

CHANGES IN INCOME TAX IN ROMANIA

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Abstract

The Romanian legislation changes quite often, a situation that prevents companies to establish an action plan in the longer term. Income taxes affect the company's liquidity. In many cases legislative changes were announced shortly before application. In this article we intend to identify changes in income tax in Romania for a period of time and their implications on the company.

Keywords: income tax, legislation, impact, profit, tax.

1. Introduction

Tax legislation plays an important role regarding earnings remained for an enterprise after withholding taxes. Fiscal policy also influences the decision of foreign investors to conduct business in firms established in Romania.

For profit tax or income tax are set different tax rates, different taxable bases and hence the size of the effect on net profit is different.

The purpose of the present study is to present the characteristics of micro enterprises' income tax (definition, conditions, optional or mandatory nature of the application, taxable base, tax rate). The main objective of the study is to highlight changes to micro enterprises' income tax and to identify the frequency of legislative changes.

The period referred to in the study is 2003-2016. Data is extracted from the Fiscal Code and implementing rules (periodically modified variants) published on the website of the National Agency for Fiscal Administration.

"These small companies, which individually do not have a financial power and no substantial taxable bases, but overall can generate significant revenues to the budget,"¹ received a big beating in 2013 by the requirement to apply micro enterprises income tax.

"Authorities found more appropriate (again) to COMPEL taxpayers to pay a tax that has nothing to do with profitability."²

Stenzler (2013) made a study on the effect of compulsory of this tax on the companies in Romania and he shows that this tax "is not equitable in relation to different categories of companies by not considering

(..) value added, income tax is burdensome for traders and producers.

Taxation system in Romania was studied by other authors. Bigioi (2015)³ examines complaints submitted to the National Agency for Fiscal Administration. 8% of total complaints relate to income tax.

2. Content

Profit tax and income tax represent revenue for the state budget. In Romania these taxes are regulated by the Fiscal Code (Law no 571/2003).

Definition of microenterprise

In 2003 a microenterprise is a firm for which the following conditions are met on December 31 the previous year:

- a) The company has as main activity the production of goods, services and/or trade;
- b) The company has between 1 and 9 employees;
- c) Revenues did not exceed the Ron equivalent of 100.000 euros;
- d) The share capital is not owned by the state, local authorities or public institutions.

First condition changes in August 2006, with effect from 2007: revenues, other than those of consulting and management, are more than 50% of total revenues.

For 2010 income tax provisions are abrogated by Government Emergency Ordinance no 109/2009, which eliminates the possibility of opting for such a tax.

In 2011, microenterprise income tax becomes an option again, resuming previous conditions, except for the first. Incomes derived can not be related to the

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¹ Daniel Stenzler, "How micro enterprises will be affected by income tax?", 2013

² Sorin Biban, "Lump-sum tax: How will encourage evasion, instead of it decrease?", 2013

³ Adrian Doru Bigioi, „Study on the Evaluation of the Contestation Degree of Excise Duty Rules, by Romanian Companies”, *Revista Audit Financiar, Anul XIII, nr. 123 - 3/2015, pg. 74*

activities of banking, insurance or reinsurance, capital market, with the exception of persons performing brokerage in these areas, gambling, consultancy and management. The share capital can not be owned by a shareholder or associate (legal person) with more than 250 employees.

Note that the performance of activities of management and consultancy no longer offers the possibility to opt for this type of tax, regardless of the share in total income.

The year 2013 brings substantial changes regarding the conditions for classification as a microenterprise. Thus, there was no restriction on ownership of share capital by a shareholder or associate (legal person) with less than 250 employees, was eliminated the condition of having between 1 and 9 employees, and income threshold decreases from 100.000 euros to 65.000 euros.

In 2014 a microenterprise has allowed to obtain income from consultancy and management but less than 20% of total revenues. In addition, the microenterprise should not be in the situation of dissolution with liquidation.

