



IMPACT OF THE FISCAL REGULATIONS ON THE ECONOMIC ACTIVITY OF THE ECONOMIC ACTORS

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Rezumat

Perioada dificilă pe care România o traversează încă din anul 2008 a determinat autoritățile publice să adopte noi măsuri fiscale, cu scopul, printre altele, de a colecta cât mai multe venituri la bugetul de stat. Totuși, aceste reglementări (în special cele privind impozitul forfetar și cel minim) au avut un puternic impact negativ asupra sectorului privat, multe firme încetându-și activitatea, sau, cum a procedat majoritatea, adoptând un comportament mai puțin onest, și anume sustragerea de la plata obligațiilor fiscale, evaziunea fiscală.

Articolul analizează impactul impozitelor forfetar și minim asupra IMM-urilor, punctând avantajele și dezavantajele aplicării lor, opinii ale membrilor Uniunii Europene, și propune unele soluții de sprijinire a mediului de afaceri, respectiv de îmbunătățire a situației financiare a agenților economici.

Abstract

The difficult period which Romania crosses as of 2008 determined the public authorities to adopt new fiscal measures with the purpose, among other, to collect more revenue to the state budget. However, these regulations (mainly those concerning the lump sum tax and the minimal tax) had a strong adverse impact on the private sector; many companies closed down or adopted a less honest behaviour, as most of them did, by avoiding paying the taxes, tax evasion.

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The paper analyses the impact of the lump sum tax and the minimal tax on the SMEs, showing the advantages and disadvantages of their application, opinions from EU members and proposals to support the business medium, to improve the financial situation of the economic agents.

Keywords: fiscal regulations, lump sum tax, minimal tax, economic agents, methods of tax evasion, measures to support the business medium

JEL classification: D21, E62, G01, H26, H32, K34

1. Fiscal measures to control the effects of the economic decline

The governments worldwide were confronted by a dilemma when they had to decide how to react to the economic crisis. The recession meant less revenue from taxes, which induced budget deficit, so that some countries increased taxation. However, the higher taxation may also have adverse effects – intensifying recession because the income of the physical persons decreased, as did the company budget for investments. Therefore, in other countries, the governments decreased the taxation in order to promote the economic revival. For instance, the Great Britain reduced temporarily the VAT from 17.5% to 15% during December 1st, 2009 and January 1st, 2010.

In an attempt to cover the deficit of revenue to the state budget, the Romanian government decided several measures, such as cancelling the deductibility of fuel expenditure for VAT calculation and for individual tax calculation and compelled the companies to pay a presumptive tax and the small companies to pay a minimal tax. The budget deficit remained, however, high, being around 7.5%. Unfortunately, quite aggressive measures have been adopted, such as the delay in VAT reimbursement, which had an adverse effect on the business. In 2009 there was political instability, there were presidential elections, factors which deterred tougher decisions from the government.

There were very many speculations on the possible increase of VAT or of the tax on profit and on the individual income. Such measures would be counterproductive because they would slow

down the speed of economic recovery and would impact adversely the revenue to the state budget. Instead, the government should focus on a more efficient collection of the revenue and on the informal economy which, according to the estimates, still accounts for a substantial share of the economy. "For instance, the fiscal inspections should be directed towards the companies and persons that display a high risk of tax evasion, and they should not be done randomly, as they are done presently."¹

2. The effects of the minimal tax on the company

The obligation to pay a minimal tax is different for each taxpayer in relation with the system of payment of the tax on profit correlated with the basic condition that the tax on profit should be smaller than the minimal tax stipulated by the law.

Thus, for the taxpayers which calculate, declare and pay the tax on profit on a quarterly basis, the comparison of the tax on profit with the minimal tax, which is also done quarterly, leads to a different situation, function of the tax on profit recorded each quarter.

