

# Value Added Tax (VAT) and rules of settlement according to amendment the law of VAT – selected issues

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**Abstract:**

**Aim:** The prime aim of this publication is to present the rules of the VAT tax settlement as well as to discuss selected issues. In this significant era of submitting many important changes to the VAT Act, I believe it is only appropriate to introduce the newest issues such as Standard Audit File for Tax (SAFT), the POLTAX (Polish Tax) system, or the reverse charge mechanism imposed on the entrepreneurs that raise fears and doubts; such issues are also a huge support for the offices in controlling the correct application of the regulations stated in the VAT Act. The article points out the statutory exceptions that may cause confusion leading to the incorrect tax settlement, it also focuses on the possibility of using the regulations stated in the Act in an optimal manner for a given entrepreneur. Nowadays, the VAT tax and its settlement are more and more controlled and the regulations become even more complicated, not to mention the fact that they are changed and altered rather frequently, which is also a case that is pointed out in this article.

**Research methods:** the article consists of a comprehensive analysis of the regulations of the VAT tax and their connection to other legal regulations such as the Labour Code or the Income Tax Act. I am going to review and discuss selected matters with reference to the examples of situations that have occurred among entrepreneurs on the basis of which the conclusions will be drawn (deductive method).

**Conclusions:** The regulations of the VAT Act are among the most complex and complicated ones. The existence of many exceptions are a significant complication for the Polish entrepreneurs during the process of the VAT tax settlement. Every single change in said regulations has unpredictable consequences that influence the businesses of the economic entities not only in the VAT related area but also on the basis of the regulations of the Income Tax Act or the Labour Code.

**Originality/value of the article:** The topic of the VAT tax is constantly expanded and explored by many publications. The authors themselves admit that the issue is complex and difficult, and due to the very dynamic

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nature of the changes in regulations it is impossible to fully present the consequences of a given change in the VAT regulations. The summary of a couple of issues related to VAT tax is an attempt to explain the VAT tax regulations and it may serve as a starting point for further amendments of the regulations or their clarification. Combining theory with practical examples may be a prime source of the information for those interested in the topic of VAT tax and as well as for the entrepreneurs.

**Keywords:** VAT, reverse charge mechanism, tax, Standard Audit File (SAFT), construction services.

JEL codes: K34, K31, H25, H26, H32

## 1. Introduction

Tax on goods and services, commonly known as VAT is an indirect tax and it is paid by every citizen while making a purchase of any kind. The rules of its calculation and its discharge to the state budget have been specified in the Goods and Services Tax Act.

The founding father of the Polish VAT tax is prof. W. Modzelewski who introduced said tax to the Polish tax system in 1993, though the concept of value added tax was first developed by a French economist – M. Laure in 1954.

Introducing the VAT tax was a groundbreaking moment for a country that was on the way to rebuild an independent state system and specify the basics of the tax system, especially after the first failed attempts of introducing said tax by Jan Krzysztof Bielecki's government in 1991.

The VAT tax, just like any other tax, is supposed to supply the country's budget with money. The main assumption is that the last person purchasing a product, an individual customer, pays the tax in the moment of payment. The remaining parties, mainly the sellers, the suppliers, the producers, running economic business are able to deduct the tax and its payment follows other set of rules and it does not need to be paid (assuming that a given economic entity is an active taxpayer).

## 2. The VAT tax in literature

The Value Added Tax (VAT) is the main source of income of the country's budget. In 2017 the VAT impact value equaled 156,801,21pln<sup>1</sup> ([www.finanse.mf.gov.pl/budzet-panstwa/wplywy-budzetowe](http://www.finanse.mf.gov.pl/budzet-panstwa/wplywy-budzetowe)). It is not a surprise then that the correctness and lawfulness of implementing the provisions of the Act by the obliged entities is frequently controlled by the authorities of the state, and the Act itself often undergoes numerous changes. In 2017 about 3,200

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<sup>1</sup> Data calculated in thousands of pln.

VAT tax controls were ordered ([www.nik.gov.pl/najnowsze-informacje-o-wynikach-kontroli/wyzsze-dochody-z-vat.html](http://www.nik.gov.pl/najnowsze-informacje-o-wynikach-kontroli/wyzsze-dochody-z-vat.html)). The provisions that regulate the application of the tax have been subject to many amendments, still more changes are being planned, and the Act provisions are not among the easiest ones which is why they need to be frequently clarified with the use of publications that consist of interpretations of the subject. That is the reason why the VAT tax issue is a common topic in literature.

