

EVOLUTION OF DIRECT TAXATION IN ROMANIA. TAX REGULATIONS AND COSTS

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Abstract: *In this paper we present the main tax measures regarding the profit tax and the income tax that were implemented during the period 2005-2017 and we try to identify the share of direct taxes (income and profit taxes) in the total costs for the population and for the companies, as well as the amount allocated by National Agency for Fiscal Administration (NAFA) to administer these direct taxes. In order to achieve these objectives, we use a descriptive methodology, as well as an analysis based on the balance sheet, the documents needed being the Consolidated General Budget of the Ministry of Finance, the NAFA Expenditure Balance, Financial State (Centre for Financial and Monetary Research "Victor Slăvescu", 2017, "Financial Indicators of the population"), as well as tax legislation in Romania.*

Keywords: *direct taxes, direct tax regulations, direct tax costs for companies and population, administration costs.*

Jel Classification: *H 25, H 31, H32.*

1. Introduction

In Romania, until 2004, a progressive system with differentiated rates for individuals' income, namely from 18% to 40%, was applied, and from 2005 a single rate of 16% has been implemented. Regarding the profit tax, its rate has changed, so in 2000 this quota was 25%, and since 2005 it has moved to the flat rate of 16%. Also, other important moments were 2009, when the economic crisis started in Romania and the observed effects were reduction of both consumption and VAT collection, introduction of the minimum tax, increasing the VAT rate from 19% to 24% by mid-2010, and the year 2015, when it has been rewritten the Law no. 227/2015 regarding the Tax Code.

The structure of the paper is the following: we briefly present, in the first part, the main tax measures regarding the profit and income taxes implemented in the period 2005-2017 and we will determine the costs / expenses with these fiscal measures, namely, their share in the total cost of population, companies and NAFA.

2. Main tax regulations in the period 2005- 2017

Since 2005, Romania has introduced a flat tax of 16% on personal income and companies profit, the expected effects being: business expansion, increasing direct investment, reducing the share of shadow economy, sustainable economic growth, more jobs, savings and investment growth.

As stated above, progressive taxation of individuals' income (between 18% and 40%) was replaced by a single 16% rate, combined with a degressive personal deduction, which led to a slightly progressive taxation. The profit tax was also reduced, from 25% to 16%. Dividends were taxed in 2005 at 10%, lower than income tax rates, and from 2006 the quota has been of 16%.

In addition, if we look at the data below, we notice that the share of tax revenues related to corporate income tax in 2006, 2007 and 2008 remained relatively constant, between 2,5-2,6% of GDP. The same can be said about the revenues from personal income tax (2,7 – 2,9% of GDP).

Table no.1. Evolution of tax revenues (% og GDP)

	2004	2005	2006	2007	2008
Total revenues	31,1	33,5	32,9	32,2	31,9
Tax revenues	28,4	28,5	28,4	28,3	28,1
Taxes on profit, income, capital gains	16,0	15,5	15,2	15,2	14,8
Profit tax (CIT- corporate income tax)	2,8	2,5	2,4	2,5	2,6
Income tax (PIT- personal income tax)	3,0	2,6	2,7	2,8	2,9

Source: Văcărel, I., 2007. Trends in the evolution of tax systems of OECD and EU member countries and Romania.

For 2006, no essential changes to the tax system are foreseen, maintaining the principle of the single tax rate. However, in order to secure the necessary sums from the perspective of joining the European Union, certain measures will be taken to increase the budget revenues.

In 2009 (May), the minimum tax was introduced (companies will still pay a 16% tax, but not less than the minimum threshold). The minimum tax rate is estimated to have resulted in the closure of over 100.000 small businesses (implicit cost). The measure entered into force on 1 May, which led to two fiscal years. The measure was abolished starting with 1 October 2010 by Emergency Ordinance, but at the same time it also created two tax years.

