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analyzes

Audit of the Supreme Audit Office in the scope of VAT centralization in JST

Newsletter "VAT in local government" (8/2020) | May 20, 2020

The Supreme Audit Office carried out the first inspections among local government units regarding centralization in the goods and services tax. Preliminary reports indicate that the results of these controls may be unfavorable in terms of deducting VAT.

No VAT deduction in JST as a sign of mismanagement

NIK audits in the area of VAT centralization in local government units (JST) began in autumn 2019 (we have already written about planned audits in our bulletin). At present, according to NIK reports, the first of them are being finalized, and their results indicate, among others

allegation of failure to deduct VAT in certain situations where regulations allow such deduction.

First of all, it should be noted that the lack of VAT recovery, which according to the law is recoverable, can be considered as a mismanagement. Undoubtedly, this applies to all those situations where VAT represents a significant amount, individually or collectively, in a given period, which in practice mainly concerns investment expenditure or recurring current expenditure that is more widely related to VAT taxable activities. In such circumstances, however, the majority of local government units take action to deduct VAT, being aware that this may be a material amount to fund the budget.

The situation is slightly different in relation to expenditure that is only slightly associated with VAT-taxable activities. We are talking here in particular about expenditures incurred by local government units on the functioning of offices, schools, kindergartens, social welfare centers, etc., where local government units run mixed activity, i.e. they perform both VAT and non-VAT or VAT exempt activities. Then JST can recover only a part of VAT and in order to calculate this part it is necessary to apply appropriate proportions. These proportions are usually at a very low level (e.g. in schools it is usually 1-2%), which means that the amounts of VAT subject to recovery can sometimes be even symbolic. In such cases, some local governments resign from deducting VAT, considering

Apart from the above, often the recovery of VAT in local government units, due to their complex nature of operation, requires lengthy disputes with tax authorities and is associated with the risk of negative tax consequences (tax arrears, interest). Hence, in some situations - regardless of recoverable amounts of VAT - LGUs decided to resign, guided by minimizing possible risks and costs.

It seems that such arguments may not convince NIK, which raises the objection of mismanagement in the management of public funds in some situations where VAT was not recovered despite the existence of such a possibility in the law.

Preparation for control or implementation of post-control recommendations

In this situation, it would be reasonable to consider actions that could secure JST in the context of a potential allegation of mismanagement when deducting VAT. If local government units have not done VAT deductions in all cases allowed by law, it would be necessary first of all to analyze such cases and determine whether there are rational premises for the current proceedings (legal, economic justification). Depending on the results of such an analysis, it may also be necessary to decide on a possible correction in this area and to start making current VAT deductions.

It should be remembered, however, that the position of the Supreme Audit Office presented after the first audits raises considerable doubts, primarily in terms of the economic sense of deducting VAT at all costs. It is also not excluded that in individual cases this position may differ and even change at further stages of the audit. Therefore, far-reaching caution seems to be advisable when making final decisions, as well as careful observation of further reports in this matter.

However, given the current difficulties of local governments in connection with declining budget revenues (in the context of the situation caused by COVID-19), this may be the right moment to review the approach adopted so far for VAT deductions and consider wider actions in this area.

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