Many publications deal with the subject of VAT in agriculture, they describe the issues with the tax settlement in said area. Despite the tax being in function for many years now it still causes a lot of problems with correct settlement of it by the farmers (Kondraszuk 2016: 154-159). The authors of the publications also seek to present the rules of the cash accounting scheme for VAT in agriculture. Applying this scheme is especially beneficial for it helps with lowering the payment gridlocks (Kondraszuk 2017: 113-118).

Complicated and full of exceptions nature of the VAT regulations opened the door for many entrepreneurs wanting to use it for their own purposes, taking advantage of the loopholes in the law they started making transactions to extort the country's budget for VAT. In order to prevent such incidents from happening the government introduced a number of changes to ensure the lawfulness of the entire process, one of such changes was the reverse charge mechanism. The functioning of the mechanism is still being analyzed by the experts, and it is quite difficult to determine its effectiveness on the Polish economy as a whole. Unfortunately the positive impact of the reverse charge mechanism that is felt in one industry leads to criminal acts in others (Szłęzak-Matusiewicz 2015: 265-276). The size of the tax fraud problem is so big that most of the publications are dedicated only to this growing issue, the articles explain the issue trying to clarify the mechanisms behind the extortion of VAT, as well as they describe the Polish tax system, whose knowledge allows people to commit tax frauds (Kozłowska 2017: 117-125).

One of the most common tax frauds is so called "carousel fraud", such operation is possible to perform with the involvement of businesses in various countries in the European Union. The fraudster creates an economic fiction in which the goods and the tax are passed around between different companies and industries, the last of which gets the tax refund from the country's budget, which is an example of extortion (Sebastianka 2017: 285-297).

The publications also mention the construction services which get a very peculiar treatment from the regulations of the VAT Act, the exception always apply to them. In previous

years, the VAT tax from the invoices that documented the sale of the construction service was available only after receiving some or all of it. Nowadays the construction services, precisely the subcontractors, are subject to the reverse charge mechanism. The authors of the publications also seek to present the influence of said mechanism on the finances of the construction industry companies. Taking under consideration the fact that the reverse charge mechanism is a relatively recent mechanism the literature lacks in the number of publications related to it. However it is not hard to determine that its impact on the financial situation of enterprises, especially in the small and medium sector, causes problems with liquidity (Rogowska-Rajda, Tratkiewicz 2017: 269-282). Value Added Tax – VAT is among the most complicated and complex taxes, in both settlement and application, therefore it constantly undergoes changes, this is mainly the reason why the VAT-related problems are in the focus of many articles and publications. Due to the dynamic nature of the changes of the VAT regulations it is difficult to conduct a comprehensive analysis of a given issue and determine its consequences. All of the publications help shed a light on the very intricate VAT-related issues and highlight the effects of the functioning of the VAT regulations as well as introduced changes.

This article focuses mostly on selected issues and the functioning of the tax in the construction industry, precisely in the earthworks and the road works. The article also points out the result of linking the VAT Act with other acts present in Polish law, and showing the practical side of implementing the VAT Act regulations in the functioning of enterprises.

### **3. The rules of VAT settlement**

The Goods And Services Tax Act defines two different kinds of VAT: input tax and tax due. The input tax is included in VAT invoices of the purchases made while the tax due is included in the VAT invoices regarding sales and in the fiscal receipt. The excess of the VAT due over the VAT input tax results in the necessity to pay the resulting difference to the country's budget (art. 99 section VAT). In the reversed situation, the excess of the VAT input tax can be enclosed in the VAT return declaration document for the next tax period, the taxpayer can apply for a refund of the excess amount to his bank account or count it towards future liabilities due to this tax or other (art. 86 par. VAT). The penultimate scenario may result in a sudden Tax Office control or a set of verifying activities performed in order to check whether said excess is correctly

calculated, though due to the fact that in 2018 all economic entities became subject to the obligation of sending a Standard Audit File for Tax<sup>2</sup> to the Ministry of Finance, such controls and verifying activities are to occur less frequently.

General idea behind the Standard Audit File for Tax is to identify and exclude from the group of controlled entities the subjects with the lowest likelihood of committing fraud.

The SAFT is a set of background documents that are recorded in the VAT register of sales and purchases. The File is in a form of a table that encloses information useful for detecting any kinds of irregularities, these information include: the document's (VAT invoice's) serial number, tax ID number of the contractor, the name and the address of the company, the accounting document number, the date on which the document was issued as well as the date of the purchase, the net amount as a whole and after dividing it into individual tax rates (art. 193a of Tax Code, art. 109 section VAT).

