

TAX OPTIMIZATION FOR BUSINESS START-UPS IN ROMANIA

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Abstract

One of the most important early decisions for an entrepreneur is choosing the optimal form of organization for his business. According to the data provided by the Registry of Commerce, Romanian entrepreneurs usually choose between: Limited Liability Company (LLC) and Authorized Natural Person (ANP).

LLCs offer liability protection for its owner. This advantage has made the LLC a popular business form for smaller companies, who don't plan to grow the business significantly. Newly set-up companies in Romania are required to apply the micro-companies revenues tax system starting with their first year of operation. For next years, this system is applied only if annual turnover does not exceed EUR 65,000.

An individual can pursue an economic activity as an ANP. An advantage of the ANP is the reduced number of tax returns field. In addition, in certain circumstances, an ANP may opt for a very advantageous system of taxation of personal income tax, based on predetermined fixed income.

Each one of these entities involves fiscal advantages and disadvantages, which we will try to highlight in this paper.

Keywords: Tax optimization, Limited Liability Company, Authorized Natural Person, personal income tax, corporate income tax, micro-companies revenues tax.

1. Introduction

Tax optimization includes any decision which may reduce or streamline tax burden. Newly formed businesses have an important tax planning opportunity. A start-up has several options when it comes to the legal structure of the new business. For a small business there are usually two options: Authorized Natural Person (ANP) and Limited Liability Company (LLC). Each option has different tax consequences, as well as other implications, such as the extent of personal liability for business debts or the way to withdraw profits from the new business, for example, by paying dividends (if the option is a company).

In section 2 we compare taxes owed by companies (separately for micro-companies and ordinary companies) with those due by ANP. We analyze only those taxes that are different for each type of entities: micro-companies revenues tax / corporate income tax / personal income tax (due by ANP), tax on dividends and mandatory social contributions related to commercial revenues. We do not treat value added tax and compulsory social contributions related to wages, because their value is the same regardless of the type of entity (ANP or LLC).

Forecasting income and expenses is very important since the start-up. To make use of tax optimization strategies, it is essential that the entrepreneur estimates the revenues and the expenses for the next few years. This forecast will help him to estimate the overall tax burden and to choose the most

effective form of business organization (the one that involve the minimum overall tax burden. The practical examples from section 3 illustrate this process.

In section 4 we highlight the advantages and disadvantages of each form of organization, taking into account not only the fiscal aspects, but also by other specific issues such as: setting-up / split-up conditions, legal status, liability for business debts etc.

2. Newly formed business tax optimization

For entrepreneurs who are starting a business it is essential to know what taxes due. These taxes vary depending on the type of entity as follows in table no. 1.

Table no. 1: LLC taxes versus ANP taxes

LLC taxes	ANP taxes
▪ Corporate income tax $CIT=16\% \times \text{Fiscal income}$; or ▪ Micro-companies revenues tax $MRT=3\% \times \text{Revenues}$ ▪ Tax on dividends $TD=16\% \times \text{Dividends}$	▪ Personal income tax $PIT=16\% \times \text{Net income}$ ▪ Individual health insurance contribution $IHIC=5,5\% \times \text{Net income}$ ▪ Social security contribution ▪ $SSC=26,3\%$ $\times \text{Monthly income insured}$

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2.1. Tax obligations for Limited Liability Companies

2.1.1. The micro-companies revenues tax (MRT)

According to the Fiscal Code, a mandatory revenue tax system is applicable for Romanian micro-companies which meet both of the following criteria at the end of the previous fiscal year:

- their annual turnover is lower than the RON equivalent of EUR 65,000 euros in the course of a year (the exchange rate for converting euro into RON is that of the closing of the previous fiscal year);
- their shares are held by entities other than the state or local authorities;
- the companies are not in winding up with winding-up proceedings.

It is not considered micro-company the entity that:

- derive income from consultancy and management activities, in a proportion greater than 20 % of total revenue (nature of the revenue shall be justified by the contracts and other documents)
- derive income from activities other than banking, insurance and reinsurance, capital market or gambling.

The micro-companies revenues tax (MRT) is mandatory for entities which meet the conditions referred to above.

