. The benefits for the taxpayer include the reduction of formal duties and the potential reduction of tax dues. In practice, this method offers the potential for the practical elimination of the tax burden [Mazur (red.), 2013, p. 19]. The flat-rate scheme is profitable when the flat rate of 4% is found to be lower than the difference between the output and input VAT. For this to be effective, the taxpayer should carefully plan and anticipate their purchase expenses, including the input VAT, and confront those values against the viable turnover proceeds. Taking into account the low flat rate of taxation and the minimization of formal obligations, it may be assumed that this form of settlement proves profitable to many entities.

Special VAT settlement procedures are also available to farmers of the so-called flat-rate category, i.e. those electing to settle without books of accounts. VAT exemption is offered to farmers selling products or services described in the Act. However, the exemption is provided on a voluntary basis, and there are consequences to selecting this form of settlement. For instance, if a flat-rate farmer sells VAT-exempt products or services to a VAT-registered entity, he or she is eligible for a flat-rate tax return (art. 115 of the Act). The return value is calculated as product of net sale and the flat rate of 7%. In effect, the purchaser of said agricultural goods or services is required to increment the sum due to the 'flat-rate' farmer by 7%. The underlying idea is to make the tax accountable not to the seller, but to the purchaser. The latter issues a sales invoice and transfers the payment to a special account set up by the seller. The tax paid is then accounted for by the purchaser, and calculated for the month the actual payment was registered for.

The profitability of this method, from the flat-rate farmer's perspective, is related to two factors. The most important factor is the sum of input tax on purchases made for business purposes. The other factor to be taken into account is the projected cost of evidencing, settlement and risk involved in standard VAT settlement procedures. The flat-rate method is profitable when the tax return is higher than the potential surplus of input VAT over output VAT (that would apply in the case of the standard settlement procedure). Another flat-rate premium is the minimization of the formal obligations imposed on the taxpayer.

Thus, the flat-rate procedures can be perceived as beneficial for agricultural entities, since it eliminates the burden of formal settlement procedures that come as part of the standard settlement procedures. However, in the case of large purchases (e.g. of the investment type), the sum of input VAT in relation to output tax may be quite high and in excess of the flat return rates offered.

5. Conclusions

It goes without saying that special procedures provided for in the VAT settlement process in Poland greatly contribute to the increased flexibility of taxation, since they provide selected groups of taxpayers with the right to adjust their settlement options based on their individual economic situation. It must be stressed, however, that special

procedures are not always a profitable solution. Therefore their application should be preceded by a careful examination of the associated benefits and costs. The cost-benefit analysis should also take into account the projected purchases and turnovers or, to put it in a different perspective, the sums of projected input and output VAT. The simplification of procedures, typical for the special settlement solutions, is also of considerable value for the purpose of calculating the most profitable method of VAT settlement available.

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PROCEDURY SZCZEGÓLNE ROZLICZANIA VAT

Streszczenie: Podatek od towarów i usług funkcjonuje zgodnie z ogólnymi zasadami, do których zalicza się m.in. powszechność, neutralność, wielofazowość i unikanie zakłócenia warunków konkurencji. Realizacja tych zasad odbywa się poprzez stosowanie jednolitych procedur rozliczeniowych. Ogólny mechanizm rozliczenia polega na odliczaniu podatku naliczonego od należnego i jest stosowany przez wszystkich podatników. Podleganie obowiązkowi podatkowemu oraz obowiązek rozliczania VAT oznaczają konieczność ponoszenia kosztów i ryzyka podatkowego. Koszty te oraz ryzyko mogą być stosunkowo wysokie i trudne do poniesienia w przypadku prowadzenia działalności na relatywnie niewielką skalę. Dlatego w przepisach VAT przewidziano możliwość zastosowania procedur szczególnych, które pozwalają na ograniczenie ciężaru wynikającego z rozliczeń. Podatnicy powinni wybierać stosowanie tych procedur, uwzględniając własne korzyści. Ich wystąpienie zależy jednak od indywidualnej sytuacji przedsiębiorcy.

Słowa kluczowe: podatek od towarów i usług, ryzyko podatkowe, procedury szczególne.