The taxpayer is notified if the Tax Office finds any abnormalities and is obliged to correct his Standard Audit File for Tax within a given amount of days, and if the situation requires, also his VAT return for a given tax period; the irregularities may concern, for example, wrong tax ID number. The newly introduced SAFT system will help detect when a company issues a VAT invoice while not being an active VAT taxpayer, it also aids with detecting the incidents when the buyer deducts the VAT from an invoice that he has not paid the VAT for – he has not included in his registries the VAT due which should be submitted in the form of the Standard Audit File for Tax.

The last buyer of goods or services must pay VAT, while other entities do it only if such necessity arises, although it is important to notice that not all products are subject to the VAT tax, some of them are considered tax exempt or are supplied with zero VAT rate, which means the tax does not need to be paid for them. Such products include, for example, big wall maps used for educational purposes, the delivery of scanners, and printers (art. 42, 43 section VAT), the range of products exempt from VAT is very narrow which means that the buyer almost always pays the tax.

Polish government, due to the economic crisis, decided to rise the tax rates on goods and services by one percentage point and introduce new ones, the changes were supposed to apply only between 01.01.2011 – 31.12.2013 with the possibility of the tax rates being raised by one

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<sup>2</sup> Standard Audit File for Tax introduced in 2018 for all active taxpayers, SAFT for short.

percentage point in the upcoming years. Although the VAT provisions were supposed to be transitional, not permanent, the higher tax rates are still in effect and there is no information if that is going to change in the future; these are the VAT rates up until 31.12.2010: 0%, 3%, 7%, 22%, right now the tax rates present as follows: 0%, 5%, 8%, 23% (art. 41, 42, 146a section VAT).

The introduced Tax Act changes were supposed to increase the VAT tax impact on the country's budget, in theory the taxpayers should be able to tell the difference in the gross prices of the purchased goods expressed in the value between the changed rates (that is, basically, by one percentage point). In practice, the situation is much different and the increase in prices of goods and services is much higher than just one percentage point of the net value of a given product. Therefore the amounts paid to the country's budget are bigger, because of the raise of the VAT rates and because of the raise of the net value of goods.

Autor believes it is important to mention the appearance of the reverse charge mechanism<sup>3</sup>. From 01.01.2017 the provisions stated in the VAT Act were changed, said provisions were of great importance for companies providing construction services, specifically for construction subcontractors. The reverse charge mechanism was introduced and covered a number of services provided mainly by construction companies, such as the use of machines used for constructing and erecting buildings, general construction services, services connected with earthworks, plumbing installations, electrical installations, roof construction services (classified in Polish Ranking (Classification) of Goods and Services from 2008 for the tax purposes, in groups 41-43). How do the companies deal with the changes of provisions and what consequences of said changes do they need to face?

By the regulations of the VAT Act that came into effect on 01.01.2017, the index of services subject to the reverse charge system expanded greatly and the sellers were placed under additional obligations connected with submitting documents to the Tax Office. Up until 01.01.2017 the index of groups subject to reverse charge mechanism was quite narrowed (art. 17 section 1, point 7 with the annex no. 11 to the VAT Act), however it does not mean it did not concern the construction companies at all. Such companies did come in contact with reverse charge mechanism and they had to include it in their documentations while buying construction

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<sup>3</sup> The reverse charge mechanism is treated like a reverse charge VAT rate.

materials, such as flat hot-rolled products (Polish Ranking of Goods and Services 24.10.31., 32., 35., 36.0), hot-rolled rods (Polish Ranking of Goods and Services 24.10.61.0), or open sections made of non-alloy or alloy steel (Polish Ranking of Goods and Services 24.10.71.0, 24.10.73.0).

The VAT Act was enriched by the annex no. 14 (in connection with art. 7 section 1 point 8 of the VAT Act) which included a list of services that the reverse charge mechanism should be applied to. Said annex consists of 48 items, 47 of which are construction machines. It is important to remember that the annex does not include all of the construction services therefore one should always check if a given service is provided on the list. The change concerns only subcontractors, though the Act does not tell precisely who exactly is considered to be a subcontractor and who should be treated as one which caused a general confusion. Provided explanations specify that in this situation a simple and commonly known definition of subcontractor should be applied and used, in said definition subcontractor is a subject that is ordered to provide the services listed in the annex no. 14 by a subject who, as a general contractor, signed a contract (or is obliged to carry out construction works) to carry out work with an investor (the principal), (the ruling of the Provincial Administrative Court in Cracow I/SA/Kr103/17).