Newly established companies are required to follow the micro-companies tax regime starting with the first fiscal year, if their shares are held by entities other than the state or local authorities. However, if the share capital is at least EUR 25,000, companies may opt for normal tax regime (corporate income tax-CIT). The option is for good.

The taxable base comprises the revenue derived from any source, with several exceptions:

- Revenue related to the costs of inventories;
- Revenue related to the production cost of work in progress;
- Revenue related to the capitalised costs of tangible and intangible non-current assets;
- Revenue from subsidies for operating activities etc.

The tax rate applicable to micro-company revenues is 3%.

The calculation and payment of the tax is made quarterly, no later than 25 of the month following the quarter for which the tax is calculated.

If, during a fiscal year, a microcompany registers a turnover greater than EUR 65,000 or derives revenues from consultancy and management activities exceed 20 % of its total revenue, the company will pay corporate income tax starting with the quarter in which the limit is exceeded. The tax will be calculated based on expenses and revenues registered from the beginning of the fiscal year as follow:

CIT due = CIT calculated from the beginning of the year - MRT due in that year

2.1.2. Corporate income tax (CIT)

A company with an annual turnover exceeding EUR 65,000 due CIT.

The standard CIT is 16%.

The taxable base is calculated as follows:

Taxable income = Revenue derived from any source - Expenses incurred in obtaining that taxable revenue - Non-taxable revenues + Non-deductible expenses - Deductions

The most relevant types of **non-taxable revenue** stipulated by the Romanian Fiscal Code are:

- Dividends received from a Romanian legal person or from a foreign legal person paying profit tax or a similar tax, located in a third country with which Romania has a convention for the avoidance of double taxation, if the Romanian legal person receiving the dividends holds at the date of their distribution at least 10% of the share capital of the Romanian or foreign legal person distributing the dividends, for a continuous period of one year;
- Dividends received by a Romanian company from a subsidiary situated in an EU Member State, provided the Romanian company pays corporate income tax and has held at least 10% of the subsidiary's shares for a continuous period of at least one year prior to the dividends being distributed;
- Favourable fluctuations in the price of shares and long-term bonds, registered by the company in which the shares and long-term bonds are held, as a result of capitalisation of reserves, benefits or share premiums;
- Revenue from reversal or cancellation of provisions / expenses that were previously non-deductible, recovery of expenses that were previously non-deductible and revenues from reversal or cancellation of interest and late payment penalties that were previously non-deductible;
- Revenue from the annulment of a reserve registered as a result of a participation in kind in the capital of other legal entities;
- Revenue from deferred income tax etc.

Expenses fall into three categories: deductible expenses, limited deductibility expenses and non-deductible expenses.

Expenses are deductible only if incurred for the purpose of generating taxable income.

According to the Fiscal Code, the following expenses shall have a **limited deductibility**:¹

- Protocol expenses are deductible up to the limit of 2% of (the total taxable revenue - the total expenses related to the taxable revenue, other than protocol and profit tax expenses);
- Social expenses are deductible up to 2% of salary expenses. Social expenses can include: maternity allowances, expenses for nursery tickets, funeral benefits and allowances for serious or incurable diseases,

¹ Law no. 571 of 22 December 2003 regarding the Fiscal Code, as amended and completed.

as well as expenses for the proper operation of certain activities or units under taxpayers' administration (i.e. kindergarten, nurseries, canteens, sports clubs, clubs, etc).

- Meal tickets expenses are deductible up to the limit of one ticket per employee per worked day;
- Health insurance premiums are deductible for employers up to the limit of EUR 250 per employee per year;
- private pension insurance premiums are deductible up to the limit of EUR 400 per person per year;
- Expenses incurred with company vehicles weighing under 3,500 kg and with fewer than nine passenger seats (including the driver's seat) that are not used exclusively for business purposes are deductible up to 50%.