2015 draft amending the Fiscal Code proposes to modify the total income threshold as follows: for 2017- 75.000 euros, for 2018- 85.000 euros, for 2019- 100.000 euros.⁴ At the same time, companies with business exploration and development of oil and natural gas deposits are excluded from the application of this tax.

Increased threshold for total revenue will be difficult to overcome it. A newly established trading company will pay 3% on all sales (excluding VAT), although they gain is the profit margin. Convenient in this case is the income tax, but the company will have to have a high volume of sales to benefit from this tax.

The date of payment

Calculation and payment of income tax for microenterprises are made quarterly by the 25th of the month following the quarter for which the tax is calculated.⁵ The tax is declared until the date of payment.

Note that for companies that pay profit tax, final tax is declared and paid up to March 25 next year. Final tax is due for the last 3 months of the year, taking into account the profit tax calculated during the year. A microenterprise has a shorter deadline for payment. The income tax for the last 3 months of the year must be paid until January 25 next year. The difference lies in two months. This period has influence on the cash flow of the firm. Equivalent income tax can generate value by investing for two months.

The option to pay income tax

Since 2003 enterprises' income tax is optional.

A company paid profit tax can opt for income tax early next year if the conditions were met and if the company not ever enjoyed in the period prior to this option. A newly established company could opt for income tax from the first year if the condition on the number of employees was accomplished within 60 days after registration of the company.

If at the end of a year, one of the conditions is not met, the company is forced to quit this taxation system starting next year, without the possibility of benefit from this tax, even if the conditions are met again later.

The Government Emergency Ordinance no 138/2004 introduces the possibility that microenterprises with income tax to opt for profit tax starting next fiscal year.

The choice for microenterprises' income tax is possible by 2012, except for 2010 when the law obligates companies to pay profit tax.

2009 brings a novelty: the minimum tax (see paragraph on tax rates)

The year 2013 is atypical. If a company meets the conditions at December 31 the previous year, the company is required to pay income tax since February 2013. Note that this obligation is introduced by Government Emergency Ordinance no 8/20013 published on January 23.

That same year, the law provides that a newly established company fall under this type of tax if, the date of registration, the company has a share capital owned by others than the state or local authorities. Law 168 of May 2013 mentions two exceptions from newly established firms mentioned above, giving the possibility to choose profit tax: the intention to carry out activities which do not fall under income tax, or the existence of a capital of at least 25.000 euros when setting up the company.

The second exception made final the option for profit tax for the period of existence of the legal person under the condition of maintaining minimum share capital. The law mentions the exchange rate of the National Bank on the date of registration of the legal entity.

Microentities' income tax is compulsory between 2014 and 2016 (with the exceptions listed above).

A legal entity is not required to apply the income tax system starting next year, if at December 31 one of the conditions that define microenterprises is not fulfilled. Type of tax changes during the year if the threshold of total revenues is exceeded during the year (change from 2006).

Thus, if during the year revenues exceed the threshold (100.000 euros or 65.000 euros since 2013) the company will pay profit tax beginning with the quarter in which threshold was exceeded, taking into account incomes and expenses from early and income tax payments made during the year⁶.

⁴ Article 46, paragraph (2), Draft of Fiscal Code published on February 18, 2015

⁵ Article 112⁹, Law 571/2003

⁶ Art 107¹, Law 571/2003

Since 2007 a new condition is added: revenues from consulting and management can not be greater than 50% (20% in 2014) of total revenues. Exceeding this value during the year requires the change mentioned in the previous paragraph, without the possibility of benefit for the next period of this type of tax.

Consulting work involves high income and low costs. For this reason it is more convenient to state that these activities are taxed at 16%.

For 2016 changing the type of tax during the year occurs if during the quarter the company begins to develop activities in banking, insurance, reinsurance, gambling, mining oil and gas fields.

The novelty is that for calculating the profit tax it takes into account the revenues and expenses incurred in the quarter (not from beginning of year, as it was previously).