The subcontractor (being an active VAT taxpayer) needs to issue an invoice using the reverse charge mechanism if he completes the service listed in the annex no. 14 of the VAT Act. It is crucial to remember that the reverse charge is a VAT tax rate, which means that said rate should not be defined as an exempt or a zero VAT rate. The issue should specify that the VAT tax rate is considered to be of reverse charge, and it should also include the insertion that says: reverse charge – VAT is settled by the buyer – service is included in the annex no.14 of the VAT Act (art. 17 section 1, point 8).

The transactions subject to the reverse charge mechanism should also be included in the VAT return for a given tax period, as a separate item. If a company is the seller then such transactions should be included in the VAT return (version 17) in item 31 (only the net value, without VAT).

Besides that one needs to submit an additional document to the Tax Office – the information summarizing VAT-27, in the D-section of said document (information on the services provided) there should be a list of all the contractors that bought the services subject to reverse charge (art. 100, 101 section VAT).

That section should also cover the information about the name of the company, tax ID and the total value of all transactions in PLN. The buyers are also subject to additional obligations regarding tax returns, though they should submit only VAT-7 return, the transactions mentioned before should be enclosed in the section intended for the VAT input tax and VAT due. From the VAT net value presented on the invoice the buyer must calculate the 23% of VAT, and then disclose it in VAT-7 return in item 36 (net value) and 35 (VAT). The same amounts need to be included in the D.2. section of the VAT return in item 45 (net value) and 46 (VAT). The reverse charged transactions should be neutral for the taxpayer VAT-wise (the VAT input tax balances the VAT due).

It is important to be aware of the fact that the invoices that document the reverse charge should be included in the same tax period as they have been issued in. If, for any reason, this has not happened, a proper correction of the VAT return for a given tax period should be prepared, it does not matter whether it is a purchase or a sale (in this case there is no possibility of disclosing the amount from the purchase invoice in two subsequent tax periods) (art. 86 section VAT).

The companies that are obliged to apply the reverse charge mechanism with every sale do not need to pay the VAT input tax for they do not apply it. Buying the materials that are later used in order to perform a complex construction service that is subsequently sold, the companies receive a set of documents that include the VAT input tax, and they are entitled to deduct said tax. Though in a situation when they do not disclose the VAT due there is nothing that would allow to deduct the VAT tax from purchases, what happens then is an accumulation of the VAT input tax; in such case a company can apply to the Tax Office for a tax return to the bank account. In a VAT return for a given tax period one should disclose the amount the VAT refund as well as the number of days in which it should be granted. It seems important to remember that in a case of the reverse charge mechanism the VAT due does not occur, therefore the fastest date in which one could get their refund is 180 days, that means that the taxpayer needs to wait about 180 days for his tax refund since the day of submitting his VAT return. The number of days may be even higher if the taxpayer gets inspected and becomes a subject to verifying controls, for during such processes the course of 180 days is stopped. However the Tax Office may grant the refund that resulted from overpayment of VAT much earlier than 180 days (art. 87 section VAT).

The length of the tax refund period is of a great importance for the liquidity of the enterprises, extended tax refund period (when it is said to be 180 days, which is half of a year)



causes the freezing of the companies' funds. The contractors should be paid more, by the VAT rate, than the company gets from the principal (the profit from a given construction work is not included). The construction services contracts are usually made for high amounts of money, let's say that from the purchase amount, that is 123,000,000 pln gross, 23,000,00 pln will not be covered by the money made on a construction service and it still needs to be paid to the contractor. In the long run such situations can be the cause of serious financial problems, the payment gridlocks are more likely to occur which has a negative impact on a financial state of the enterprise. Reducing the waiting time for the VAT refund, in cases when it is caused by the reverse charge mechanism, sounds like a legitimate solution to the problem. It should be noted that in a situation where a taxpayer in addition to the sale that is subject to the reverse charge mechanism, sells a product using the VAT rate, for example 23% (if he completes a construction service as a general contractor) he can apply for a refund of the overpaid VAT at shorter notice, which is 60 days (item 59 in the VAT-7 return). The waiting period is much shorter and definitely more beneficial for the taxpayers (art. 87 section VAT).

What should also be mentioned are the services included in the annex no.14 of the VAT Act. There are items that include earthworks, the earthworks are carried out with specialized equipment such as excavators or backhoe loaders, for various reasons some companies do not possess such machines therefore they need to rent them. The equipment can be rented with or without an operator – just a machine (construction companies often hire their own operators or people who have the operator permission and privileges). It is important to remember that these are two very different situations, in the annex no.14 of the VAT Act there are words “constructional work”, which should be interpreted as renting an excavator with an operator for that is the only way the work can be done, renting only a machine cannot be considered “work” because without a driver the machine does not perform any action. That leads us to believe that in the case of renting a machine with its operator the company renting it becomes the subcontractor of the construction services and should apply the reverse charge mechanism, renting a machine, without the driver, is not included in the annex no.14 of the VAT Act (annex no.14 section VAT).