Also, in order to finalize the tax on profit within the context in which the minimal tax is a compulsory minimal obligation, it can not be reimbursed by the end of the year, because the restitution of the minimal tax would not justify its introduction. However, in order to determine the tax on profit for each quarter, the minimal tax due for the preceding period is deducted, if it had to be paid, and only the amounts representing the tax on profit are reimbursed.²

According to the authorities, the minimal tax achieved its goal, which is why it was introduced in 2009, to "take out of passiveness and to eliminate those companies which were used just for intermediation, and which were actually inactive": "over 73% of the companies which closed in 2009, were inactive, being used just for intermediations and transactions aiming at some sort of fiscal fraud".³

¹ Mark Gibbins, *Tax Partner and Coordinator of Tax Department within KPMG.*

² *Ministry of Finances, Directorate of Communication, Public Relations, Mass Media and Transparency.*

³ *Prime Minister E. Boc, Newschannel, January 2010.*

Arguments against the minimal tax⁴:

The business environment considers that the *introduction of the minimal profit* is inopportune. Other alternatives could have been used, such as the enforcement of the anti-abuse measures from the fiscal legislation (ANAF has the right to reconsider the transactions concluded between affiliated companies in order to apply a higher taxation, the provisions from the treaties to avoid double taxation, tax evasion law, the competency of authorities in certain instances, to set the taxation basis by evaluation etc.).

However, if a presumptive tax is to be introduced, there are several recommendations:

- introduction of a fixed amount tax (such as in France) or a percent from the income, but up to a fixed amount;
- deduction of this minimal tax from the tax on profit due by the company and the carry over of this deduction for compensation with future fiscal dues (tax on profit due in the future years) – such as in France;
- correlation with the European Directive 90/435/CEE on the relations between the mother companies and their branches, which stipulates that the income from royalties received from a branch from another country are exempt under certain conditions;
- elimination of the inactive taxpayers or declared to be inactive, which have no activity at all and who only have, for instance, financial incomes from banking interests;
- definition of the taxable person, not just of the types of activities, because in practice there may be confusions concerning the taxpayer who has the obligation to pay that specific tax (for instance, in the case of real estate transactions);
- further clarifications on the treatment of the fiscal losses (fail to use the fiscal loss in the year of paying the presumptive tax) – the fiscal years in which the taxpayers pay the minimal tax on profit should not be taken into consideration when determining the period or reporting of the fiscal losses.

Reasons for these suggestions:

- It is discriminatory to use a similar treatment on taxpayers in different circumstances. Making a mathematical calculation on the

⁴ Study „Tax Law Design and Drafting”, volume 1; 1996; Victor Thuronyi, Chapter 12, *Presumptive Taxation*.

basis of the legal conditions, the introduction of the minimal tax on profit means that the law-maker treat identically both a company with losses and a company with high incomes.

- The anti-abuse measures stipulated in the Ordinance are restrictions to the fundamental liberties if they are not justified – the introduction of the minimal tax on profit is the anti-evasion or anti-abuse measure which has restrictions to the domestic market liberties and which are forbidden by the EU treaty, except in the case they are justified⁵; they are not justified in the case of the companies having real losses from their economic activity;

- This type of tax is presently considered for elimination in other EU states. Other countries have introduced similar taxes with the tax on minimal profit (France, Hungary) during periods of economic boom, when the suspicion towards the attempt of the taxpayers to increase artificially their expenditure might somehow justified; however, during times of crisis, this suspicion lacks support, therefore countries such as France and Hungary are working to eliminate this tax.

- IFA (Imposition forfaitaire annuelle) is the deductible expenditure from the calculation of the tax on profit. As of 2009, the companies with turnover below 1.5 million EUR are exempt. In 2010, the companies with turnover below 15 million EUR will be exempt. As of 2011 this tax will be completely removed.

- The tax of solidarity is 4% from the accounting profit, with some adjustments, limited however in comparison with the calculation of the taxable profit. Hungary will cancel this tax as of 2010.

IMF opinion on the minimal taxes

IMF specialists concluded that the minimal tax on profit, calculated at the level of the gross income, is inequitable and that it distorts the economic activity⁶.

According to IMF experts, the taxation system imposed by the ordinance has no quality what so ever, besides that it is easily manageable and that it has a short-term effect of marginal increase of

⁵ According to the ruling from CEJ Halifax (C-255/02), „...the anti-abuse measures are not justified if the economic activity of the company may have explanations other than the mere acquisition of fiscal advantages.”