The tax rate on micro enterprises' income is 3% in 2009 compared to 2,5% in 2008. If the tax due by micro-enterprises is lower than the annual minimum tax, they are obliged to pay the tax at this level.

Dividend tax remains constant during the period analysed (10% -16%), with the exception of reinvested dividends, from 2009, with the view to preserving and increasing new jobs for the development of the Romanian legal persons distributing dividends, which are exempt from paying it.

According to the authorities, it appears that 119 charges and tariffs have been reduced, canceled or merged, thus their number reaching approximately 300.

New taxes are being introduced in 2010, as well as the fact that from 1 October 2010, the minimum tax is abolished. The latter measure had a positive impact on the companies, by reducing the tax burden, but a negative impact on the state budget revenues, generating a minus of 1000 million lei (according to the Emergency Ordinance for amending and supplementing Law No. 571/2003 on the Code fiscal, Official Monitor No. 0669 of 30 September 2010)

For the next period, fiscal consolidation measures aim at a new approach, namely development, equity, discipline, namely the general reduction of taxation; widening the tax base; simplifying the tax system; increasing revenue collection; reducing tax evasion.

Therefore, starting with February 1, 2013, it is applied the system of compulsory payment of the tax on micro enterprises' income for Romanian legal entities, which on December 31 of the previous fiscal year had a turnover of less than 65,000 euro; the requirement to have between 1 and 9 employees is eliminated; companies so listed can no longer choose between corporation tax or income tax, and are required to pay a 3% tax on revenues from 1 February 2013.

Microenterprises that exceed a 65,000 euro income ceiling in one year will pay tax on profits at the beginning of that year - the income tax paid being regularized with the corporation tax due.

For the budget, the government estimates the measure will triple the revenues from 207 to 678 million.

We should also mention the introduction of the "construction tax" as a special measure of extending the tax base on buildings, other than those for which building tax is due, of 1,5% of the accounting value; the budget impact was 488 million lei (according to the Macroeconomic Situation Report for 2014 and its projection for the years 2015-2017, the Ministry of Public Finance).

According to Emergency Ordinance no. 8 / 23.01.2013, income tax on agricultural, forestry and piscicultural income is introduced according to pre-established income rules. The 2% retention of the value of the products handed over to collection centers is eliminated.

During 2015 is written the Tax Code, namely Law no. 227/2015 regarding the Fiscal Code, aiming to continue the measures for increasing the efficiency of the tax system.

The main measures were:

a) Profit tax:

- elimination of the holding conditions considering as non- taxable income from dividends;

- changing the general principle of deduction of costs, including those incurred by the employer - employee relationship;

- Increase of the minimum turnover limit from 0,3% to 0,5% for the deduction from the corporate tax of amounts representing sponsorship / mecenate / private scholarships;

- Extending the application of the exemption for reinvested profits in the production / acquisition of electronic computers and peripheral equipment, cash registers, cash for control and billing, as well as in computer programs;

- increasing the social deductibility ceiling from 2% to 5% of the value of staff salaries;

- Introducing specific tax rules for legal entities that are dissolved with liquidation, in order to define an extended fiscal year, correlated with the period of application of the winding-up procedure and clarifying the issues related to the declaration and payment of corporate income tax in the extended fiscal year.

b) Tax on dividends paid to Romanian legal persons

- Reduction of dividend tax rate from 16% to 5% for dividends paid to Romanian legal entities.

c) Income tax for micro-enterprises:

- Increasing the ceiling for enforcing this tax system from 65.000 euro to 100.000 euro, as well as introducing a differentiated system of tax rates between 1% and 3%.

Tax rates on micro-enterprise income are: 1% for micro-enterprises with more than 2 employees; 2% for micro-enterprises with one employee; 3% for micro-enterprises with no employees.

- Introducing a support measure for newly created micro-enterprises by applying a 1% tax rate in the first two years of existence of the legal entity, conditioned to hire one employee.