The current VAT tax law imposes many restrictions concerning deducting the VAT input tax on the taxpayers. Not every entrepreneur needs to be an active taxpayer, one can become a

VAT taxpayer voluntarily after registering on the appropriate print called VAT-R, or after exceeding the financial turnover defined in a specific act.

Entrepreneurs who did not exceed said turnover from the sale of goods and services that is subject to be taxed 200,000,00 pln<sup>4</sup>, according to the VAT Act, may benefit from the tax exemption ([www.wskazniki.gofin.pl](http://www.wskazniki.gofin.pl)). That means that every sale of goods or services is made without VAT, in net value (art. 96 section VAT).

In other cases the VAT tax must be added to the net value of given goods or services. Poland stands out in Europe as one of the countries with the highest VAT rate, which currently is 23%. Most of goods and services are subject to said tax, that includes: petrol, clothing and footwear for adults, computers, paving, carpets, curtains, furniture, cars. Another, 8% tax rate covers construction services performed in residential buildings (except for single-family houses, the usable area of which exceeds 300m<sup>2</sup> and apartments with an area larger than 150m<sup>2</sup>), tropical and citrus fruits, seedlings of trees and shrubs, firewood, and pet food. The 5% tax rate covers walnuts, hazelnuts, blueberries, flour products such as pasta or ready meals and dishes, excluding those in which the alcohol content exceeds 1.2%. The vast majority of goods and services is subject to 23% VAT rate, though in some cases all it takes is to add one ingredient or component for the rates to switch from 5% to 23% (annexes no. 3, 5, 6, 8 in the VAT Act).

Enterprises are obliged to pay the VAT input tax while purchasing goods or services and sell their products with VAT due. In case the purchased goods or services are connected with creation of sale of goods or services VAT can be deducted from the amount due.

The option of reducing the VAT due with VAT input tax comes from a basic VAT principles, which is the principle of neutrality. In theory the value added tax should impose burden only on the consumption zone, not have an impact on manufacturers or intermediaries of goods and services intended for final consumption, in practice though, due to the existence of many exceptions specified in the VAT provisions, the situation is quite different.

General rule of calculating the VAT input tax deduction is that it can be done in the same month the VAT invoice was issued, or in two subsequent tax periods (art. 86 section VAT), although a situation can occur where the taxpayer will not be able to provide the original copy of VAT invoice, the lack of said document may be a result of simply losing it or not receiving it

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<sup>4</sup> The limit came into effect in 2017, up until then it was 150,000,00 pln.

from the contractor. These two cases require two different methods of action. In the first scenario, that assumes the taxpayer lost his invoice the VAT input tax should be deducted in the exact month of receiving the invoice or in two subsequent tax periods, there may or may not occur a need of submitting a document correcting the VAT tax. However if the taxpayer did not receive a VAT invoice from the contractor then the date of the issue of the duplicate of the invoice indicates the tax period in which the VAT tax can be deducted, which means that if the original invoice was issued on January 12<sup>th</sup> and the duplicate on June 14<sup>th</sup>, then the VAT tax should be deducted in the VAT return in June, July, or August, and if the taxpayer lost his invoice he would have to submit a correcting document for January.

Accountancy operates with a term “small taxpayer”<sup>5</sup>, it is a taxpayer whose turnover from the previous year did not exceed the amount of 1,200,000 € expressed in Polish currency with the average euro exchange rate from the last day of September ([www.wskazniki.gofin.pl](http://www.wskazniki.gofin.pl)). Those companies, that met the abovementioned requirement may freely benefit from many amenities or exemptions, such as the possibility of submitting the VAT return every three months instead of every month, and settling the VAT tax with the cash accounting method, that means including in the VAT return both VAT input tax and VAT due of goods and services after paying for a given product or service. Including the VAT tax in the VAT return occurs in the moment of payment for the invoice in whole or in part from the part that was already paid (art. 21 section VAT). If the invoice is not paid the deduction can be completed in the tax period valid 90 days after the issue of the document (in the situation when the buyer is an individual customer). The mentioned principle does not concern only the issuer of the VAT invoice – the small taxpayer, but also the buyer of the goods or services from the small taxpayer (art. 86 par. VAT 10E section VAT). The economic entity who bought the product from the small taxpayer may deduct the VAT charged from the invoice when he pays the entire amount for it or if he pays only a part of the due amount, however, with the partial payment, the deduction can only be made partially (in proportion to the amount paid). The mentioned scenario can occur only if both transaction parties are economic entities. In the case of the buyer being a natural person who does not carry out economic activity, the deduction would apply in the moment of payment for the entire amount or only for a part of the due amount, and if the payment does not happen then it applies 90 days after