Non-deductible expenses include:

- Profit tax expenses;
- Expenses related to non-taxable revenues;
- Interest, fines and penalties due to Romanian or foreign authorities;
- Expenses incurred for management, consultancy, assistance or other supply of services if no written contracts or any other lawful agreements are entered into and the beneficiary cannot justify the supply of such services for the activities performed and their necessity;
- Sponsorship and patronage expenses and those related to private scholarships;
- Expenses recorded without justifying documents;
- Expenses in favour of shareholders, other than those related to goods or service provided by the shareholders at market value;
- Expenses representing fixed assets impairment, when as a result of a revaluation, a step-down in value is recorded;
- Expenses incurred from deferred profit tax and changes in fair value of real estate investments by taxpayers applying the International Financial Reporting Standards;
- Expenses relating to missing or damaged non-imputable inventories or tangible assets, for which no insurance contracts have been concluded etc.

The deductions include:

- interest expenses related to loans contracted from other entities than banks or financial institutions carried over from previous period
- legal reserve fund are deductible up to 5 % of adjusted accounting gross profit and until it reach a fifth part of the share capital;
- fiscal depreciation
- fiscal provisions

CIT is calculated as follows:

$CIT = 16\% \times (\text{Taxable income} - \text{Fiscal losses to be recovered from previous years})$

$CIT \text{ due} = CIT - \text{Sponsorship and patronage expenses (up to 0.3\% of turnover or 20\% of the profit tax due, whichever is lower)}$

As a general rule, the statement and payment of the CIT should be done quarterly, until 25th, inclusive, of the first month following the end of the I-III trimesters. Starting with January 1st 2013, companies may choose to declare and pay the annual profit tax with quarterly advanced payments.

2.1.3. Tax on dividends

If the owner of a LTD decides to distribute the net income of the company in the form of dividends, he will have to pay new tax:

Tax on dividends = 16% x Gross Dividends

Companies paying dividends must compute, withhold and pay the tax. The tax must be paid by the 25th day of the month following that in which the dividends were paid. However, withholding tax on dividends which have been declared but not paid by the end of the year must be paid by 25 January of the following year.

2.2. Tax obligations for Authorized Natural Persons

2.2.1. Personal Income Tax (PIT) calculated in the real tax system

Authorized natural persons are required to fill in certain specific simplified accounting records: the journal of receipts and payments, the inventory ledger and keeping tax records.

Net income (NI) from independent activities and PIT shall be determined as follows:

$NI = \text{Gross Revenue} - \text{Deductible Expenses}$

$PIT = 16\% \times NI$

As in the case of CIT, expenses incurred by individuals fall into three categories: deductible expenses, limited deductibility expenses and non-deductible expenses. Rules of deductibility are very similar to those in the case of CIT.

Authorized Natural Person has to make quarterly advance tax payments for the PIT due during the fiscal year (until 25th, inclusive, of the last month of each quarter). In order to achieve definitive taxation, tax payers shall submit until 25 May of the following year a statement of income, based on which the tax authority determine the difference of PIT to be paid or to be charged.

2.2.2. Personal Income Tax (PIT) calculated on the basis of a fixed income

Natural persons who obtain income from commercial activities that are included in the list drawn up by the Ministry of Public Finance² may calculate PIT on the basis of a fixed income annual allowance. This tax system is optional.

² Order of the Minister of Public Finance no. 2875/2011 approving the Nomenclature of independent activities in respect of which the net income may be determined on the basis of a fixed income annual allowance.

Local tax authorities shall determine and publish annually these fixed incomes before 1 January of the year for which they were established. Fixed incomes may be reduced in certain circumstances. For example, the income shall be reduced by 50% for persons who have a contract of employment, for an indefinite period, or for people with disabilities. For women over the age of 60 years and men over 65 years the income shall be reduced by 40%.

For these individuals PIT shall be determined as follows:

$$PIT = 16\% \times \text{Fixed income}$$

The calculation and payment of PIT is made quarterly, no later than 25 of the last month of each quarter.

If in the previous fiscal year individuals have recorded an annual gross income of more than EUR 100,000 euros, they have to apply the real tax system starting with the next fiscal year.