Tax measures for introducing a differentiated tax rate system for micro-enterprises between 1% and 3% of total revenues, based on the number of employees, compared to 3% previously, increasing the income ceiling to which a firm is considered a micro enterprise from the equivalent in lei of 65.000 euros to 100.000 euros, resulted in an estimated budgetary impact of Ministry of Finance of about -300 million Lei. Also, the exemption of reinvested profits and the revision of dividend income received from Romanian legal entities by non-taxation of dividends received from a Romanian legal entity had a budgetary impact of - 56 million lei, namely -57 million lei.

It was estimated that micro-enterprises, almost entirely with domestic capital, will be more committed to fairness in business and reducing the hidden economy. It was also estimated that around 80.000 micro-enterprises, which in 2013 not recorded any turnover or number of employees, will remain inactive. These measures aimed to increase the number of jobs by about 101 thousand, increase of profit / loss reduction for micro-enterprises with more than 2 employees, increase of revenues from income tax and social contributions if some of these micro-enterprises will change their entrepreneurial approach and hire one or two employees to benefit from the 1% tax.

d) Construction tax: in 2016 the agricultural constructions are excluded from the tax base for determining the tax on construction. In 2017 it will be eliminated.

e) Income tax - regulations on income from self-employment, income from wages and salaries, income from the use of goods, investment income, pensions, etc.

The year 2017 was characterized by low revenues to the state budget due to:

- Emergency Ordinance in January 6, 2017, regarding the change of the micro-enterprise regime (increase of the threshold up to which a company is considered a micro enterprise from 100,000 euros in 2016 to 500,000 euros as of 1 January 2017), a group of companies to which the tax rate on profit ratio is significantly lower than other types of firms,

- wage increases in the whole economy with potential negative effect on companies' profits and, implicitly, lower corporate income tax than in 2016;

- the introduction, from 1 January 2017, of the specific tax for businesses in the tourism and food sectors that basically replaced the corporate tax (but with a reduced tax rate!).

- income from dividend tax declined, compared to the previous year - the reduction in dividend tax rate at that time changed the behavior of companies in the sense that they have paid dividends well above the usual levels. Although the immediate consequence was the improvement of the budgetary impact of the tax rate reduction, it has been appreciated that large dividend distributions were temporary, the loss of income being felt in the coming years.

In the year 2017 other tax measures were adopted, but generated negative impact on revenues collected from income tax:

- tax exemption for pensions of less than 2.000 lei,

- the revenues from the income tax on the transfer of the real estate assets in the personal patrimony decreased by almost 400 million lei, in the context of the introduction of a non-taxable ceiling of 450.000 lei for the revenues obtained as a result of the transfer of the ownership right.

Also, in order to identify the potential effect of the tax changes in 2017 on microenterprises, Iancu Guda (Coface) realised an impact study, and the conclusion was that the ordinance will generate, during this period, a reduction of taxes paid by micro-enterprises with income below 500.000 euro of about 955 million lei, but the entire fiscal saving should be directed to cover additional salary costs, the latter increasing by 936 million lei, due to the increase of the gross minimum wage by 16%, from 1.250 lei to 1.450 lei, starting with February 2018.

3. Costs determined by the tax regulations

Tax costs are an important element of the cost of any business; it does not only mean tax rates, but also the payment terms and the recovery time of tax receivables or losses. The tax costs of a taxpayer are influenced by a multitude of factors, some of which are directly controlled by the taxpayer. The way each taxpayer chooses or uses each of these factors in his activity will also determine the level of his tax costs.

Tax measures have a stronger impact on small firms, as they are unable to cope with the growing costs of adapting to permanent changes (Chittende, F., Foster, H., Sloan, B). There are also some factors that influence the costs of taxation, such as: the number of tax payers, the structure of the tax system, tax evasion, technological progress that helps businesses to comply with the law. The issue of hidden costs of taxation has become more important as countries have introduced new taxes to ensure a fair and equitable tax system to increase the amount of revenue collected to the budget.