⁶ Tax Law Design and Drafting., volume 1; 1996; Victor Thuronyi, ed., Chapter 12, Presumptive Taxation.

the fiscal revenue. The same features, however, can be found in the taxes on sales and, if the purpose is to introduce a tax with these qualities, the government shouldn't disguise it under another tax, but it should adopt it explicitly.

Anyhow, a *tax on the gross income from sales* is deficient because:

- The system implies cascade taxation;
- The system is inequitable;
- The system is correlated inadequately with the taxpayer's capacity of payment;
- The system is difficult to apply in practice and it leads to inequitable/selective application;
- The system encourages new forms of tax evasion and tax dodging.

Another reason against the minimal tax is its economic impact:

- the minimal tax on profit deters the new investments – in the start-up stage, the businesses have large expenditures and sustain losses, but they have to pay this tax;
- the minimal tax on profit deters the large investments – the purchase of expensive technologies, amortized by accelerated amortisation (method guaranteed by the fiscal code) may generate fiscal losses; the companies making such investments, still have to pay this minimal tax on profit;
- the minimal tax on profit affects the entire sector of strategic services of the emerging economies, whose proportion in the GDP is essential to improve their rate of competitiveness;
- the minimal tax on profit affects the retail companies – under circumstances of economic crisis, the retailers are compelled to make substantial price cuts and make large advertising and marketing expenditure, which makes them to sustain real losses;
- the food industry is extremely exposed to the duty to pay a disproportionate tax, because the food industry depends on the agriculture which fluctuates every year;
- the real estate transactions concluded with losses during this period of assets depreciation are further penalised by an additional cost;
- the minimal tax on profit encourages tax evasion – the companies don't declare all incomes, use schemes to dodge the stipulations of this Ordinance, by classifying the incomes in categories which are levied more favourably.

Therefore:

The elimination of the minimal tax as of January 1st, 2010 is welcomed⁷; its replacement with presumptive taxation for businesses in which tax evasion is more difficult to evaluate, such as restaurants, infringes the principle of levying a tax on accounting basis. All the companies in Romania should be taxed with the same type of tax. "A presumptive tax infringes the principle of levying the tax according to the accounting rules applied to the other companies. Any company should report its economic activity according to the accounting rules and be taxed accordingly. By implementing a presumptive taxation system, ANAF confirms its incapacity to collect the tax adequately and to curb tax evasion".⁸

Another measure under debate is the introduction of a level up to which the young people on low incomes should be exempt from taxation; although it is well intended, this measure would introduce discrimination from the other people on low incomes.

3. The presumptive tax and tax evasion

With a delay of one year, the authorities get ready to give up the minimal tax on profit and introduce the presumptive taxation in areas of high tax evasion such as hotel business and restaurants, bars and fitness centres, undertakers. On the same list can be included the parks for trailer houses, camping sites, camps and other housing services, computer service companies, communication equipments, household appliance, house and gardening repairing etc.

The new system of levying the small companies creates confusion in the business area. The application of the 16% tax on profit, instead of 3%, will force the entrepreneurs to close the business or to shift to the grey economy. "The taxes and the methods to dodge them are just like viruses and antiviruses. When a new virus appears, there will always be an antivirus to control it "⁹. The presumptive taxation seems to favour the higher incomes, because the applied percentage decreases as the turnover increases.

The small enterprises have found ways to avoid paying the presumptive taxation.

⁷ Peter de Ruiter, partner and leader of the department of fiscal and legal consultancy with PricewaterhouseCoopers Romania.

⁸ Dan Schwartz, managing partner with Scot&Company Consulting.

⁹ Gabriel Sincu, specialist in fiscality.

- **fiscal emigration**, by moving the company outside Romania (particularly the service providers). The disadvantage, however, is the foreign legislation which is not known as well as the Romanian legislation. The single tax rate is an instrument often used by the developing countries, particularly to attract foreign investments. For instance, the Czech Republic has a single taxation rate of 15%, Slovenia of 21%, and Lithuania of 24%. Even Russia, reputed for the restrictive business legislation, has a single taxation rate of 13%.

