

# COMPARATIVE ANALYSIS REGARDING THE ENTERPRISES TAXATION IN ROMANIA AND SOME EUROPEAN UNION MEMBER STATES

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## Abstract

The main difficulties that SMEs meet in the current tax context is the tax burden, tax legislation lack of predictability and stability and bureaucracy. Compared with the Member States of the European Union, Romania is in the lead in terms of labour taxation (with an aggregated statutory rate for social contributions of 44%), in the middle of EU ranking when talking about security contributions, and on the last places as regards the consolidated budget revenues from security contributions.

In this paper we are trying to make a comparison, in terms of taxation, of enterprises in Romania and other EU Member States and to propose some solutions for them to develop in a healthy and competitive economic environment.

**Keywords:** taxes and duties, small and medium enterprises, EU member states, fiscal legislation

**JEL Classification:** H25, H27, H32

## 1. Introduction

Taxation is one of the areas that has passed through the most important changes in recent years; these changes have occurred either too slow or too sudden, determining the taxpayer's certainty to interpret tax legislation as a factor of instability in the development of the Romanian economy.

The business environment recognizes however the progress made in fiscal legislation, such as harmonization with the European regulatory framework or introduction of the flat tax. However, the weak link of the Romanian tax system remains the poor administrative capacity of the authorities. The taxation's efficiency

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and certainty, the stability and predictability of the tax system represent essential principles for a viable economy, and it also should be highlighted the need for fiscal policy yield and solutions for a balance between this and the taxpayers' tax burden.

## **2. Aspects concerning the EU Member States taxation**

According to the study conducted by Mazars Company, "Central Eastern European Tax Brochure 2014", the fiscal environment changes within the period 2013-2014 in Central and Eastern Europe indicate that at the region's level it has been preserved a slight tendency of reduction in direct taxation, in parallel with the attenuation of the VAT increase. According to the mentioned study, the average profit tax rate is currently about 17% and the average VAT rate remains at about 21%.

During 2013-2014, two countries in the region decreased by one percentage each the level of profit tax - Slovakia to 22% and Ukraine to 18%. At European Union level, apart from Slovakia, another two Member States have decided to ease the direct taxation in the same period. According to the latest Eurostat report, the greatest reduction of 2 percent was applied by Great Britain (from 23% to 21%), followed by Slovakia (from 23% to 22%) and Denmark (25 % to 24.5%).

Romania still remains the country with the one of the lowest profit tax rate (16%), both in the European Union and in Central and Eastern Europe. The average adjusted rate of 17.2% at regional level is at present with nearly 6 percentage points below the EU average (23.1% in 2014).

Among the countries included in the Mazars study, Romania is most closely to Poland, both as level of applied rate (Poland - 19%) and as variation, the two countries maintaining the tax rate unchanged in the last five years. It should also be taken into account the possibility that on medium term Romania to change the details of this comparison, if the mediatized transition to progressive taxation will become a reality. Compared to the European Union, where profit tax varies between 10% (Bulgaria) and 38% (France), Central and Eastern Europe is characterized by smaller variations of the applied quotas from one state to another. The lowest level of 9% is in Montenegro, and the highest, 26%, in Greece.

The tendency of increasing VAT, manifested since 2009 as a result of attempts to reduce the national budget deficits, alleviated in

the period 2013 - 2014. Within this interval, two countries in the region have raised by 2% the VAT: Montenegro (to 19%) and Slovenia (to 22%), but this change did not significantly influence the average rate calculated for the 16 countries, of 21%. The level is similar to the European Union one (21.5%).

The VAT remains a significant tax burden in Central and Eastern Europe, Romania being placed the 3rd in terms of the level of this quota, after Hungary (27%) and Croatia (25%). The 24% rate maintains Romania on one of the first places at entire European Union level, only four states having a higher VAT: Hungary, Croatia, Denmark (25%) and Sweden (25%). On the opposite side there are Luxembourg (15%) and Malta (18%).

The income tax system in the 16 countries analysed in Central and Eastern Europe has not changed in the interval 2013-2014. Montenegro is still the country with the lowest income tax rate in the region, of 9%, while the highest rates are in Austria and Slovenia (maximum rate of 50%).