2.2.3. Social contributions due from natural persons authorized

The taxable income obtained by Authorized Natural Persons is subject to social security contributions (SSC) as well as to individual health insurance contribution (IHIC), calculated as follows (Table no.2):

Table no. 2: SSC and IHIC due by ANP

	Social Security Contribution	Individual Health Insurance Contribution
real system	SSC=26.3% x declared monthly income*	IHIC=5.5% x estimated/ obtained monthly income**
fixed income system	SSC=26.3% x monthly fixed income	IHIC=5.5% x monthly fixed income

* Declared monthly income is chosen by the ANP. The insured amount cannot be lower than 35% of the average gross salary (RON 2.415 in 2015) or higher than five times the average gross salary per month that applies in the year concerned.

**Monthly income = (Revenues - Expenses, excluding social contributions) / 12. The base cannot be lower than the applicable national gross minimum wage (RON 975 in 2015), if the income derived from independent activities is the only income on which health insurance contributions apply.

SSC is not due if individuals already derive other income (e.g. employment) that is subject of SSC or they receive pensions or unemployment benefits.

Both SSC and IHIC are payable quarterly, in four equal instalments, no later than 25 of the last month of each quarter.

3. Case Studies concerning tax optimization for a start-up

A start-up has several options when it comes to the legal structure of the new business, each one having different tax consequences. For a newly small business the options include:

- Limited Liability Company, obligated to pay Micro-companies revenues tax (MRT) in the first year
- Limited Liability Company, which opt to pay Corporate income tax (CIT) - only if the share capital is at least EUR 25,000
- Authorized Natural Persons, obligated to pay Personal income tax (PIT) calculated in the real tax system
- Authorized Natural Persons, which opt to pay PIT calculated on the basis of a fixed income annual allowance - only if his activity is included in the list drawn up by the Ministry of Public Finance)

Table no. 3 includes the entrepreneur's options for the following years, which depend on income levels registered in the first year of operation.

Table no. 3: Options on the form of organization from the second year of operation

Income levels registered in the previous year	Options
under EUR 65,000	<ul style="list-style-type: none"> • LLC paying MRT • ANP paying PIT calculated in the real tax system • ANP paying PIT calculated on the basis of a fixed income
EUR 65,000 – EUR 100,000	<ul style="list-style-type: none"> • LLC paying CIT • ANP paying PIT calculated in the real tax system • ANP paying PIT calculated on the basis of a fixed income
over EUR 100,000	<ul style="list-style-type: none"> • LLC paying CIT • ANP paying PIT calculated in the real tax system

The entrepreneur has to choose which involves the minimum overall tax burden

We will take an example for each of the three situations in which we can put total revenues: less than EUR 65,000, between EUR 65,000 and EUR 100,000 and over 100,000 EUR.

Case Study 1 (for revenues under EUR 65,000): an entrepreneur residing in Bucharest wants to start a business under the following conditions:

- Object of activity: repairing computers and peripheral equipment (CAEN code 9511)
- He is qualified in this field and can prove it through documents
- Initial capital held: RON 10,000
- He does not obtain other income outside of the business (e.g. wages, pensions or unemployment benefits).
- He estimates that it will get in a year (2015) the

following revenues and expenses:

- Total Revenues from providing services (repairing computers) RON 250,000
- Total Expenses RON 120,000, of which:
 - Materials expenses RON 35,000
 - Other external charges (energy and water) RON 2,000
 - Expenditures on salaries (for 1 employee) RON 60,000
 - Expenditures on rent RON 20,000
 - Other deductible expenses RON 3,000

The entrepreneur has the following options for the organization of his activity:

(A) LLC paying MRT

(B) ANP paying PIT calculated in the real tax system

(C) ANP paying PIT calculated on the basis of a fixed income. For Bucharest the fixed income for this activity (CAEN code 9511) is of 16,200 RON.

If he chooses the ANP form, the entrepreneur will need to submit the Statement Nr. 600 on the income secured from the public pension system. We assume that the income declared is RON 850.