- **temporary cessation of activity**

- **licensed natural person or individual enterprise**

The disadvantage of the people choosing to become Licensed Natural Person (LNP) is that the very responsibility they choose. "If their business goes bankrupt, then the creditors may take their goods from the particular patrimony: the house, car, etc," said Gabriel Sincu.

- **association, merging or take over by large companies**, in order to be able to access a fiscal consultant.

Other possibilities to dodge an excessive presumptive tax, in the case of the small companies, are to merge or to be taken over by larger companies. All these solutions incur, nevertheless, costs.

Another consequence of profit taxation and lack of fiscal facilities is the **transformation of micro-enterprises in off-shore companies, LNPs or bankrupt companies**. For almost half of the micro-enterprises, the introduction of the tax on profit will probably mean bankruptcy; about 15-20% of the companies with no more than 9 employees and turnover less than 100,000 euro, will turn into LNPs, particularly those which were used exclusively to receive wages, without running any activity and without having employees, particularly since when they turn into LND they can not have employees.

"A LNP only pays once 16% as profit taxation, without paying tax on royalties. When it was micro-enterprise the company was paying to the state 3% tax on the profit and 16% tax on dividends, so the state will not get extra revenue to the budget"¹⁰. About quarter of the former micro-enterprises "will start to pay the new tax on profit by adding extra loads to the expenditure and by (legal) fiscal and financial engineering".

¹⁰ Mirela Șerban, *fiscality specialist, Deloitte*.

The balance of enterprises will consider functioning under the umbrella of an off-shore, given the lower and lower costs and the increasing simply variants of functioning emerging in this area.

The profitability for establishing an off-shore company, i.e. the minimal amount of money worthy to invest differs with the intended type of business. For instance, in the case of a company whose activity and profits are generate exclusively on the territory of Romania, an off-shore company generally becomes profitable starting from a minimal taxable profit of 20,000 euro. The annual costs of running an off-shore company range between 1000 - 1800 euro to about 3000 - 4000 euro, function of the country where it is established, the type of activity, international agreements etc.

The use of an **off-shore company may bring a taxation rate of even 0-5%** on the taxation basis.

"It is therefore clear that this type of companies becomes very attractive: not just the former micro-enterprises will start an off-shore company, but an increasing number of other companies will do the same because the crisis reduced the gross profit anyhow, and the share holders will want to keep for themselves as much as possible as of it as net profit. The Romanian state may curb this increasing phenomenon only by introducing or maintaining fiscal facilities for specific categories of companies, which will preserve the employees, etc."¹¹

Conclusions and proposals

The fiscal pressure is among the factors which influence the behaviour of the economic agent towards the fiscal system by the multitude of fiscal levies, next to the fiscal regulations corroborated with the fiscal bureaucracy.

Romania needs a simple, efficient and easy to understand (by the taxpayers) and implement (by the fiscal authorities) legislation. The fiscal legislation must stimulate the investments and the efficient work and it must provide a reasonable and predictable level of the revenue to the budget, which to finance the current costs and to provide the financing sources for the large projects of infrastructure, the lack of which already suffocates Romania.

The main adverse effects of these problems are two types of losses: losses by the low level of foreign investments and actual

¹¹ *Idem 10.*

losses of money from the state budget. At least 3% of the GDP is money lost due to the deficient legislation, without counting the losses due to tax evasion.

In terms of ways to improve the collection of revenue from the informal economy, IMF rule applies perfectly: a small rate applied to a large basis. The implementation of a system of instalments is recommended in paying the taxes, function of specific criteria such as the history of good taxpayer of the company, the company size, the number of employees, number of jobs created during the past year, affiliation to strategic industries/domains (for instance, auto making industry).

For the period of crisis measures should be adopted which follow the European practice to improve the cash-flow of the company:

- **Eliminate VAT payment at customs for the imported goods** – giving up the system of paying VAT at customs when entering Romania might create significant benefits, by making Romania a logistic centre in this part of Europe. Such an example is the Netherlands which, using this facility, make of Rotterdam, the number one logistic centre in Europe for the imported goods.

- **Reversal taxation for the real estate transactions** – the reintroduction of the reverse taxation for the real estate transactions between Romanian entities, VAT payers, would offer a significant facility of cash-flow for the beneficiaries of real estate transactions of significant value. This measure would be especially beneficial for the purchase of services of construction-mounting, with the purpose to stimulate investments.