**Table 1**

**Taxation rates in Central and Eastern Europe- 2014 (%)**

Country	VAT(standard/ reduced)	Profit tax	Income tax	Total employer's contributions
Austria	20/10	25	0-50	21,83
Bosnia and Herzegovina	17	10	10	10,5/no
Bulgaria	20	10	10	17,9
Croatia	25/13/5	20	12/25/40	15,2
Czech Republic	21/15	19	15	34
Greece	23/13/6,6	26	22/32/42	27,46
Hungary	27/18/5	10/19	16	27
Macedonia	18/5	10	10	No
Montenegro	19/7	9	9	9,8
Poland	23/8/5/0	19	18/32	21
Romania	24/9/5	16	16	28
Russia	18/10/0	20	13/30	30/10
Serbia	20/10	15	10/15/20	17,9
Slovakia	20/10	22	19/25	35,2
Slovenia	22/9,5	17/15	16/27/41/50	16,1
Ukraine	20/7/0	18/0	15/17	36,76-49,70

*Source: Mazars Company , “Central Eastern European Tax Brochure”*

The flat tax system is applied in eight of the 16 countries, while in the other eight states the progressive rate system functions. Eurostat data indicate that neither at EU level have intervened changes: apart from Finland and Sweden, which have operated income tax increases, no other Member State has changed tax rates in the interval 2013-2014.

In European Union the lowest level is of Bulgaria's (10%) and the highest ones, of more than 55%, are applied in Sweden and Denmark. With the 16% rate, Romania is within the echelon of EU countries with the lowest income tax rates, along with Bulgaria, Lithuania and Hungary.

Romania has a relatively low corporate tax, which is of interest to investors. However, one of the permanent difficulties is represented by frequent legislative changes, both in the spheres of direct and indirect taxes. Although the challenges of government to maintain budget revenues during this difficult time are obvious, an increased stability of tax legislation would bring many benefits to business environment and to the economy as a whole. Entrepreneurs need to plan their activities on medium and long term and taxes that are to be paid should be clear. Unexpected changes may produce undesirable effects in the business environment.

### **3. Enterprises taxation in Romania and some EU member states. Total tax rate**

Enterprises tax system, presently in force, begins to stop functioning in a globalized world. Therefore, there are two opinions: either enterprises pay too small profit taxes or they find subterfuges in order to avoid paying taxes in systems where these are too high.

Taxation of companies is seen differently by administrations: if taxes are too high, investors are moving to places where the tax system is more friendly - with lower levels or exemptions. Therefore, the representatives of the 20 largest economies in the world have asked the OECD to examine how corporations avoid paying profit taxes.

The institution noted that different tax systems of the countries and the lack of interaction between them, or the application of certain bilateral treaties on taxation, determined the income from cross-border activities to remain untaxed or to pay very low taxes.

Romanian State has one of the highest tax burdens in Europe. According to World Bank, in 2014 Paying Taxes report, for a

Romanian firm, the overall rate of taxation (including profit tax, labour taxes and other taxes) reaches almost 43% of profit. OECD average is 41.3%, to the state being returning, through various taxes and duties, much less from the firms profits, even in very rich economies.

In comparison, total tax rate of a company in Great Britain is 34%, in Switzerland, 29.1%, in the northern states - 27% in Denmark, 39.8% in Finland and 40.7% in Norway. We mention that these percentages do not include value added tax, excise duties, the new 1.5% special tax on firm's construction.

Thus, these states compensate the high level of taxes and contributions with a slight taxation in other areas, reducing, in addition, to minimum the bureaucracy and administrative additional costs the taxpayers transfer. In fact, the number of taxes that must be paid each year by Romanian entrepreneurs is among the highest in the continent: 39, compared to only 4 in Norway and Sweden, 7 in France, 10 in Denmark.

Regarding the time required for paying taxes, a local firm needs 200 hours each year, compared to only 83 hours in Norway, 93 in Finland and 110 in Britain.

**Table 2**

**Total taxation rate (% of profit corporation)**

Country	Total taxation rate (%)
Bulgaria	27,7
Croatia	19,8
Denmark	27
Switzerland	29,1
Germany	49,4
Italy	65,8
Latvia	35,9
Great Britain	34
Norway	40,7
Poland	41,6
Romania	42,9
Sweden	52
Europe and Central Asia	41,3
OECD	41,3

Source: World Bank, 2014 *Paying Taxes report*

A corporation does not pay the profit tax only, and the PricewaterhouseCoopers's study "Paying Taxes" shows that the profit

tax is not even the biggest part of the obligations the companies pay to the state. In fact, in average, companies pay more labour taxes and social security contributions for employees than the profit tax . To these are added property and environmental taxes and other similar financial obligations.