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<sup>5</sup> Small taxpayer has to inform the buyer of a given good or service about his status with a special symbol “MP” (Mały Podatnik) on the sales invoice.

the issue of the document. In the first presented scenario the VAT principle of neutrality is very well explained, the contractor can deduct the VAT input tax if the other party of the transaction pays VAT due from the same invoice (art. 21 section VAT).

The possibility of reducing the VAT due by the VAT input tax also applies to purchases of fixed assets to the company, the VAT input tax from such purchases in the VAT settlement declaration is shown in a separate column. That means that the amount of VAT relating to the fixed assets can be assumed directly from the VAT return. The entrepreneurs can deduct the VAT tax from purchasing trucks, all kinds of equipment, or other assets that are considered to be capital assets, if they are active VAT taxpayers. The legislator put some restrictions on said principle, though they do not concern the passenger cars<sup>6</sup>. Under the recent amendments to the VAT Act<sup>7</sup> only half of the VAT tax can be deducted from the purchase of a passenger car, however the part that is not included in the tax deduction can be counted as tax-deductible cost. Said restriction includes the purchase of passenger cars, technical reviews, and also the purchase of petrol and parts for repair. The entirety of the VAT tax can be deducted although the entrepreneur needs to meet two requirements: the purchased car needs to be included in the VAT-26 document as an asset used only for the purposes of the economic business activities and such information should be supported by the vehicle mileage logbook (art. 86a section VAT).

It is important to mention the regulation whose original concept was to motivate the contractors to fulfill their obligations. In the situation where the entrepreneur does not pay off the due amount of money in 150 days from the date stated on the invoice, he is obligated to return the VAT tax he deducted. In the declaration for the tax period in which the 150th day from the date of payment falls, the VAT input tax shall be reduced by the amount of VAT resulting from the unpaid document. The seller who did not receive the payment for a good or service is also entitled to the correction of the VAT tax, only, in this case, the VAT due. That means that in the VAT return he can reduce the VAT tax by the amount of the VAT from the unpaid invoice, to do so he is obligated to perform additional activities. He needs to submit a document with the data of the contractor who is in default of payment to the Tax Office (art.89a section VAT), it should be done in order to verify whether the debtor has corrected the VAT input tax in his VAT registers.

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<sup>6</sup> Passenger car within the meaning of the VAT Act.

<sup>7</sup> Introduced on 01.04.2014 after gaining the approval of the European Union Council.

Another interesting issue concerns the taxation of VAT the contribution in kind<sup>8</sup> provided to an enterprise, usually a share-holding company. It often happens that one of the shareholders contributes to the share-holding company not financially but with capital of different nature, for example with fixed assets, stocks, or sometimes even an enterprise. In the situation where the contribution is made in fixed assets or stocks the VAT invoice has to be issued and the VAT tax from the contributed value of fixed assets should be deducted. A contribution can also be made with an enterprise as a whole or just its organized part, in this case the VAT tax does not need to be deducted, this type of transaction is exempt from the tax on goods and services ([www.lex-portal.pl](http://www.lex-portal.pl)).

Other situation where the VAT tax should be paid to the Tax Office is the moment of the liquidation of the enterprise, if the company possesses any fixed assets in the moment of liquidation the amount of the VAT tax corresponding to the value of said assets in the moment of the VAT deduction while purchasing them should be paid to the Tax Office. Although if the company does not possess any fixed assets or if they were previously sold, the liquidating economic entity is not obligated to deduct the VAT tax on goods and services in the way described above. Though it is quite important to remember that while selling the fixed assets the VAT tax has to be deducted as well, but it may be reduced by the VAT input tax charged from the purchases made. It should be noted that in the situation where a company is being liquidated the Tax Office has the right to appeal to the taxpayer for a physical inventory carried out on the day of the liquidation.<sup>9</sup> In the situation where the physical inventory equals 0,00 pln or there are not any fixed assets purchased for the enterprise there needs to be an explanation provided as to what happened to the fixed assets (art. 14 in connection with art. 29e section VAT).