With regard to the business environment, economic agents face increasing costs to cope with frequent changes in legislation. Although the Tax Code provides principles of taxation (principles according to which taxation must be clear, legal regulations should be clear and the provisions of the Tax Code must have long-term stability in order not to affect the activity of individuals and legal entities and to ensure efficiency), these principles are not respected in practice. Thus, firms must provide their employers the necessary training to properly enforce the law – fact which generates an extra and perhaps unforeseen cost for the company. The more legislation is harder to understand, the more companies need to allocate resources for understanding legislation, enforcing it and ensuring compliance.

Other hidden costs might be: cost of hours when the employe/ employee fills documents (at first glance this is a normal cost of business, but when changes occur, attention and time to fill the documents in order to conform increase), the cost of consultants' services.

When proposing new tax reforms, not only the budgetary impact, but also the costs of new taxes should be considered. Romania, in present, has a single tax system, both in terms of personal income tax and that of companies (among the new EU Member States, only Poland and Slovakia do not have a single tax rate. One of the main advantages of a single tax rate is its simplicity, which increases compliance and reduces the administrative burden for both taxpayers and tax authorities, which ultimately means lower tax collection costs.

Thus, given the absence of different tax deductions and tax credits, a single tax system is expected to come at lower collection costs than a progressive taxation system. Consequently, when the authorities want to give up the single tax, they have to look not only at the revenue side of the budget, but also at the part of the expenses, meaning the costs of collecting taxes.

In this paper we try to identify the share of direct taxes (profit and income taxes) in total costs, for population and firms.

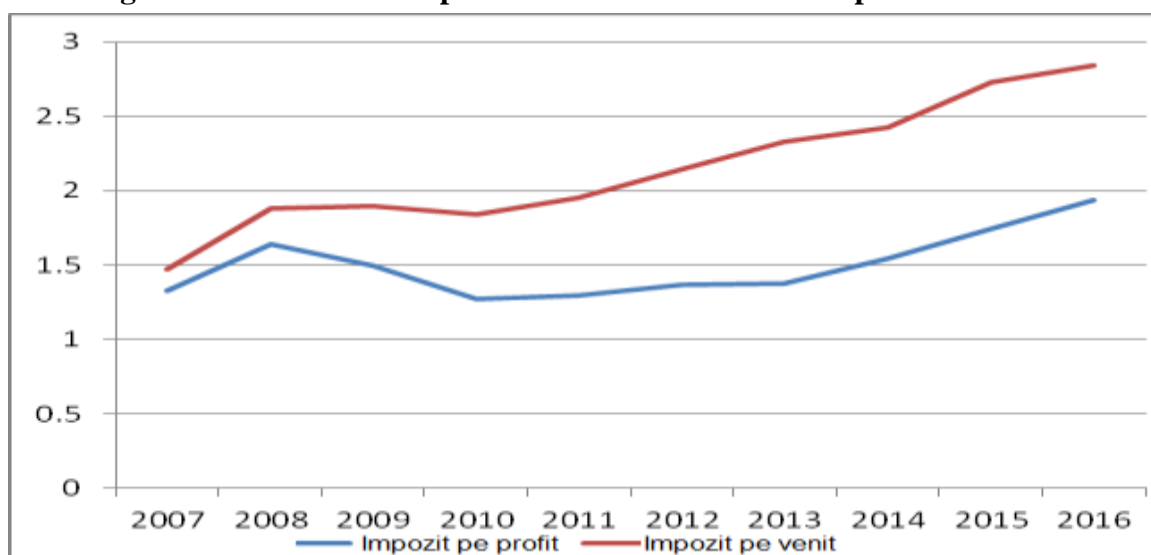
The methodology is as follows: information on expenses/ costs with profit tax and income tax is related to tax revenue from profit tax and income tax, which are found in the Consolidated General Budget of the Ministry of Finance. The total expenditures of the population are collected from the Financial Statement 2017, from the „Financial Indicators of the Population” and the total expenses of the companies are taken from the Balance Sheets - the annual financial statements of the active trading companies in the real economy of Romania. We also want to see what amount is allocated by NAFA (National Agency for Fiscal Administration) for managing direct taxes (profit and income tax). We use in this context the amount of direct taxes (iprofit tax and income tax) reported to the total expenditure of NAFA (taken from the NAFA Expenditure Balance) for the years 2013-2016.