On average, a global company pays about 43.1% of income taxes, divided as follows: 16.3% labour taxes, 16.1% profit tax, 10.7% other charges. Corporations in North America are, on global average, with 41.4% of revenues for taxes: 17% labour taxes, 19.5% profit tax, 4.9% other charges. By comparison, Europe has significantly higher labour taxes, but lower profit taxes than America: 26.5% labour taxes, 12,9 % profit tax, 1.7% other charges.

In Romania, the taxation of enterprises can be divided as follows: 10.3% profit tax, 31.5% labour taxes and 1.1% other taxes (a total of 42.9% ).

Leaders of this hierarchy are Croatia (taxes of 19.8%), Luxembourg (20.7%), Cyprus (22.5%), Ireland (25 %), Denmark (27%), Bulgaria (27.7%) and Switzerland (29.1%). In the bottom of the table are: Hungary (49.7%), Sweden (52%), Austria (52.4%), Belgium (57.5%), Spain (58.6%), France (64.7) and Italy (65.8%).

PwC shows that "the current tax regime was conceived when economies were based mainly on the exchange of tangible goods" when companies were more nationally and foreign trade represented less of GDP. In present, the modern economy depends on services and intangible goods, that easily exceed the boundaries.

#### **4. The Romanian firm fiscal obligations**

Even though in the last two years in Romania paying taxes has become easier by reducing the payments frequency from quarterly to every six months, our country is still at the end of the ranking in terms of costs and ease of paying taxes to the state, according to Doing Business Report, conducted this year by the World Bank. According to this indicator, the cited document places us in 134 rank (out of 189 analysed countries), which means that the tax environment is still unfriendly, entrepreneurs losing more time and money for starting and developing a firm.

Most entrepreneurs do not only proclaim the large number of taxes to be paid to the state or their amount, but also their implementing chaotic way, which cause the exponential growth of necessary tax compliance costs.

According to the Fiscal Code, the tax liabilities of the entity are: corporate tax, wage tax, dividend tax, value added tax, excise duty, contribution to social security, unemployment insurance, health insurance, accident and occupational diseases insurances, guarantee fund to pay salary receivables, stamp tax, buildings and auto taxes.

Among these, taxes for certain activities are added: taxes on gambling, the contribution for tourism, advertising taxes, annual different taxes for authorization, licenses, fines, penalties, and delay increases for failure to pay them in time.

As regards the local taxes, starting with January, the 1th, 2014, legal entities are required to pay the specific building tax mentioned in the Catalogue first group about the classification and normal operation periods for fixed assets, other than those for which the tax on constructions is due. This tax is calculated by applying a rate of 1.5% on the value of building existing in the taxpayer's heritage on December 31 last year.

Thus, the profit tax is 16%, dividend tax 16%, income tax is 16% and is applied on taxable income corresponding to each source in each category to determine the income tax from: independent activities, salaries, investments, pension, agricultural activities, awards or other sources.

Enterprises' income tax is 3%.

The VAT standard rate is 24%; the reduced rate of 9% applies to the tax base for certain services and / or supplies of goods; the reduced rate of 5% is applied to the tax base for the delivery of housing as part of social policy, including the land on which they are built. The land on which the house is built include the footprint of the house.

### **Contributions to the State Social Insurance Budget**

#### **Employee contributions**

Contributions to the state social insurance (SIC): 10.5%

Contributions to unemployment: 0.5%;

Contributions to social health: 5.5%.

#### **Employers' contributions**

Starting with October 1, 2014, entered into force the reduction of employer's SIC by 5 percentage points. Therefore, new quotas for social insurance contribution are: 15.8%; 20.8%; 25.8%, depending on working conditions (capped);

The contribution to health insurance: 5.2%;  
Contribution for holidays and health insurance benefits: 0.85%  
(capped);  
Contribution to the guarantee fund for payment of wage  
claims: 0.25%;  
Contributions to unemployment: 0.5%;  
Contribution for of insurance against accidents at work and  
occupational diseases: 0.15% - 0.85%, differentiated according to the  
working conditions.