(AI) LLC paying MRT

First, we determine earnings before taxes (EBT), then the micro-companies revenues tax (MRT) and net income (NI):

$$EBT = 250,000 - 120,000 = 130,000 \text{ RON}$$

$$MRT = 3\% \times 250,000 = 7,500 \text{ RON}$$

$$NI = 130,000 - 7,500 = 122,500 \text{ RON}$$

On the assumption that the net income is distributed in its entirety as dividends, the tax on dividends will be:

$$\text{Tax on dividends} = 16\% \times 122,500 = 19,600 \text{ RON}$$

$$\text{Total taxes} = 7,500 + 19,600 = 27,100 \text{ RON}$$

The remaining amount for entrepreneur is:

$$\text{Dividends net} = 130,000 - 27,100 = \mathbf{102,900 \text{ RON}}$$

Entrepreneurs will benefit from this amount next year, when the dividends will be distributed.

(BI) ANP paying PIT calculated in the real tax system

First, we determine monthly taxable base for Individual Health Insurance Contribution (IHIC):

$$(\text{Revenues} - \text{Expenses, excluding social contributions}) / 12 = (250,000 - 120,000) / 12 = 10,835 \text{ RON}$$

The social contributions monthly will be:

$$SSC = 26.3\% \times \text{monthly income declared} = 26.3\% \times 850 = 224 \text{ RON}$$

$$IHIC = 5.5\% \times 10,835 = 596 \text{ RON}$$

$$\text{Total annual contributions} = 12 \times (224 + 596) = 9,840 \text{ RON}$$

Net income will be:

$$NI = 130,000 - 9,840 = 120,160 \text{ RON}$$

Personal income tax:

$$PIT = 16\% \times NI = 16\% \times 120,160 = 19,226 \text{ RON}$$

$$\text{Total taxes} = 9,840 + 19,226 = 29,066 \text{ RON}$$

The remaining amount for entrepreneur is:

$$130,000 - 29,066 = \mathbf{100,934 \text{ RON}}$$

Entrepreneurs will benefit from this amount anytime they want during the year.

(CI) ANP paying PIT calculated on the basis of a fixed income

Social contributions monthly:

$$SSC = 26.3\% \times 850 = 224 \text{ RON}$$

$$IHIC = 5.5\% \times \text{monthly fixed income} = 5.5\% \times 16,200 / 12 = 5.5\% \times 1,350 = 74 \text{ RON}$$

$$\text{Total annual contributions} = 12 \times (224 + 74) = 3,576 \text{ RON}$$

$$PIT = 16\% \times \text{Fixed income} =$$

$$16\% \times 16,200 = 2,592 \text{ RON}$$

$$\text{Total taxes paid} = 3,576 + 2,592 = 6,168 \text{ RON}$$

The remaining amount for entrepreneur is:

$$130,000 - 6,168 = \mathbf{123,832 \text{ RON}}$$

Entrepreneurs will benefit from this amount anytime they want during the year.

Conclusion1: For this level of revenues and expenses, optimum choice (which corresponds to a minimum of total taxes) is ANP paying PIT calculated on the basis of a fixed income. If the activity are not included in the list drawn up by the Ministry of Public Finance, optimum choice would be the LLC paying the micro-companies revenues tax.

Case Study 2 (for revenues between EUR 65,000 and 100,000 EUR): an entrepreneur residing in Bucharest wants to start a business under the following conditions:

- Object of activity: repairing computers and peripheral equipment (CAEN code 9511)
- He is qualified in this field and can prove it through documents
- Initial capital held: RON 10,000
- He does not obtain other income outside of the business (e.g. wages, pensions or unemployment benefits).

He estimates that it will get in a year (2015) the following revenues and expenses:

- Total Revenues from providing services (repairing computers) RON 360,000
- Total Expenses RON 200,000, of which:

- Materials expenses RON 50,000
- Other external charges (energy and water) RON 4,000
- Expenditures on salaries (for 2 employee) RON 120,000
- Expenditures on rent RON 20,000
- Other deductible expenses RON 6,000

Because revenues are greater than EUR 65,000, the entrepreneur has the following options for the organization of his activity:

(A) LLC paying MRT at the beginning of the activity and paying CIT after having exceeded the ceiling of EUR 65,000 euro.

(B) ANP paying PIT calculated in the real tax system

(C) ANP paying PIT calculated on the basis of a fixed income. For Bucharest the fixed income for this activity (CAEN code 9511) is of 16,200 RON.

