INCOME TAX SHIFTS – CAUSES AND EFFECTS ON ROMANIAN ENTERPRISES

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Abstract

This paper aims to make a point in what the fiscal environment has been and is about in Romania. In 2008, the crisis was obvious to our authorities, who before declared with nonchalance that our system is way back from Europe's and the crisis will pass near us. This didn't happened and here we are, in front of it. The financial crisis has reduced the state budget incomes in a drastic manner, making the authorities to do what they knew better – put more fiscal weight in taxpayer's burden. In this paper we will approach the minimum income tax amount, tax amount which has been the cap for more than 25% of the Romanian enterprises. The government took the easy way, more tax, no analysis on what the side effects of this tax over the economy will be on short-medium term. As you guessed, the only good that came from this measure was more money at the budget, but only for a couple of months because, as previously said, 25% of the enterprises closed their activity, meaning no more income tax payments, no more social and health contributions, no more wages paid etc. The budget has got a big hole because now, beside the fact that it didn't cashed in from the closed enterprises, has to pay unemployment help for those who worked in those firms. As the crisis goes deeper, the government removed at the end of 2010 the minimum income tax amount, declaring with "drums and trumpets" that these measures are in order to revive the economy and the enterprises activity. We shall see about that.

Keywords*: SMe, income tax, level of taxation, Romanian legislation, global crisis.*

Introduction

After the communist regime has fallen, a sort of market economy has been installed. Since then, a proper fiscal legislation has not been conceived. As Ovidiu Nicolescu (the vice-president of the Worldwide SMes Organization) said: " Sudden decline of economic and political institutions of the old system, institutions that provided leadership through orders received from the center, along with emergence of democratic political institutions has created an incompatibility between various components of the socio-economic mechanism. The hybrid institutional and economic system reform cannot be achieved only by corrections and by adjustments, it also requires making some structural changes in its substance. This process should not be allowed to run as a "natural" process, it must be based on decisions arising from a political will, materialized through strategies and programs, meant to reduce the duration of the transition and to achieve a

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viable system within a reasonable amount of time. Abrupt canceling of strictly centralized planning system without replacing it with other institutions to take over, at least in part its functions has generated a huge gap in the functioning economic system, fact which led to strong disruption of the entire mechanism of social production. At that time it has been intervened with corrective measures - price liberalization (01/11/1990). It has been tried in this way a removal of distortions and existing inconsistencies in the system of command economy and settlement of the prices on natural principles, related to costs and demand/supply. It has been "hoped" that in this institution, of market economy - the price could replace the central planning, by taking (by the price system) the mechanism for allocating resources, without a real competition in the economy, dominated by producers of "monopoly", the price liberalization has not had the desired effect, but generated a abusive economic behavior of monopoly operators function in the economy"

The legislation in function is meant to put weight on taxpayers, the reason there were more taxes than in any European Union state, an worldwide behind only Belarus, Uzbekistan and Ukraine[1]. The effective taxation percent was at 57,2%. Since the EU accession, Directives have been given to implement. There were many effective systems to copy and implement but no such things have been done yet, only a small reduction of the total taxation percent, which is actually at 44,9%, and overall, the Romanian government has been taken very few action in order to simplify the tax system and ease the taxpayer's fiscal burden.

During the past years, the government has introduced fiscal measures aimed at helping to achieve budget deficit targets. This measures include the minimum income tax, increase in the VAT rate from 19% to 24%, along with the introduction of additional VAT compliance measures[2]; an increase in local taxes (e.g. taxes on the issue of building certificates, higher vehicle taxes, advertising taxes); and the introduction of a new late-payment penalty system.

Local legislation matters

The government has approved a series of austerity measures due the financial crisis, without a proper analysis of medium and long term effects over economy and population. One of the measures was the instatement of the minimum income tax that each firm had to pay no matter the profit or loss it had obtained during the financial exercise.

This measure, which had no reasoning but the desperation of bringing more money at the state budget, did not took into consideration the diminution of the absurd expenses the state system employees are making with no verification and accountability (and we do not refer to the 25% diminution of wages).

Analyzing the down effects of this measure, we infer that all was in vain. It did not do anything but to put more weight that a microenterprise or SMe can handle. In Romania worked about 1.2 million enterprises, from which approximately 320,000 have vanished as an effect of those measures, meaning 25%. Because of this fact the state loss massive, in the sense that this enterprises paid contributions at the social security budgets and at the special budgets, paid income tax, mostly paid VAT and the most important, it paid wages. Now, the state does not cash in from their account and furthermore it pays unemployment help for their former employees.

In all strong working economies, the state is helping the small and medium enterprises, which generate over 90% of GDP and hires over 95% of the occupied work force[3]. In Romania everything seems backwards. In the present, 70 percent of Romanian's GDP is produced by small and medium enterprises. It, also provide in our country about 70% of overall jobs.