The current economic context represents a challenge for the Romanian SMEs. Basically, in the arsenal of firms that can successfully cope with any problem there should be three attributes that make the difference: financial discipline, transparency and predictability. Moreover, firms that demonstrate diligence in terms of payment to suppliers and creditors - here is also included the State, payment of taxes, that are conducted properly in the area of taxation, have the biggest chances to be able to access, in good condition, the financing from banks, a very important aspect in this period.

Lately, reducing the tax burden was encouraged through coherent measures such as introducing the holding legislation or introducing provisions concerning the reinvested profit, measures that are expected to have significant positive effects on the business environment.

Also, the tax burden may be reduced by decreasing tax rates or the tax base; in terms of reducing tax bases, it might be introduced measures that provide exemptions from wages taxation below a certain threshold or increase the personal deduction granted to persons from maintenance of employees. In terms of reducing tax rates, the specialist Biris Goran considered appropriate the reduction of tax burden by decreasing the social security contributions, both at employee and employer, but also by reducing the standard rate of VAT.

Reducing tax rates and ceiling the tax base for contributions to social health securities are not the only proposals stated by specialists to improve the tax system. Transparency of this system also became a necessity, not only a desire.

### **5. Proposals and recommendations**

Romanian State has one of the highest tax burdens in Europe, according to the World Bank and the European Commission,



especially because of labour taxes . Specifically, for a Romanian firm, total tax rate (including profit tax, labour taxes and other taxes) reaches almost 43% of profit. OECD average is 41.3%, so to the state returns, through various taxes and duties, much less from the firms profits, even in very rich economies.

In order for a company to grow in a favourable economic environment, two ingredients are necessary: a fiscal "cleaning" that every company needs to do in its own home and, secondly, the comfort of the fiscal code, meaning the legislative predictability to determine the focus on the business itself.

We believe that the efficiency of a tax system involves the system's capacity to stimulate the economy, nationally taxing the international business, stimulate the interest for investments, create an open, friendly, stable business environment.

In this regard, we believe that the first key element that should be amended is the Tax Code, by changing, for example, definitions of terms and acceptance for modern and structuring principles. It takes a clear and simple tax legislation that could be easily applied both by taxpayers and tax authorities.

In assessing the Romanian fiscal system efficiency, it presents importance factors in the direction to which we consider that tax authorities would take measures in order to increase the competitiveness and attractiveness of the economy.

Two of the factors to be considered are the predictability and stability of the tax system, features that have missed Romania in recent years. Tax legislation has changed numerous times by laws and emergency ordinance, whose provisions were applicable within a few days from the publication, or even retrospectively, there were no implementing rules for them and, in some cases, they were abrogated a few months after the entrance into force, creating confusion and dissatisfaction among taxpayers. For example, the tax code has changed 22 times in 2013 and in the first nine months for 9 times!

A third element is the administrative process and the ease with which it can perform tax obligations. According to the Paying Taxes report, Romania ranks 134 out of 183 economies analyzed in terms of fiscal attractiveness. This inferior position in the ranking is mainly due to the number of payments (39) that must be made during the year, and the large number of hours required for the fulfilment of tax obligations (200 hours).

We believe that measures are needed to increase the efficiency of the tax system, such as the reduction in the number of statements (or introduction of a single statement), social contributions ceiling, granting fiscal functional facilities.

An important issue of fiscal policy remains the revenue collection to the state, in regard to this issue being reported three major deficiencies: law enforcement, its costs and efficiency.

The last period was characterized by an insufficient collection of state revenues, the high cost of collecting in many cases compared to the income obtained, low tax compliance degree, favorable conditions for tax evasion and shadow economy.

In order to avoid an increasingly low degree of tax compliance for enterprises, we believe that:

- a reduction of social security contributions could be a significant incentive to transfer a substantial part from the informal economy into the formal one;
- improved legislation, its adaptation, and its strictly enforcing to those applied in the EU area. In this regard, it will be pursued, on one hand, the increase of control efficiency and the evidence system of labour and taxation areas, as well as strictly application of penalties and sanctions in case of detection informal activities;
- simplification of taxes and duties system, while reducing bureaucracy;
- reduction of certain taxes and duties system that prevent work in the formal sector, investment or private initiative, while increasing others that are currently undersized in Romania, such as wealth or capital tax;
- introduction a complex system of tax deductions and inducements and its effective application, after the model of Western countries.

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