If he chooses the ANP form, the entrepreneur will need to submit the Statement Nr. 600 on the income secured from the public pension system. We assume that the income declared is RON 850.

(A2) LLC paying MRT and CIT

At the beginning of the activity the company will pay micro-companies revenues tax (MRT). The company will pay corporate income tax (CIT) starting with the quarter in which the limit is exceeded. The tax will be calculated based on expenses and revenues registered from the beginning of the fiscal year, as follow:

$$EBT = 360,000 - 200,000 = 160,000 \text{ RON}$$

$$IP = 16\% \times 360,000 = 12,960 \text{ RON}$$

$$NI = 160,000 - 12,960 = 147,040 \text{ RON}$$

On the assumption that the net income is distributed in its entirety as dividends, the tax on dividends will be:

$$\text{Tax on dividends} = 16\% \times 147,040 = 23,526 \text{ RON}$$

$$\text{Total taxes} = 7,500 + 19,600 = 27,100 \text{ RON}$$

The remaining amount for entrepreneur is:

$$\text{Dividends net} = 160,000 - 36,486 = \mathbf{123,514 \text{ RON}}$$

Entrepreneurs will benefit from this amount next year, when the dividends will be distributed.

(B2) ANP paying PIT calculated in the real tax system

Monthly taxable base for Individual Health Insurance Contribution (IHIC):

$$(\text{Revenues} - \text{Expenses, excluding social contributions})/12 = (360,000 - 200,000)/12 = 13,333 \text{ RON}$$

Social contributions monthly:

$$SSC = 26.3\% \times 850 = 224 \text{ RON}$$

$$IHIC = 5.5\% \times 13,333 = 733 \text{ RON}$$

$$\text{Total annual contributions} = 12 \times (224 + 733) = 11,484 \text{ RON}$$

Net income will be:

$$NI = 160,000 - 11,484 = 148,516 \text{ RON}$$

Personal income tax:

$$PIT = 16\% \times NI = 16\% \times 148,516 = 23,763 \text{ RON}$$

$$\text{Total taxes} = 11,484 + 23,763 = 35,247 \text{ RON}$$

The remaining amount for entrepreneur is:

$$160,000 - 35,247 = \mathbf{124,753 \text{ RON}}$$

Entrepreneurs will benefit from this amount anytime they want during the year.

(C2) ANP paying PIT calculated on the basis of a fixed income

Social contributions monthly:

$$SSC = 26.3\% \times 850 = 224 \text{ RON}$$

$$IHIC = 5.5\% \times \text{monthly fixed income} =$$

$$5.5\% \times 16,200/12 = 5.5\% \times 1,350 = 74 \text{ RON}$$

$$\text{Total annual contributions} = 12 \times (224 + 74) = 3,576 \text{ RON}$$

$$PIT = 16\% \times \text{Fixed income} = 16\% \times 16,200 = 2,592 \text{ RON}$$

$$\text{Total taxes} = 3,576 + 2,592 = 6,168 \text{ RON}$$

The remaining amount for entrepreneur is:

$$160,000 - 6,168 = \mathbf{153,832 \text{ RON}}$$

Entrepreneurs will benefit from this amount anytime they want during the year.

Conclusion2: For this level of revenues and expenses, the optimum form of organization is ANP paying PIT calculated on the basis of a fixed income. If the activity are not included in the list drawn up by the Ministry of Public Finance, optimum choice would be ANP paying PIT calculated in real system.

Case Study 3 (for revenues over EUR 100,000): an entrepreneur residing in Bucharest wants to start a business under the following conditions:

- Object of activity: activities of consultancy in information technology (**CAEN code 6202**)
- Possess documents evidencing qualification in this field
- Initial capital held: 10,000 RON
- He does not obtain other income outside of the business (e.g. wages, pensions or unemployment benefits).