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[1] According to a report prepared by PWC and the World Bank on 178 states – *Paying taxes 2008.*

[2] Raluca Rizea, Radu Filip, *Codul fiscal 2011 cu Norme medodologice de aplicare, 2010, Ed. Indaco*

[3] Ovidiu Nicolescu, *Intreprenoriatul si Managementul IMM*, 2008, Ed. Economica

Furthermore, info on the European Union states:

Country	% SMe's in overall enterprises	% SMe's in GDP	% SMe's in overall employers
Austria	99.60	50.86	65.50
Belgium	99.80	64.49	68.90
Denmark	99.70	58.75	68.74
Finland	99.75	44.33	59.15
France	99.79	45.76	66.86
Germany	99.63	60.17	59.85
Greece	99.95	82.87	86.68
Ireland	99.59	33.02	69.59
Italy	99.94	71.38	80.34
Luxembourg	99.62	74.20	72.32
Holland	99.56	56.06	62.47
Portugal	99.87	66.80	78.87
Spain	99.89	55.30	79.45
Sweden	99.67	51.51	61.37
Great Britain	99.80	38.40	55.30
EU - 15	99.81	51.69	66.32

(source: The white cart of SMe's in Romania)[4]

In Denmark for instance, small and medium enterprises are characterized by a high level of specialization. The particularity is the fact that the enterprise did not develop such sensitivity at global market changes, like the counties that have their industry specialized in just a few sectors. The unique tax percentage is 28% and, from 1976 an avoidance convention for double taxation was signed with Romania, which impose a reduced tax income of 15%.[5]

France has the standard rate at 33,33%. Small enterprises (the enterprises in which less than ¾ of the shares are owned directly or indirectly by individuals or companies that declare business less than 7,7 million Euro) are taxed with 15% for the less than 40k (approximately) Euro taxable income, or at standard rate for what exceeds this amount. The reduced tax amount is applied to industrial royalties also. The latest news in the taxes domain is that France wishes to harmonize it's tax system to Germany.

This harmonization is intended primarily for the elimination of the differences and to create a more stable environment (and here we refer to the global crisis). One of the first measures was that France has dropped the wealth tax.[6]

In Great Britain there are a series of encouragement policies for small and medium enterprises from which we only mention the reduction of income tax from 20% to 19%. The

[4] Prof.Dr. Ovidiu Nicolescu, *CARTA ALBA A IMM-urilor din ROMANIA*, ed. CNIPRMM

[5] Harm Gustav Schroeter, *The European enterprise: historical investigation into a future species*

[6] Kevin Keasey, R. S. Thompson, Mike Wrig, *Corporate governance: accountability, enterprise and international comparisons*

income tax for the first year of activity is reduced from 10 to 0%. This also applies to companies that does not exceed 10,000 Pounds profit (the equivalent of almost 12,000 Euro – at a 1,18 EUR/GBP rate)

One of the strongest European economies is the Austrian. Most of the companies are small and medium, about 80% of these have least than 100 employees and only 1% over 1,000 employees. The state charges with a minimum 1,600 Euro minimum income tax from limited liabilities companies (GmbH) and 3,200 Euro from share companies (AG). But, the state sustains the companies with lots of coaching programs, funding, cooperation with R&D institutes etc. The state also subsidizes 25 to 35% from research and development expenses, until 20% of personnel training expenses etc.

In Germany the economy works with the same types of companies as in Austria. The most common type is the limited liability enterprise (GmbH). This implies a minimum capital of 25,000 Euro. One or more individuals or companies, domestic or foreign can associate trough a society agreement that must be signed by all owners and authenticated at the notary. In the situation that one of the associates could not assist personally, he can be represented by another, but only with a notarized authorization. The registering form must be submitted at the Commerce Registry of the local territorial administration.[7]

The state is also protecting the small and medium enterprises, the competition is strongly shielded and globally promoted. Another particularity is that in Germany, the big companies, like the machines one, do not produce the components, they lend this activity to small and medium enterprises, only dealing with the installation and assembly.

Czech republic is a country with lots of foreign capital in it's economy. In present there are over 1,600 foreign companies, the foreign investments providing during 1990-2004 about 350,000 work places and saving another about 600,000. Trough personnel reconversion, in 2002, 23,000 new work places were created on an direct foreign investment in amount of 9,1 billion Euro. A qualified analysis revealed that about 65-70% of the export production belong to foreign investment companies. The taxation system contains income taxation (for individuals and companies), VAT, excise (on fuel and lubricant, distilled and alcoholic beverages, beer, tobacco and tobacco products, alcoholized wines, sparkling wine and champagne), the real estate property tax, road tax, tax on inheritances and donations and real estate transfer tax

Next to Ireland, Luxembourg has the lowest taxation level of EU, the global tax reaches 30,38% (from which 16% retirement fund – 8% paid by the employer and 8% by the employee, health insurance 7,5% - 2,6% paid by the employer and 4,9% paid by the employee, unemployment fund of 4% etc), tax income is 22% and local taxes about 7,5%. VAT in Luxembourg is applied in the following percentages: 3% for food and base necessity goods), 6%, 12% (as intermediary VAT) and the general tax of 15%