Table no.2. Total direct taxes (profit tax and income tax) in the period 2006-2016-million lei

Tax	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Profit tax	7939	10558	13046	11893	10115	10309	10855	10926	12238	13825	15394
Income tax	9764	14375	18366	18551	17957	19076	20957	22736	23692	26640	27756
Σ taxes	17703	24933	31412	30444	28072	29385	31812	33662	35930	40465	43150

Source: Ministry of Finance, General consolidated Budget 2007-2017.

Figure no.1. Evolution of profit and income taxes in the period 2007- 2016



Source: Ministry of Finance, General consolidated Budget 2007-2017

Both taxes have a peak in 2008, then a sharp drop (during 2009- 2010), followed by a slight increase of income tax (2011-2013). In 2010, the income tax records a minimum, then it has a growing trend.

A. For the population

We note: CHB = Total Population Costs

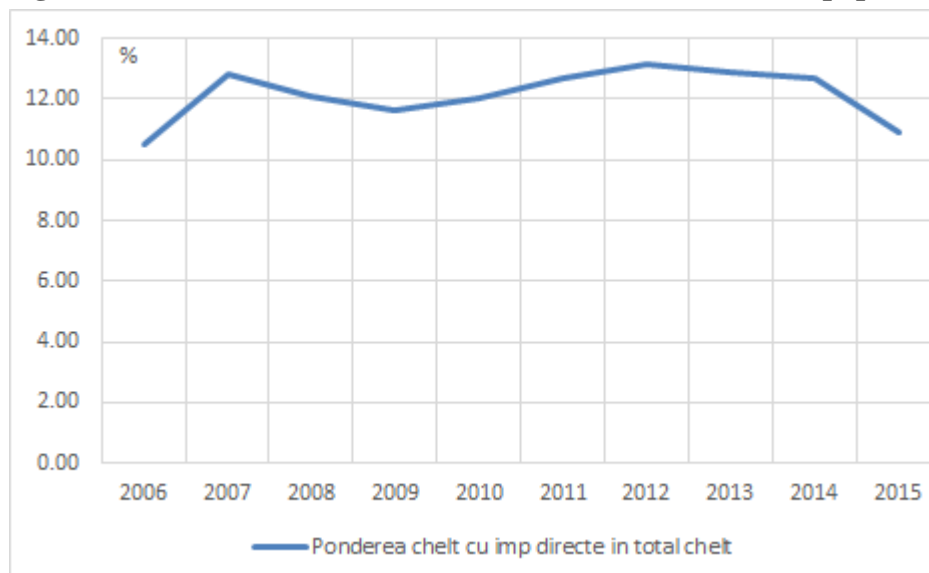
IV = income tax; value taken from the Consolidated General Budget and represents the tax income from income tax

Table no.3. The share of direct taxes costs in total costs for population

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
CHB	98100	136480	143443	153427	154003	158928	165379	173291	183398	209825	254450
IV	9764	14375	18366	18551	17957	19076	20957	22736	23692	26640	27756
%	9,95	10,53	12,80	12,09	11,66	12,00	12,67	13,12	12,92	12,70	10,91

Source: Table 2, Financial Statement 2017, Consolidated General Budget 2007-2017.

Figure no.2. The share of direct taxes costs in total costs for population



Source: Financial Statement 2017, CCFM, 2017, Consolidated General Budget 2007-2017.