He estimates that it will get in a year (2015) the following revenues and expenses:

- Total Revenues from providing services (consultancy in information technology) RON 500,000
- Total Expenses RON 200,000, of which:
 - Materials expenses RON 50,000
 - Other external charges (energy and water) RON 4,000
 - Expenditures on salaries (for 2 employee) RON 120,000
 - Expenditures on rent RON 20,000
 - Other deductible expenses RON 6,000

Since revenues come entirely from consultancy and management activities, the company does not comply with the conditions for the micro-companies revenues tax system. Therefore, the company will pay CIT from the beginning of the activity. Even if the revenues would be of other nature, during the year the company would have exceeded the threshold of EUR 65,000 and would have become liable for pay CIT.

The entrepreneur has the following options for the organization of his activity:

(A) LLC paying CIT

(B) ANP paying PIT calculated in the real tax system

(C) ANP paying PIT calculated on the basis of a fixed income. For Bucharest the fixed income for this activity (**CAEN code 9511**) is of 26,000 RON. The entrepreneur benefits from this tax system only in the first year. If in 2015 the threshold of EUR 100,000 is exceeded, the entrepreneur will have to go to the real system of taxation in 2016.

If he chooses the ANP form, the entrepreneur will need to submit the Statement Nr. 600 on the income secured from the public pension system. We assume that the income declared is RON 850.

(A3) LLC paying CIT

$$EBT = 500,000 - 200,000 = 300,000 \text{ RON}$$

$$CIT = 16\% \times 300,000 = 48,000 \text{ RON}$$

$$NI = 300,000 - 48,000 = 252,000 \text{ RON}$$

On the assumption that the net income is distributed in its entirety as dividends, the tax on dividends will be:

Tax on dividends = $16\% \times 252,000 = 40,320$ RON

Total taxes = $48,000 + 40,320 = 88,320$ RON

The remaining amount for entrepreneur is:

Dividends net = $252,000 - 40,320 = 211,680$ RON

Entrepreneurs will benefit from this amount next year, when the dividends will be distributed.

(B3) ANP paying PIT calculated in the real tax system

Monthly taxable base for Individual Health Insurance Contribution (IHIC):

(Revenues - Expenses, excluding social contributions) / 12 = $(500,000 - 200,000) / 12 = 25,000$ RON

Social contributions monthly:

SSC = $26.3\% \times 850 = 224$ RON

IHIC = $5.5\% \times 25,000 = 1375$ RON

Total annual contributions:

$12 \times (224 + 1375) = 19,188$ RON

Net income will be:

NI = $300,000 - 19,188 = 280,812$ RON

Net income will be:

PIT = $16\% \times NI = 16\% \times 280,812 = 44,930$ RON

Total taxes = $19,188 + 44,930 = 64,118$ RON

The remaining amount for entrepreneur is:

$300,000 - 64,118 = 235,882$ RON

Entrepreneurs will benefit from this amount anytime they want during the year.

(C3) ANP paying PIT calculated on the basis of a fixed income (only in the first year of activity)

Social contributions monthly:

SSC = $26.3\% \times 850 = 224$ RON

IHIC = $5.5\% \times$ monthly fixed income =

$5.5\% \times 26,000 / 12 = 5.5\% \times 2,166.67 = 119$ RON

Total annual contributions = $12 \times (224 + 119) = 4,116$ RON

PIT = $16\% \times$ Fixed income = $16\% \times 26,000 = 4,160$ RON

Total taxes = $4,116 + 4,160 = 8,276$ RON

The remaining amount for entrepreneur is:

$300,000 - 8,276 = 291,724$ RON

Entrepreneurs will benefit from this amount anytime they want during the year.

Conclusion3: For this level of revenues and expenses, optimum choice from the fiscal point of view is ANP paying PIT calculated on the basis of a fixed income. This option is only possible in the first year of activity. For the next years the optimum choice would be ANP paying PIT calculated in real system.

4. Conclusions

Analysis of the examples showed that the entity that ensures a minimum payment of taxes is Authorized Natural Person paying personal income tax calculated on the basis of a fixed income.

For a right decision on the optimal form of organization should be considered both taxes, as well as other non-fiscal issues such as: the setting-up / split-up conditions, liability in the event of insolvency,

mandatory professional training in the field of activity etc.

Only a comparative analyse of the advantages and disadvantages of each form of organization will result in an optimal decision.