Apart from the restrictions I have mentioned in the deduction of the VAT input tax from the VAT due there are also good and services from which only companies conducting specific activities can deduct VAT. Such situation occurs in the case of selling the supportive meals or providing accommodation services, companies that deal with this kind of business has to charge

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<sup>8</sup> Contribution is the transfer of ownership of an enterprise, fixed assets or intangible assets in exchange for company shares.

<sup>9</sup> On the day of liquidation the taxpayer must carry out a physical inventory in accordance with the provisions regulating the income tax (par. 27 section 1 - regulation of the Minister of Finance regarding the keeping of the tax book of revenues and expenditures) and the VAT Act.

8% VAT for every sale whereas the companies buying the abovementioned services and goods cannot deduct the VAT tax from them. The gross value of the invoice is a deductible expense.

In the presented situation the principal of neutrality is not quite in force for one transactional party has to deduct the VAT due and the other party, purchasing certain goods and services from the same invoices, cannot deduct the VAT tax. Though what is important to remember is that the catering invoices are treated differently than gastronomic services – the VAT tax can be deducted from such invoices, that is the reason more and more entrepreneurs decide on buying the catering services (art. 88 section VAT).

#### **4. Regulations of the VAT Act in practice**

##### **4.1. Standard Audit File for Tax (SAFT)**

The VAT Act has a direct influence on the activity of Polish companies, every introduced amendment to the provisions means that they have to make changes and adjust their company's activity to the new requirements. The entrepreneur being an active taxpayer has been carrying economic activity for years. In his business he deals with providing for advertising services and putting out a paper. During the course of his activity he enters into cooperation with many contractors; a peculiar situation occurred during the cooperation with one of them. Both parties declared themselves to be active VAT taxpayers. The seller, in this situation – the contractor issued an invoice with the VAT tax, and the buyer – in the situation the entrepreneur, deducted said VAT. In 2018 the buyer submitted the Standard Audit File for Tax and after some time he was notified by the Tax Office that the seller with indicated tax ID does not exist in the active VAT taxpayers records, therefore the VAT cannot be deducted from the submitted invoice. In such case a correcting VAT return should have been submitted reducing the VAT input tax by the VAT from the invoice and the correcting SAFT document should have been sent. In the presented situation the buyer had to pay extra for the VAT tax, though that was not the end of the story, the Tax Office ordered a set of verifying activities in order to check if there were any transactions between the seller and the buyer in the previous years (specifically from the moment when the seller got removed from the active VAT taxpayers records).

The verifying activities showed that indeed transactions were made, therefore the buyer was obligated to correct the VAT returns from the previous years and pay the due amount of

VAT plus interest. This situation happened in February of 2018 in one of the companies, this is the perfect example of how efficient the SAFT is in finding irregularities by checking only the invoices, i.e. the transactions between the entrepreneurs. It is also an example of how submitting the Standard Audit File for Tax to the Ministry of Finance works in practice, showing one abnormality entails further control activities and consequences. It is for our own financial and fiscal safety to verify the contractors in terms of their active VAT taxpayer registration before deducting the VAT tax.

#### **4.2. Correction of VAT and late payment**

The entrepreneur who has been in business for 4 years and deals with providing transport services sold the service to one of his contractors. The VAT invoice was issued with payment due on 30.04.2017. The buyer deducted the VAT input tax in his VAT return, and the seller paid the VAT tax to the Tax Office. The invoice was not paid. 150 days after the date of payment passed on 27.09.2017, in the tax period in September (if the invoice was paid before submitting the VAT return for September, which was on 25<sup>th</sup> of October the VAT due would not have to be reduced). The buyer should have lowered the VAT input tax by the amount of VAT from the VAT return. The seller is entitled to reducing the VAT due in the same tax period but he needs to inform the Tax Office about the contractor's data. The buyer of the service did not fulfill his responsibility and did not reduce the VAT input tax. The Tax Office, having the contractor's data, ordered a set of control activities in order to enforce actions in accordance with the VAT Act. The situation presented shows a positive, for the entrepreneur, aspect of the provision that allows to make corrections of the VAT due in case of late payment from the contractor. Although it is crucial to remember that not every case permits the reduction of the VAT due by the amount of the tax from the unpaid invoice. The law would not be in force if in the moment of submitting the correcting document the debtor was not in the active VAT taxpayers records, was in bankruptcy or in the process of liquidation.

The contractor is late 150 days with his payment. In this case the seller makes the decision of correcting the VAT due. The Tax Office receives a proper set of documents, which include the VAT return, along with the additional information on the debtor's data. The Tax Office responds with a letter informing that the reduction of the VAT due cannot be performed for in the moment of submitting the VAT return the debtor did not exist in the active VAT taxpayers records. After receiving such information the entrepreneur was obligated to correct the previously submitted

VAT return. The situations presented above are prime examples of how important it is to verify the contractors, especially their existence in the active VAT taxpayers records.