While total population costs increase each year, the share of direct tax costs tends to fall. After a peak in 2013 (13,12%), in the following years the trend is declining, reaching the 2007 level, before the financial crisis. We note that in 2016, the costs were 2,59 times higher than in 2006 (between 2016 and 2006).

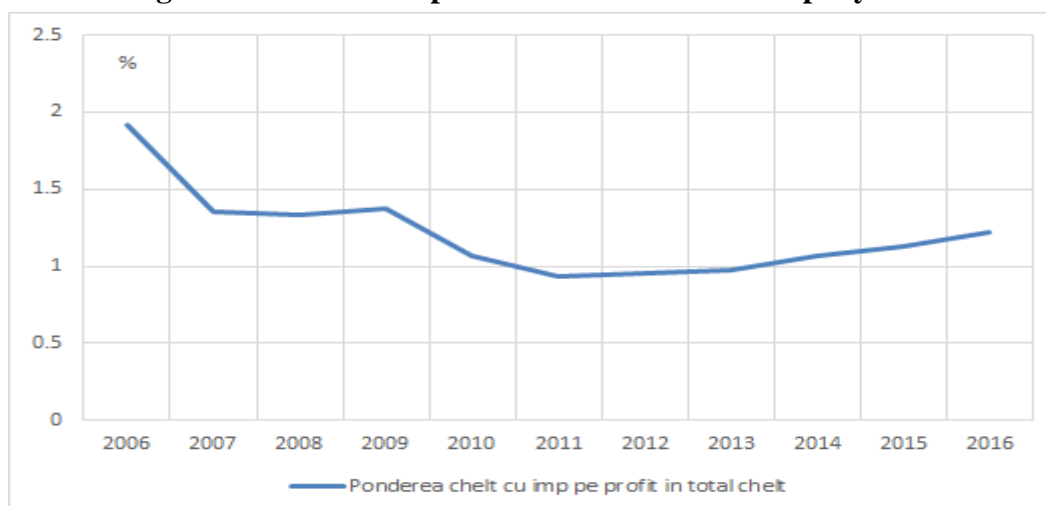
B. For firms

Table no.4. Share of profit tax costs in total company costs

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total profit tax (mld.lei)	7939	10558	13046	11893	10115	10309	10855	10926	12238	13825	15394
Total costs (mld.lei)	414276	777946	979544	864712	946090	1110211	1139672	1120975	1145710	1221633	1260804
%	1,92	1,36	1,33	1,38	1,07	0,93	0,95	0,97	1,07	1,13	1,22

Source: Table no. 2, Consolidated general budget 2007-2017, the annual financial statements of the active trading companies in the real economy of Romania.

Figure no. 3. Share of profit tax costs in total company costs



Source: Consolidated general budget 2007-2017, the annual financial statements of the active trading companies in the real economy of Romania.

The profit tax depends on the taxable amount and the tax rate. During the crisis, the share of corporate (profit) tax costs in total costs decreased (reached a minimum in 2011). In the following years, we observe a slight growth, approaching the level of the 2007-2009 period.

C. NAFA costs with administration

The role of NAFA is tax administration. Therefore, we want to find out which amount of the tax revenues from the profit tax and the income tax it collected at 1 leu "invested" by the state, namely, the share of the costs with the administration of the taxes on profit and income in the NAFA total costs.

**Table no.5. The efficiency of NAFA activity
(Evolution of Tax Administration Costs and Income collected by NAFA)**

	2013	2014	2015	2016
Total amount of revenue collected from direct taxes (mil.lei)	33662000	35930000	40465000	43150000
Annual costs NAFA (mil.lei)	239035	503854	441159	552484
Efficiency (%) (rd.1/rd.2)	140,82	71,31	91,72	78,10

Source: Table no. 2, NAFA 2013-2016 balance sheets.