In Romania, since September 2010, when the negative effects of the minimum income tax were finally obvious for the government, it was removed by GEO 87/2010, measure that is supposed to sustain and re-launch the economy, and I quote from it:

”[...] *In the context of maintaining the current financial and economic crisis that affected Romania and still affects the business environment;*

Considering that this crisis affects the cash flow of economic operators, which in his part generates major negative effects like financial blockages, insolvency, with influence over the survival of economic operators and loss of many jobs;

Premises in order to create economic recovery by reducing the tax burden of the taxpayer [...]”[8]

[7] Russell A. Miller, Peer Zumbansen, *Annual of German & European law, Volumes 2-3*, 2006

[8] GEO 87/2010

Following this measure, 2010 has two financial exercises. It is an unprecedented situation that has puzzled all accounting professionals that will have to fill two income tax statements. The problem it's not here, it's in the fact that just like any article of law issued by the Romanian authorities, this one is incomplete and does not refer to the situation in practice. The problem in practice is who will fill two statements?

The majority, including the representatives of the Ministry of Finance, consider that all contributors, except for those who were founded during 2010, must fill in two income statements. I consider that the law in force is clear enough in this matter:

Article18, paragraph 2 of the Fiscal Code, as amended by Ordinance 34/2009 states:

"(2) taxpayers, except those provided in paragraph (1), art. 13 letter. c)-e), Art. 15 and 38, where their tax is less than minimum corresponding to their income amount, under par. (3), are obliged to pay tax at minimum amount."

Article 34, paragraph 16 of the Fiscal Code, introduced by GEO 87/2010 states:

(16) Taxpayers who, until September 30th 2010 inclusive, had to pay the minimum tax, the income tax due calculation for the fiscal year 2010, will comply with the following rules:

a) for the period between January 1st and September 30th, 2010:

calculation of the profit tax for that period and the effectuation of the comparison with the minimum annual tax amount, as provided by art. 18 paragraph (3), recalculated accordingly for the period January 1st to September 30th, 2010, by dividing the annual minimum tax to 12 and multiplying the number of months in that period, in order to establish the income tax due[9];

By exception from the provision of paragraph (1),(5) and (11) and Article 35 paragraph (1), submission of income tax statement for the period January 1st to September 30th, 2010 and income tax due payment from the completion of taxation, is to be made until February 25th, 2011;

b) for the period between October 1st and December 31st, 2010:

taxpayers submit the tax statement and pay income tax due under paragraph (1), (5) and (11) and Article 35. Paragraph (1)."

We interpret that, in the prementioned context, the statements in the two periods only draw those who were forced to pay the minimum tax, those who had, between January and September 2010 period, the income tax lower than the minimum tax amount. The opinion according to which all taxpayers (with few exceptions) were required to pay minimum tax, which on those

who are of the opinion that all taxpayers must fill the two statements we believe it is not correct and does not comply with the law in force.

The entities who registered income tax (not minimum income tax) do not apply the provisions of paragraph 16, so, will only fill a single income tax statement for the fiscal year of 2010.

Article (18) tax loss recorded in this two periods for the year 2010 shall be recovered according to Art. 26, each fiscal year period being considered as a fiscal year meaning of 5 to 7 years. "

As you can see, there is no distinction between taxpayers nor any reference to an article that makes this distinction.

Currently, as the articles of the Fiscal Code are, the problem is only for interpretation. The application rules cannot modify the law, they should only bring more light in understanding it and more details. The phrase "have been forced to pay the minimum income tax" can be changed only by amending the law.

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9 Raluca Rizea; Radu Filip *Ordinul MFP 3055 pe 2009. Reglementări contabile*

The comparison between calculated and minimum income tax (for the verification that the calculated income tax is greater than the minimum one) can be based on the Register of Fiscal records at a tax audit.

This change in Art. (18)" tax loss recorded in the two periods for the year 2010 shall be recovered according to Art. 26, each period being considered as one fiscal period meaning 5 to 7 years." is the only one from which we can conclude that in the year 2010 there are two financial exercises.

Conclusions

Since the accession in EU, the total tax rate has been reduced, mainly as a result of falling labor tax rates for social security, health insurance, and unemployment contributions. In the most recent years, the Romanian government has taken several measures to help and support the business environment during the economic recession, very few being truly helpful. Taxpayers have been granted social security exemption during periods of temporary inactivity, and also the potential to defer tax liabilities under certain conditions. These measures, however, didn't improve the economy and as we actually see, 2011 is going to be the toughest year since the crisis.

In 2010, due to economy recession the minimum income tax has been introduced. This desperate measure battered the economy and closed about 25% of the total number of companies. After realizing this measure was not bringing any benefits, the government approved its removal, as stimulation for both the economy and enterprises. The true effects on this minimum income tax amount have been presented in the upper pages, along with the accounting practice problems.

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