#### **4.3. Liquidation of an economic entity**

Civil partnership providing the printing and advertising services since the early years of XXI. In 2017 both partners came to the decision of liquidating the company. The company was closed down while doing all the necessary activities related to the process. Entrepreneur submitted a notification document to the Tax Office informing about the liquidation of the company and the made physical inventory. After a couple of months he received an official letter from the Tax Office that according to the data in the POLTAX (Polish Tax) system the company, before the liquidation, purchased fixed assets from which the VAT tax was deducted (due to the fact that VAT return shows input VAT deducted from the purchase of fixed assets in a separate item, it was possible to determine the fact of their purchase), but they were not included in the physical inventory, which equaled 0,00 pln. In such situation the taxpayer had to file an explanation clarifying what happened with the assets. In this case they were contributed in kind to a share-holding company. This situation is a perfect example if the precision and accuracy of the tools used for checking the transparency of the companies' operations, all activities must be carried out according to the Polish tax law.

#### **4.4. VAT deduction and the labor law**

The contractors hiring the employees are subject to many regulations and provisions in their work organization. The working conditions are checked and verified by the health inspector or the National Labour Inspectorate. The regulations I have mentioned were introduced in order to protect the health and life of the people hired. The entrepreneur carrying out his economic activity since 1995 deals with providing the paving services. He has 12 employees and it has been this way for many years. The work of a paver is very specific because it is done outside therefore the worker is exposed to atmospheric conditions, so to comply with the law the entrepreneur provided the employees working overtime on repairing some of a damage with meals; the meals were included in the VAT invoice as gastronomic service, therefore the VAT deduction could not take place for the VAT Act prohibits VAT deductions from this kind of service, without any exceptions even situations that result from other regulations. The entirety of



the gross price was included in the tax-deductible costs (VAT tax also included). In the situation where, instead of gastronomic service, there was catering on the VAT invoice, the VAT input tax could have been deducted.

It is crucial to keep in mind there are situations subject to the Labour Code and the regulations connected with health and safety at work, when the employer is obliged to provide his employees with supportive meals (for example in winter if the employees work outside or with high energy input required on the caloric demand reaching 2000 calories regarding men and 1100 calories regarding women). The VAT Act on goods and services does not provide for any exceptions, even in the case I have mentioned. This situation seems to be discriminating towards the entrepreneurs, if the regulations made by the Polish government impose obligations under sanctions of the law, then the regulations of another Act (the VAT Act in this particular case) should give the opportunity to benefit from the full tax deductions.

#### **4.5. The cash accounting scheme**

The company, due to the low turnover, is considered to be a small taxpayer. The economic activity is related to providing the excavator services (essentially earthworks), and it sold the service to one of the contractors on May 16<sup>th</sup>. One part of the payment was paid in July and the rest of the amount in October. Both parties of the transaction include the service in the VAT return in the same tax period, both the buyer and the seller of the service deduct the VAT tax from the amount paid in July in the July tax period, and the rest of the amount in October – after the payment. In the situation where the buyer is an individual customer the rest of the amount would need to be deducted in the September tax period for 150 days from the issue of the VAT invoice pass in September.

The described method of the VAT tax deduction for an economic entity can be beneficial, choosing such way of tax deduction should definitely be preceded by a comprehensive analysis whether such method would really prove to be more beneficial than the tax deductions not using the cash accounting scheme. The situations mentioned show the possibilities provided by the VAT Act, It was also shown to what extent the authority controlling the correctness of all activities by entrepreneurs was developed.

### **5. Conclusions**

The tax on goods and services is not a tax that is easy to deduct, there are many restrictions and exceptions specified in the VAT Act and additional obligations imposed on the taxpayers that complicate the entire process. The frequent amendments to the Act cause destabilization of the regulations, and the entrepreneurs have serious problems with the correct VAT tax deduction. The Ministry of Finance has more and more tools used in order to control and verify the correctness of the tax deduction, ongoing monitoring of the process allows faster recognition of irregularities and their correction by the taxpayers. The consequence of that may cause another changes in the regulations in terms of facilitating and providing transparency to the interpretation of the rules, which would be the result of many years of experience in the VAT tax on goods and services functioning.

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VALUE ADDED TAX (VAT) AND RULES OF SETTLEMENT OCCORDING TO AMENDMENT THE LAW  
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