The tax base

The tax base includes all revenues except:

- Income related cost of inventories of products and services in progress
- Revenue from the production of tangible and intangible assets
- Income from subsidies
- Income from provisions and adjustments for depreciations
- Income from interest and penalties cancellation, expenses not deductible in computing taxable profit
- Income from damages from insurance companies for damage to tangible assets or own stocks.

The acquisition value of the cash register is deducted from the taxable base in the first quarter of functioning.

In 2013 are eliminated from the taxable base, the trade discounts granted after invoicing and commercial discounts are added subsequently received invoice.

An important aspect is the exchange gains or losses. For 2013 foreign exchange gains was included in taxable base; the income tax was paid for a possible gain, if we consider monthly revaluation of the debt and liabilities denominated in foreign currencies or according to a currency.

Since January 2014⁷ is eliminated from the taxable base the foreign exchange gains and is added the difference between commercial discounts received and granted after invoicing. Regarding the exchange rate differences, in the tax base is included in the fourth quarter, only favorable difference between exchange gains and losses recorded cumulative from the beginning of the year.

Draft of Fiscal Code for 2016⁸ increases tax base with:

- reduced or canceled reserves, representing legal reserves or revaluation of assets reserves which have

been deducted in calculating taxable income and not taxed in the period in which the company was paying profit tax;

- reserves representing tax breaks, established in the period in which the company was paying profit tax

The tax rate

Enterprises' income tax is paid quarterly.

In 2003 the tax rate was 1.5%.

The Government Emergency Ordinance no 138/2004 and Law no 343/2006 change tax rate as follows: 2% for 2007, 2.5% for 2008 and 3% for 2009.

In 2009 a company paid the greater of the tax obtained by applying the rate of 3% and annual minimum tax. The annual minimum tax depends on the total incomes obtained in the previous year less the same income falling outside the tax base for microenterprises:

Annual total incomes (lei)	Annual minimum tax (lei) ⁹
0 - 52.000	2.200
52.001 - 215.000	4.300
215.001 - 430.000	6.500
430.001 - 4.300.000	8.600

In 2010 income tax is repealed.

Starting 2011, the tax rate is 3%.

The draft for Fiscal Code for 2016 mentions different rates of tax depending on the number of employees:

- 1% (over 2 employees, including)
- 3% (an employee)
- 3% + 1530 lei quarterly (without employees).

This amount is updated according to the evolution of the minimum gross salary guaranteed

- 3% for microenterprises without employees and which is in one of the following situation:

1. dissolution followed by liquidation;
 2. temporary inactivity;
 3. not active at the head office/ secondary offices
- 1530 lei amount is recalculated based on the number of days that microenterprise is not in cases 2 or 3.

Change in number of employees during the year change the tax rate in the first quarter of this change.

Note that it is considered that the employee is a person employed by individual labor contract full time, which means that hiring part-time employees involve an additional tax of 1530 lei.

Fixed income tax mandatory for microenterprises without employees is 1530 quarter, ie 510 lei/month. The costs for a full-time employee with

⁷ Government Emergency Ordinance no 102/2013 published in November 2013, with effect from January 2014

⁸ Draft for Fiscal Code, published on February 18, 2015

⁹ Fiscal Code 2009, article. 18, paragraph 3

a minimum gross salary per economy (975 lei since January 2015¹⁰) are approximately 1196 lei, of which 724 lei is the net salary and 472 lei are taxes.

Note that the state earns about the same amount as taxes if the microenterprise has no employees or a full-time employee with a minimum gross salary.

Since July 2015 the minimum gross salary will increase to 1050 lei/month, implying a net salary of 777 lei and 513 lei related taxes, as follows:

Tax	Percentage of gross salary	Value
Employee contribution to social insurance	10,5%	110
Employee contribution to unemployment	0.5%	5
Employee contribution for health insurance	5.5%	58
Wage tax		100
Net salary		777
Employer contribution to social insurance	15.8%	166
Employer contribution to health insurance	5.2%	55
Employer contribution to unemployment	0.5%	5
Employer contribution for work accidents	0.15% ¹¹	2
Employer contribution for wage claims guarantee fund	0.25%	3
Employer contribution for medical leave health insurance benefits	0.85%	9

Certainly from January 2016 will be decided a new increase for the minimum gross salary.