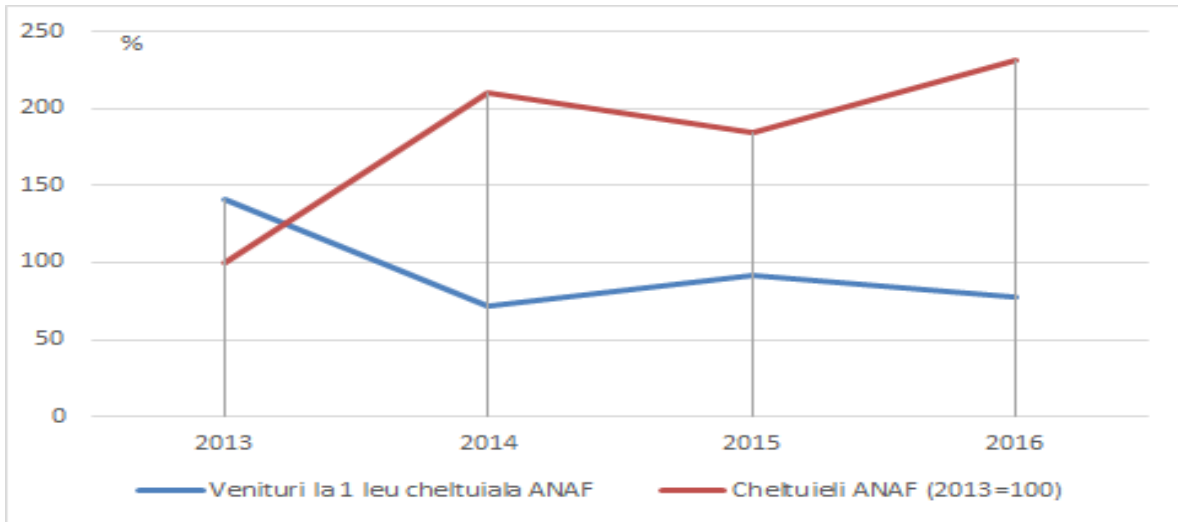
In dynamics, while efficiency is being reduced in the three years by about 62pp, the costs are 2,31 times higher.

Table no. 6. NAFA costs vs. NAFA Activity Efficiency

	2013	2014		2015	2016
Efficiency (%)	140,82	71,31		91,72	78,10
Evolution of costs (2013=100%)	100,00	210,79		184,56	231,13

Suggestively, the data is shown in the following figure:

Figure nr. 4. Evolution of Tax Administration Costs and Income collected by NAFA



Source: graph made on the basis of table no.

4. Conclusions

This paper presents the main tax measures for profit tax and income tax that were implemented during the period 2005-2017, namely the flat tax measure and other important tax changes implemented in 2009-2017. We also try to identify the share of costs with direct taxes (profit and income tax) on total costs for the population and companies, as well as the amount allocated by NAFA for the administration of these direct taxes.

About the costs of these tax changes, we refer to the implicit and explicit ones. The explicit ones refer to the actual figure found in the state budget (a plus / minus in the tax revenues related to these taxes) and the implicit ones are considered to be, for firms, for example, the effects of the breakdowns (bankruptcy, insolvency) or the number of newly created firms / number of records. For the population, the cost is reflected in the increase / decrease of inequality or the degree of poverty.

Exemplifying, the implicit costs are the 100.000 firms closed following the introduction of the minimum tax in 2009, or the increase in disruptions following the introduction in 2015 of differentiated rates on the taxation of microenterprises. As for the explicit costs, the same measures in 2015 on the introduction of the differentiated tax system for micro-enterprises, the increase in the income ceiling led to an estimated cost of Ministry of Finance at about -300 million Lei; or, exemption of the reinvested profit: the cost was - 56 mil lei; the elimination of the minimum tax, in 2010, led to a cost of - 1000 million lei.

We believe that multiple tax changes have primarily caused costs for all economic actors (state, firms, population), but have brought instability and fiscal uncertainty (factors that have contributed to the development of the underground economy), increased bureaucracy and also growth of non-compliance.

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