- **VAT group** – the main advantages of an implementation in agreement with the European practice would be the improvement of the cash-flow between the companies member of the group, which are seen as a single taxable entity.

- **Fiscal consolidation for the tax on profit** – is a concept adopted by some European states ("Fiscal Unity", in Great Britain; "Organschaft", in Germany) which allows the unification of the taxation basis for the tax on profit for the affiliated companies. The obvious advantages refer to a better planning he the cash resources within a group of companies.

In November 2009, CNIPMMR organised a seminary, "**Fiscal strategy in the EU and its impact on Romania and on the Romanian economic agents**", which presented the fiscal measures taken in the EU and their impact on the Romanian business sector.

a) Concerning the Value Added Tax

Measures that were taken: The main normative act is Directive 112/2006 which sets a general framework to make the VAT systems compatible. All states are compelled to observe the rules set by the Directive. For instance, all states are compelled to exempt from VAT all intra-community deliveries of goods, if certain conditions are met. There also are aspects which are left at the latitude of the member states, which may thus have the right to decision. For instance, VAT rate should be between 15%-25%, each state having the liberty to set the rate it considers suited for its budget necessities.

Obligations of Romania: Transposing the provisions of this directive into the legislation of Romania so that no contradictions may arise. Each time the existing stipulations on VAT are modified in the Romanian legislation, those changes must be in agreement with the Directive, otherwise they can not be implemented

Impact on the economic agents: The intra-community trade of goods and services was much simplified because the joint VAT system allows exemption of these transactions, with positive effects on the cash-flow. However, to control fraud, a system of reports has been introduced, which sometimes is perceived as difficult and extremely bureaucratic.

b) Concerning the excises

Measures that were taken: The main normative act is Directive 118/2008, which enters in force on April 1st, 2010, setting rules of owning, movement and monitoring products using excises.

Obligations of Romania: Same as in the case of VAT, each time the existing stipulations on excises are modified in the Romanian legislation, those changes must be in agreement with the Directive, otherwise they can not be implemented.

Impact on the economic agents: The impact was quite strong in terms of excises level, because in Romania it was below the minimal level imposed by the EU, which meant a gradual increase up to the European level. There also is a positive impact in terms of harmonized rules of circulation of the excisable products and because the percentual excises have been removed, as also required by the EU fiscal strategy.

c) Concerning the tax on profit

Measures that were taken: For the time being, there are two important laws: *Council Directive 90/434/EEC of July 23 1990* concerning a common taxation system applicable to the merging,

division, transfer of assets and exchange of shares between companies belonging to different member states; *Council Directive 90/435/EEC of July 23 1990* concerning a common taxation system applicable to mother companies and their branches working in different member states.

There also are proposals for the establishment of a consolidated taxable basis for the tax on profit in the EU, and for the establishment of a special scheme to tax the small enterprises.

Obligations of Romania: Unlike the regulations for VAT and excises, the European regulations on the tax on profit only concern the intra-community transfer of funds (capital, incomes, profit etc.), so that the taxation rules of the companies residing in Romania for their incomes made in Romania remain at the latitude of the Romanian state, without interference from the EU

Impact on the economic agents: The impact was favourable, particularly on two directions:

- Tax exemption for the dividends paid by towards shareholders EU legal persons, under specific conditions. It was thus necessary to establish such measures for the dividends paid towards the Romanian legal persons, observing the same conditions;
- fiscal neutrality of a merging/division performed by a Romanian legal person with a legal person from another state member.

d) In other areas of the fiscal strategy

Next to the three main areas mentioned above, other measures have also been introduced in the EU, such as elimination of the double taxation, administrative cooperation, tax evasion prevention.

Opinions, proposals and recommendations have also been formulated concerning the following main items:

- effects of applying the minimal tax on profit;
- fiscal policies for 2010;
- SMEs proposal for the elaboration of a Code of fiscal conduit, tax exemption for the reinvested profit, unification of the taxation basis for the trading companies from a group of enterprises, taxation stability without increasing taxation in 2010, improve the regulations on VAT payment, improved control procedures and avoid related abuses.

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