“Ministry of Finance argument in support of this tax grid is that 30.000 of the nearly 500.000 microenterprises operate without employees, which shows that employees have no legal employment.”¹²

The arguments of Ministry of Finance for such taxation are¹³:

- microenterprise represents 78.3% of all active companies, achieving a turnover of only 2.4% of the total turnover achieved by the companies in Romania;
- the labor force engaged in micro-enterprises account for 14% of all employees in companies that submit balance sheets;
- 47.2% of micro enterprises registered net loss on December 31, 2013

- microenterprises will be more interested in business fairness and reduce the hidden economy.

At the end of 2013 the number of microenterprises in Romania was 498.583, of which 56.1% had no employees. It is easy to calculate the gain derived from the fix tax imposed on microenterprises without employees.

The Ministry of Finance estimates for the first 3 quarters of 2016 additional revenue of 316 million lei and identifies the following benefits¹⁴ for the economy in the medium term:

- the increase employment by about 101 thousand;
- increasing profit / loss reduction for microenterprises with more than 2 employees;
- increased revenue from income tax and social contributions if some of these microenterprises will hire one or two employees to benefit from tax of 1%.

3. Conclusions

The study on microenterprises' income tax took into account the identification of characteristics of this type of tax.

For the period considered is observed changes in all these characteristics: conditions, tax rate, optional character, tax base.

The need to increase state budget revenues changes the taxes imposed on legal persons. This explains the introduction of the minimum tax in 2009. The same explanation is valid on binding nature of the enterprises' income tax with effect from February 2013.

A mandatory profit tax for management and consulting activities ensures a higher tax than microenterprises' income tax.

The proposed changes in the Draft of Fiscal Code for the period 2016 – 2018 are considering linking income tax rate for microenterprises with the number of full-time employees (before 2013 a microenterprise was supposed to have between 1 and 9 employees). Measures are designed to stimulate the hiring of labour (the tax rate is smaller for two or more employees), inexistence of employees imposing an additional quarterly tax.

This additional tax is established so state gain is approximately the same if the microenterprise has no employees or a full-time employee with a minimum gross salary.

Moreover, the law for microenterprise' income tax does not allow to take into account prior fiscal losses for income tax calculation. The prior fiscal losses can be considered if company returns to profit tax and if the period of 7 consecutive years to recover

¹⁰ Government Decision no 1091/ 2014

¹¹ between 0.15% and 0.85% depending on the company's main activity

¹² Diana Zaharia, “Proiectul Codului Fiscal: Impozitarea efectivă aproape se dublează atât pentru microîntreprinderi, cât și pentru PFA”, 2015, www. Capital.ro

¹³ Ministry of Finance, “Tax reform measures and expected results”, www.mfinante.ro, February 18, 2015

¹⁴ Ministry of Finance, “Tax reform measures and expected results”, www.mfinante.ro, February 18, 2015

the loss does not expire¹⁵. Given the proposal to increase the threshold of total revenues for microenterprises will be difficult, if not impossible, to be able to benefit from tax losses obtained before transition to income tax.

Fiscal Code provides that any change is made by law promoted by 6 month before the entry into force and implementation of change is the first day of the next year¹⁶.

But there were times when modifications have been implemented in a very short time. Government Emergency Ordinance no 8/2013 was published in

January 2013 with application since February the same year.

The estimated values of taxes for that year were not available anymore, the cash flow changed for most companies.

Businesses can not adapt to the impact of fiscal changes in a timely manner.

We notice more frequent change of rules on income tax in recent years.

The income tax is much easier to calculate, and in addition, the risk to adjust the tax is removed (the size of expenses and the percentage of its deductibility decrease the profit tax).

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¹⁵ Article 26, paragraph (4), Law 571/ 2003

¹⁶ Article 4, Law 571/ 2003