Synthetic, these advantages and disadvantages are:

Advantages of ANP

- The process of setting-up is shorter, requires fewer papers and the cost is less than in the case of LLC;

- The accounts shall be kept in a simplified system. The cost of an accountant is small;

- Tax returns to be filed are fewer than in the case of LLC;

- ANP will benefit from the income of his business anytime he wants during the year, unlike the owner of a LLC, who has to wait the end of the year and the distribution of the dividends;

- ANPs don't have to pay tax on dividends;

- For split-up an ANP, the process is easier and takes less than for LLC.

Disadvantages of ANP

- Liability in the event of insolvency is a maximum;

- For each CAEN code chosen (each activity), entrepreneurs must justify their professional training in that field;

- The taxable income obtained by ANPs is subject to social security contributions (SSC) and individual health insurance contribution (IHIC).

Advantages of LLC

- Entrepreneurs may choose several CAEN codes, without the need to demonstrate their professional training in the fields of activity chosen;

- The LLC owners are protected from personal liability for business debts and claims. They stand to lose only the money that they've invested in the LLC;

- For entrepreneurs who open their first business, there is a form of LLC which offers significant advantages: LLC-D (for debut. (rule is: they never had shares / social parts at any enterprise in the european economic space). Cost for setting up a LLC-D are zero and the entrepreneur can obtain a non-refundable financial assistance of up to EUR 10,000.

Disadvantages of LLC

- The process of setting-up is longer, requires more documents and the cost is higher than in the case of ANP; in addition, to set up a LLC requires social capital;

- The accounts shall be kept in a double entry system and requires the signature and the stamp an accounting expert;

- As an associate, in order to benefit from company's money, you have to wait the end of the financial year and the distribution of the net income as dividends;

- The LLC owners must pay a tax of 16% on dividends received;

- The split-up of a LLC is extensive and can take quite a lot.

ANP is a suitable form of organization for those who intend to carry out a limited number of activities, with few trading partners. The greatest disadvantage of ANP is unlimited patrimonial liability.

For entrepreneurs who intend to engage in complex activities, with more trading partners, on longer terms and safer, it is preferable setting-up of a legal person, in the form of limited liability (LLC) or joint stock company, depending on the number of founders and their power of participation.

Companies who obtain low income, but have, instead, a high profitability are advantaged by the revenue tax system (applicable for micro-companies). But not all companies comply with conditions for eligibility under this category.

Tax optimization is a continuous process, given that in Romania the tax law changes very often. In the draft law on the new Fiscal Code published by Ministry of Public Finance³, the government proposes a fiscal reform of the system for taxing the income of the entrepreneurs. Measures which have an impact on optimal decision regarding the form of the organization are:

- elimination of tax on dividends from 1st January 2016

- Reduction of the unique rate of CIT and PIT from 16% to 14% in 2019

- Gradual increase of the ceiling for framing as micro-company, from EUR 65,000 at present to EUR 75,000 in 2017, to EUR 85,000 in 2018 and even EUR 100,000 from 2019

- Alternation of rates of MRT as follows:

- 1% for micro-companies which have more than two employees, including;

- 3% for micro-companies which have only one employee;

- 3% + RON 1,530/quarter for micro-companies which does not have employees.

- 3% for microcompanies which does not have employees and are in one of the following special situations:

- dissolution followed by liquidation;

- temporary inactivity, according to the law;

- nonexisting activities at headquarters / secondary headquarters, in according to a declaration on his own responsibility.

Of all these measures, the elimination of tax on dividends seems to have the most significant impact on the decision of the form of organization. ANP, generally the most advantageous form of organization for small entrepreneurs in this moment, is losing ground in favor of the LLC.

References

- Law no. 571 of 22 December 2003 regarding the Fiscal Code, as amended and completed;
- Order of the Minister of Public Finance no. 2875/2011 approving the Nomenclature of independent activities in respect of which the net income may be determined on the basis of a fixed income annual allowance;
- <http://codfiscal.net/42489/mfp-noul-cod-fiscal-proiect-lege-18-02-2015>.

³ <http://codfiscal.net/42489/mfp-noul-cod-fiscal-proiect-lege-18-02-2015>.